

KAPSTONE PAPER & PACKAGING CORP
Form 10-K
March 04, 2013

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

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

For the transition period from to ,

Commission File No.: 001-33494

KapStone Paper and Packaging Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-2699372
(I.R.S. Employer
Identification No.)

KapStone Paper and Packaging Corporation
1101 Skokie Blvd. Suite 300
Northbrook, IL 60062

(Address of principal executive offices) (ZIP Code)

Registrant's telephone number, including area code: **(847) 239-8800**

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

Title of Each Class	Name of Exchange On Which Registered
Common Stock (Par Value \$0.0001)	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: **NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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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 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 shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of the above in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company
(Do not check if a 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

The aggregate market value of the 39,203,571 shares of Common Stock held by non-affiliates of the registrant on June 29, 2012, was \$641,076,962. This calculation was made using a price per share of Common Stock of \$15.85; the closing price of the Common Stock on the New York Stock Exchange on June 29, 2012 the last day of the registrant's most recently completed second fiscal quarter of 2012. Solely for purposes of this calculation, all shares held by directors and executive officers of the registrant have been excluded. This exclusion should not be deemed an admission that these individuals are affiliates of the registrant.

On February 25, 2013, the number of shares of Common Stock outstanding, excluding 40,000 treasury shares, was 47,477,511.

DOCUMENTS INCORPORATED BY REFERENCE:

The registrant's Definitive Proxy Statement for its 2013 Annual Meeting of Stockholders will be filed with the Securities and Exchange Commission no later than 120 days after the end of the fiscal year covered by this Form 10-K pursuant to General Instruction G(3) of the Form 10-K. Information from such Definitive Proxy Statement will be incorporated by reference into Part III.

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Forward Looking Statements.

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about us, including the risks set forth in Item 1A. Risk Factors below, that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may," "should," "could," "would," "expect," "plan," "anticipate," "believe," "estimate," "continue," or the negative of such terms or other similar expressions. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those described in our other Securities and Exchange Commission filings. All subsequent written and oral forward-looking statements attributable to KapStone or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph. KapStone disclaims any intention or obligation to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

PART I

Item 1. Business

KapStone Acquisition History

KapStone Paper and Packaging Corporation was formed in Delaware as a special purpose acquisition corporation on April 15, 2005 for the purpose of effecting a merger, capital stock exchange, asset acquisition or other similar business combination with an unidentified operating business in the paper, packaging, forest products, and related industries. Unless the context otherwise requires, references to "KapStone," the "Company," "we," "us" and "our" refer to KapStone Paper and Packaging Corporation and its subsidiaries.

On January 2, 2007, we consummated the purchase from International Paper Company ("IP") of substantially all of the assets and the assumption of certain liabilities of the Kraft Papers Business ("KPB") for \$155.0 million, less \$7.8 million of working capital adjustments. The KPB assets consisted of an unbleached kraft paper manufacturing facility in Roanoke Rapids, North Carolina, Ride Rite® Converting, an inflatable dunnage bag manufacturer located in Fordyce, Arkansas, trade accounts receivable and inventories. The liabilities assumed consisted of trade accounts payable, accrued expenses, and certain long-term liabilities. We subsequently paid an aggregate of \$53.7 million additional purchase price pursuant to contingent earn-out payments based upon achieving certain EBITDA targets.

On July 1, 2008, we consummated the purchase from MeadWestvaco Corporation ("MWV") of substantially all of the assets and the assumption of certain liabilities of the Charleston Kraft Division ("CKD") for \$485.0 million (net of cash acquired of \$10.6 million), less \$8.9 million of working capital adjustments. The CKD assets consisted of an unbleached kraft paper manufacturing facility in North Charleston, South Carolina (including a cogeneration facility), chip mills located in Elgin, Hampton, Andrews and Kinards, South Carolina, a lumber mill located in Summerville, South Carolina, trade accounts receivable and inventories. The liabilities assumed consisted of trade accounts payable, accrued expenses and certain long-term liabilities. There was no contingent earn-out for the CKD acquisition.

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On March 31, 2009, we consummated the sale of our dunnage bag business to Illinois Tool Works Inc. for \$36.0 million, less \$1.1 million of working capital adjustments. The Company considered the sale an opportunity to reduce its debt and focus on its core business.

On October 31, 2011, we acquired U.S. Corrugated Acquisition Inc. ("USC") pursuant to a merger for \$330.0 million in cash plus \$1.9 million of working capital adjustments. USC owned, at the time of the merger, a recycled containerboard paper mill in Cowpens, South Carolina and fourteen corrugated packaging plants across the eastern and Midwestern United States. The acquisition was financed by cash on hand and a \$525.0 million Credit Agreement consisting of a \$375.0 million LIBOR based five-year term loan and a \$150.0 million revolving credit facility. In connection with the transaction the Company paid off the remaining amount due under its then-existing credit facility. Subsequent to the acquisition, USC and its subsidiaries were reorganized into a single entity and renamed KapStone Container Corporation, a wholly owned subsidiary of KapStone Kraft Paper Corporation. See Note 3, "USC Acquisition" and Note 9, "Debt" for more information on the USC acquisition and the new senior secured credit facility.

In conjunction with the USC acquisition, the Company evaluated its segment reporting requirements and concluded that it operates in one segment, the integrated manufacture and sale of unbleached kraft paper and corrugated products for industrial and consumer markets.

Future Acquisitions

In an effort to diversify and/or grow our business we have been, and continue to be, engaged in evaluating a number of potential acquisition opportunities. No assurance can be given that we will consummate additional transactions. The structuring and financing of any future acquisitions may be dependent on the terms and availability of additional financing to us that either replaces or does not conflict with the Company's existing senior secured credit facility.

General

KapStone is a producer of unbleached kraft paper products and corrugated products. In 2012 we produced 1,558,111 tons of unbleached kraft paper, of which nearly 77% was sold to third party converters or shipped to our corrugated products manufacturing plants based in the United States and 23% was sold to foreign based customers. With the consummation of the USC acquisition in late 2011 we began manufacturing and selling corrugated products consisting of conventional shipping containers used to protect and transport manufactured goods and multi-color boxes and displays with strong visual appeal that help to merchandise the packaged product in retail locations. In 2012, the corrugating plants produced and sold about 383 million tons or 6.2 billion square feet (BSF) of corrugated products in the U.S. Our net sales in 2012 totaled \$1.2 billion, which was comprised of \$841.6 million of unbleached kraft paper and \$375.0 million of corrugated products.

The Company's business is affected by cyclical industry conditions and general economic conditions in the U.S. and in the countries where we export unbleached kraft paper. These conditions affect the prices which we are able to charge for our products. Our export sales may also be affected by fluctuations in currency values, foreign exchange rates and trade policies and relations.

Industry Overview

We view the unbleached kraft paper market as including containerboard, kraft paper, saturating kraft, unbleached folding carton board and corrugated products.

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Containerboard, consisting of linerboard and medium, is primarily used to manufacture corrugated containers for packaging products. U.S. demand for corrugated boxes and containerboard tends to be driven by industrial production of processed foods, nondurable goods and certain durable goods.

The American Forest and Paper Association's ("AF&PA") estimate of the size of the U.S. containerboard market is as follows:

(In millions)	2012	2011	2010
Total U.S. sales	30.7 tons	30.6 tons	30.6 tons
U.S. production	34.4 tons	34.0 tons	33.9 tons
Imports	0.6 tons	0.8 tons	0.8 tons
Exports	4.3 tons	4.2 tons	4.1 tons
U.S. operating rates	95%	96%	96%

The primary markets for our containerboard are our corrugated products manufacturing plants and independent corrugated and laminated products customers who focus on specialty niche packaging.

Kraft Paper

The AF&PA's estimate of the size of the U.S. kraft paper market is as follows:

(In millions)	2012	2011	2010
Total U.S. sales	1.34 tons	1.39 tons	1.43 tons
U.S. production	1.28 tons	1.32 tons	1.45 tons
Imports	0.16 tons	0.16 tons	0.17 tons
Exports	0.22 tons	0.25 tons	0.21 tons
U.S. operating rates	76%	78%	79%

The kraft paper market is comprised of three general product types. Multiwall paper is used to produce bags for agricultural products, pet food, baking products, cement and chemicals. Specialty converting paper has a large variety of uses within coating and laminating applications that requires a smooth surface and is also used to produce shingle wrap, end caps, roll wrap and dunnage bags. Grocery bag and sack paper is converted into retail shopping bags, grocery sacks and lawn and leaf refuse bags.

Over the last two decades, unbleached kraft paper capacity has declined. This decline has been caused by a decrease in grocery bags and sack paper due to a shift in market demand from paper bags to plastic. The multiwall market also contributed to a decrease in capacity due to conversion to plastics in certain end-use markets, primarily in the insulation, pet food and lawn and garden markets.

Saturating Kraft

Saturating kraft is used in multiple industries around the world, including construction, electronics manufacturing and furniture manufacturing. The major end-use is thin high pressure laminates (HPL), used to create decorative surfaces such as kitchen and bath countertops, home and office furniture and flooring. Within the HPL market there is a growing and distinct HPL segment manufacturing and selling a much thicker product called compact laminates used as surfacing products such as exterior cladding, partitions and doors. In Asia, there is significant use of saturating kraft product for the manufacturing of printed circuit boards (PCB) and copper clad laminates (CCL) and there is also a growing use for thin HPL in decorative surfaces. We are not aware of any published data reporting the size of the saturating kraft market. Barriers to entry for producing high quality saturating kraft are high as it is a technically difficult grade of paper to produce.

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Unbleached Folding Carton Board

Unbleached folding carton board is a low density virgin fiber board. Applications are widely spread throughout end uses in the general folding carton segment of the paperboard packaging market. This product can replace the use of more expensive coated recycled board, coated natural kraft board and solid bleached sulfate board which are currently much larger markets. There is no published data reporting the size of the unbleached, uncoated folding carton market.

Corrugated Products

According to the Fibre Box Association, the value of industry shipments of corrugated products was \$26.1 billion in 2012.

The primary end-use markets for corrugated products are shown below (as reported in the most recent Fibre Box Association annual report dated April 2012):

Food, beverages and agricultural products	42%
General retail and wholesale trade	16%
Paper products	15%
Miscellaneous manufacturing	15%
Petroleum, plastic, synthetic, and rubber products	10%
Appliances, vehicles, and metal products	2%

Corrugated products manufacturing plants tend to be located in close proximity to customers to minimize freight costs. The Fibre Box Association estimates that the U.S. corrugated products industry consists of approximately 575 companies and over 1,200 plants.

Manufacturing

We operate three paper mills in the southeastern United States. In 2012, we produced 1,558,111 tons of unbleached kraft paper at our mills in North Charleston, South Carolina, Roanoke Rapids, North Carolina and Cowpens, South Carolina. Currently, our mills operate on a 24 hours a day and seven days a week basis. Fiber used to make unbleached kraft paper is produced from a combination of locally sourced roundwood and woodchips. After the wood is debarked and chipped, the chips are loaded into digesters for cooking. Woodchips, chemicals and steam are mixed in the digester to produce softwood pulp. Hardwood pulp is produced in North Charleston in a similar fashion for the production of DuraSorb® saturating kraft. The pulp is screened and washed through a series of washers, and then stored prior to the paper making process. Old corrugated containers ("OCC") are used to make recycled containerboard in Cowpens. The Company processes pulp using six paper machines at our facilities. Management monitors productivity on a real-time basis with on-line reporting tools that track production values versus targets. Overall equipment efficiency is also monitored daily through production reporting systems.

As of December 31, 2012 we operated 14 corrugated products manufacturing plants, comprised of six box plants, six sheet plants, and two sheet feeder plants. Box plants operate as combining operations that manufacture corrugated sheets and finished corrugated products. Sheet feeder plants have a corrugator machine and manufacture corrugated sheets which are shipped to sheet or box plants. Sheet plants have various machines which convert corrugated sheets, purchased either from our operations or third parties, into finished corrugated products. Plants with a corrugating machine have total capacity of approximately nine billion square feet ("BSF"). In January 2013 we announced that we are opening a new sheet plant in Aurora, Illinois.

Our corrugated manufacturing plants operate in nine states in the U.S., with no manufacturing facilities outside of the continental U.S. Each corrugated plant, for the most part, serves a market

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radius that typically averages 200 miles. Our sheet plants are generally located in close proximity to our larger corrugated plants, which enables us to offer additional services and converting capabilities such as small volume and quick turnaround items.

We produce a wide variety of products ranging from basic corrugated shipping containers to specialized packaging. We also have multi-color printing capabilities to make high-impact graphics boxes and displays that offer customers such as consumer products companies more attractive packaging.

We have dedicated personnel who coordinate and execute all containerboard trade agreements with other containerboard manufacturers. It is industry practice to "trade" among industry participants who are located more closely to converting plants in order to reduce freight costs.

Distribution

Unbleached kraft paper produced in our mills is shipped by rail or truck to customers in the U.S. and is shipped by truck to nearby ports and then by ocean vessel to our export customers. Domestic rail shipments represent about 47% of the tons shipped and the remaining 53% is shipped by truck.

Our corrugated products are delivered by truck. Most of our plants have their own fleet of trucks as our customers demand timely service.

Sales and Marketing

Our unbleached kraft paper marketing strategy is to sell our products to third party converters and manufacturers of industrial and consumer packaging products. We seek to meet the quality and service needs of the customers of our corrugated operations at the most efficient cost, while balancing those needs against the demands of our containerboard customers.

We sell our products directly to end users and converters, as well as through sales agents. Our sales groups are responsible for the sale of these products to third party converters in the U.S. Sales to export markets are managed by separate teams of which certain personnel are based in Europe and Asia.

Our corrugated products are sold through an internal sales and marketing organization. We have sales representatives and sales managers who serve local and regional accounts. We also have corporate account managers who serve large national accounts at multiple customer locations. Our corrugated operations focus on supplying both high-volume commodity products and specialized packaging with high value graphics.

Customers and Products

The following represents the Company's tons of products sold:

Product Line:	2012		2011	
	Tons	% of Total	Tons	% of Total
Containerboard	690,503	41.1%	672,933	49.1%
Corrugated products	383,415	22.8%	57,186	4.2%
Kraft paper	250,280	14.9%	275,461	20.1%
DuraSorb®	253,239	15.1%	266,571	19.5%
Kraftpak®	103,028	6.1%	96,947	7.1%
Tons of product sold	1,680,465		1,369,098	

KapStone has over 2000 U.S.-based and over 200 export customers.

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Containerboard is sold to domestic and foreign converters in the corrugated packaging industry and to other converters for a variety of uses including laminated tier sheets and wrapping material, among others. Historically, our focus is on independent converters who do not have their own mill systems or converters who otherwise commonly purchase containerboard in the open market. Prior to the acquisition, USC had been a containerboard customer of ours. The USC acquisition provided us with vertical integration opportunities and we expect to increase the amount of KapStone containerboard produced in our acquired corrugated manufacturing plants.

Kraft paper is sold primarily to domestic converters who produce multiwall bags for agricultural products, pet food, cement and chemicals, grocery bags and specialty conversion products such as wrapping paper products, dunnage bags and roll wrap.

Our saturating kraft paper, sold under the trade name Durasorb® has a customer base which is split among three geographic regions, the Americas, Europe and Asia. Approximately 77 percent of our sales are exports to customers in Europe, Latin America and Asia where growth opportunities are favorable. KapStone, or its predecessor, has done business with many of these customers for well over 40 years. Some customers have consolidated to form a greater presence in their end-use markets. Customer consolidation is particularly evident in North America and is in the early phase in Europe. In Asia, there are numerous players and it is a highly fragmented market making entry difficult for some companies that do not have a presence in the region. KapStone has acquired a leadership position with our Durasorb® product through knowledge of our markets and understanding the technical needs of our customers' manufacturing processes and the demanding requirements of their products.

Our unbleached folding carton board sold under the Kraftpak® trade name has a customer base which consists primarily of integrated and independent converters in the folding carton industry. Our unbleached folding carton board product is a unique, low density virgin fiber board. KapStone believes that the best growth opportunities for Kraftpak® are in consumer brands that are changing their images to promote environmental friendliness and sustainability. Kraftpak® and similar products replace the use of coated recycled board, coated natural kraft board and solid bleached sulfate board which are currently much larger markets.

As part of the 2011 USC acquisition we have about 1,000 corrugated product customers, most of which are regional and local accounts, which are broadly diversified across industries and geographic locations. In addition, we have a select number of national accounts, or those customers with a national presence. These national customers typically purchase corrugated products from several of our box plants throughout the United States. In 2012 we sold approximately 383 million tons or 6.2 billion square feet of corrugated products.

No customer accounts for more than 10% of consolidated net sales. Our business is not dependent upon a single customer or upon a small number of major customers. We do not believe the loss of any one customer would have a material adverse effect on our business.

Backlog

Demand for our major product lines is relatively constant throughout the year, and seasonal fluctuations in marketing, production, shipments and inventories are not significant. Backlogs are a factor in the industry as it allows paper mills to run more efficiently. Most orders are placed for delivery within 30 days.

Major Raw Materials Used

Fiber is the single largest cost in the manufacture of containerboard and unbleached kraft paper. KapStone consumes both wood fiber and recycled fiber in its paper mills. Our mills in North Charleston and Roanoke Rapids use 100% virgin fiber. Fiber used to make unbleached kraft paper is

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produced from a combination of locally sourced roundwood and woodchips. We rely on supply agreements and open market purchases to supply these mills with roundwood and wood chips. Fiber resources are generally available within economic proximity to these mills and we have not experienced any significant difficulty in obtaining our mill fiber needs.

Our mill in Cowpens, South Carolina is a 100% recycled mill, whose fiber consumption consists solely of recycled fiber commonly referred to as OCC. We obtain OCC pursuant to certain supply agreements and in open market purchases from suppliers within economic proximity to the Cowpens Mill. OCC has historically exhibited significant price volatility. The Cowpens mill has not experienced any significant difficulty in obtaining OCC.

Our corrugated manufacturing plants consume containerboard from our mills and from third parties. We use third party mills which are closer to our corrugated manufacturing plants to realize freight savings. Containerboard, which includes both linerboard and corrugating medium, is the principal raw material used to manufacture corrugated products. Linerboard is used as the inner and outer facings, or liners, of corrugated products. Corrugating medium is fluted and laminated to linerboard in corrugated plants to produce corrugated sheets. The sheets are subsequently printed, cut, folded and glued into produce corrugated products.

Energy

Energy at the mills is obtained through purchased electricity or through various fuels, which are converted to steam or electricity on-site. Fuel sources include coal, natural gas, oil, bark, and by-products of the manufacturing and pulping process, including black liquor. These fuels are burned in boilers to produce steam. Steam turbine generators are used to produce electricity. To reduce our mill energy cost, we have invested in processes and equipment to ensure a high level of purchased fuel flexibility. In recent history, fuel oil has exhibited higher costs per thermal unit and more price volatility than natural gas and coal. During 2012, approximately 56% of our mills' purchased fuel needs were from coal, historically our lowest cost purchased fuel.

We purchase coal under three contracts with fixed pricing through December 31, 2013.

KapStone's corrugated product manufacturing plants primarily use boilers that produce steam which are used to power the corrugating machines. The majority of these boilers burn natural gas, although some also have the ability to burn fuel oil. Sheet plants use electricity for their main source of power.

Competition

The markets in which we sell our products are highly competitive and comprised of many participants. We face significant competitors, including large, vertically integrated companies and numerous smaller companies.

Our principal competitors with respect to sales of our unbleached kraft paper are a number of large, diversified paper companies, including International Paper Company, Georgia-Pacific (owned by Koch Industries, Inc.), Rock-Tenn Corporation and Packaging Corporation of America, all of which have greater financial resources than we do. We also compete with other regional manufacturers of these products. Our unbleached kraft paper products (other than our Durasorb® and Kraftpak® products) are each generally considered a commodity-type product and can be purchased from numerous suppliers and competition is based primarily on price.

Corrugated products businesses seek to differentiate themselves through pricing, quality, service and product design and innovation. We compete for both local and national account business, and we compete against producers of other types of packaging products. On a national level, our primary competitors include International Paper Company, Georgia-Pacific (owned by Koch Industries, Inc.),

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Rock-Tenn Corporation and Packaging Corporation of America. However, with our strategic focus on local and regional accounts, we also compete with the smaller, independent converters.

Intellectual Property

The Company owns patents, licenses, trademarks and trade names on products. However, we do not believe that our intellectual property is material to our business and the loss of any or our intellectual property rights would not have a material adverse effect on our operations or financial condition.

Employees

As of December 31, 2012, we have 2,760 employees. Of these, 842 employees are salaried and 1,918 are hourly. Approximately 1,400 of our hourly employees are represented by unions. The majority of our unionized employees are represented by the United Steel Workers (USW).

Currently, there is a collective bargaining agreement in place with union employees in Roanoke Rapids through August 2013. The Company is engaged in negotiations with its union employees in North Charleston. The mill is operating under the terms of a contract that expired in July 2012. We expect to begin negotiations to renew the Roanoke Rapids union contract soon.

During 2012, we experienced no work stoppages and have experienced no instances of significant work stoppages in the five years prior to 2012. We believe we have good relations with our employees.

Environmental Matters

Compliance with environmental requirements is a significant factor in our business operations. We commit substantial resources to maintaining environmental compliance and managing environmental risk. We are subject to, and must comply with, a variety of federal, state and local environmental laws, particularly those relating to air and water quality and waste disposal. The most significant of these laws affecting us are:

1. Resource Conservation and Recovery Act (RCRA)
2. Clean Water Act (CWA)
3. Clean Air Act (CAA)
4. The Emergency Planning and Community Right-to-Know-Act (EPCRA)
5. Toxic Substance Control Act (TSCA)
6. Safe Drinking Water Act (SDWA)

We believe that we are currently in material compliance with these and all applicable environmental rules and regulations. Because environmental regulations are constantly evolving, we have incurred, and will continue to incur, costs to maintain compliance with these and other environmental laws and regulations. We work diligently to anticipate and budget for the impact of applicable environmental regulations, and do not currently expect that future environmental compliance obligations will materially affect our business or financial condition. Total capital costs for environmental matters were \$0.1 million for 2012. We currently estimate 2013 environmental capital expenditures will be less than \$1.0 million.

We do not believe that any ongoing remedial projects are material in nature. As of December 31, 2012, we maintained an environmental reserve of \$1.9 million, which includes funds relating to on-site landfill and surface impoundments for our landfill obligations, which are accounted for in accordance

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with Accounting Standards Codification ("ASC") 410, *Asset Retirement and Environmental Obligations*. We believe these reserves are adequate.

We could also incur environmental liabilities as a result of claims by third parties for civil damages, including liability for personal injury or property damage, arising from releases of hazardous substances or contamination. We are not aware of any material claims of this type currently pending against us.

While legislation regarding the regulation of greenhouse gas emissions has been proposed at the federal level, it is uncertain whether such legislation will be passed and, if so, what the breadth and scope of such legislation will be. The result of the regulation of greenhouse gas emissions could be an increase in our future environmental compliance costs, through caps, taxes or additional capital expenditures to modify facilities, which may be material. However, climate change legislation and the resulting future energy policy could also provide us with opportunities if the use of renewable energy is encouraged. We currently generate a significant portion of our power requirements for our mills using bark, black liquor and biomass as fuel, which are derived from renewable resources. While we believe we are well-positioned to take advantage of any renewable energy incentives, it is uncertain what the ultimate costs and opportunities of any climate change legislation will be and how our business and industry will be affected.

In 2004, the U.S. Environmental Protection Agency (the "EPA") published the Boiler MACT regulations, establishing air emissions standards and certain other requirements for industrial boilers. These regulations were vacated and remanded by the U.S. Court of Appeals for the D.C. Circuit in 2007. The EPA proposed final regulations in March 2011, which would require compliance in 2014. During 2011, the EPA determined that it would reconsider certain provisions of the Boiler MACT regulations and, in December 2011, the EPA published proposed rules containing changes to the March 2011 rules. The EPA stayed a portion of the Boiler MACT regulations during its reconsideration process, but this stay was vacated by a federal district court in January 2012. In December 2012, the EPA made final changes to the March 2011 version of the Boiler MACT regulations, extending certain federal compliance requirements. These regulations could require modifications to one boiler at our mill in Roanoke Rapids, North Carolina. Based upon the Company's current understanding of the regulation, its current estimate for total cost of compliance is estimated at a range of \$2.0 million to \$3.0 million.

In addition to Boiler MACT and greenhouse gas standards, the EPA has recently finalized a number of other environmental rules, which may impact the pulp and paper industry. The EPA also is revising existing environmental standards and developing several new rules that may apply to the industry in the future. We cannot currently predict with certainty how any future changes in environmental laws, regulations and/or enforcement practices will affect our business; however, it is possible that our compliance, capital expenditure requirements and operating costs could increase materially.

Available Information

We make available free of charge our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished as required by Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, through our Internet Website (www.kapstonepaper.com) as soon as is reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Information contained in or incorporated into our Internet Website is not incorporated by reference herein.

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Item 1A. Risk Factors

You should carefully consider the following risk factors, together with the other information contained in this annual report on Form 10-K, in evaluating us and our business before making an investment decision regarding our securities. If any of the events or circumstances described in the following risk factors were to actually occur, our business, financial condition or results of operations could be materially and adversely affected. The risks listed below are not the only risks that we face.

Risks associated with our business

Conditions in the global capital and credit markets and the economy generally may materially adversely affect our business, results of operations and financial position and we do not expect these conditions to improve materially in the near future.

Our results of operations and financial position could be materially affected by adverse changes in the global capital and credit markets and the economy generally, including recent declines in consumer and business confidence and spending, both in the U.S. and elsewhere around the world. The capital and credit experienced extreme volatility and disruption in the recent past and, while generally more stable now, could experience such volatility and disruptions again particularly due to sovereign debt and related issues in Europe. Credit market dislocations can result in significant reduction in availability of liquidity and credit and increased the costs of credit when such credit is available. Conditions in the capital and credit markets and the effects of the declines in consumer and business confidence and spending may adversely impact the ability of our lenders, suppliers and customers to conduct their business activities. The consequences of such adverse effects could include the interruption of production at the facilities of our customers, the reduction, delay or cancellation of customer orders, delays in or the inability of customers to obtain financing to purchase our products, and bankruptcy of customers or other creditors. Moreover, the current worldwide financial crisis has in the past, and could in the future reduce the availability of liquidity and credit to fund or support the continuation and expansion of business operations worldwide.

While we have procedures to monitor and limit exposure to credit risk, there can be no assurance such procedures will effectively limit our credit risk and avoid losses, which could have a material adverse effect on our business, results of operations and cash flows and financial position.

We rely on key customers and a loss of one or more of our key customers could adversely affect our business, results of operations, cash flows and financial position.

During the year ended December 31, 2012, no customer accounted for more than 10 percent of consolidated net sales. However, losses of key customers could significantly impact our business, results of operations, cash flows and financial position.

We are dependent upon key management executives the loss of whom may adversely impact our business.

We depend on the expertise, experience and continued services of corporate and mill management. The loss of such management, or an inability to attract or retain other key individuals, could materially adversely affect our business. There can be no assurance that our salaries and incentive compensation plans will allow us to retain the services of these key management executives or hire new key employees.

Our indebtedness may adversely affect our financial health.

As of December 31, 2012, we had approximately \$368.8 million of outstanding debt. As a result of the indebtedness, our ability to obtain additional financing for working capital, capital expenditures, acquisitions or other general corporate purposes may be impaired in the future. The debt could make

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us vulnerable to economic downturns and may hinder our ability to adjust to rapidly changing market conditions.

A significant portion of our cash flow from operations will be needed to meet the payment of principal and interest on our indebtedness. The business may not generate sufficient cash flow from operations to enable it to repay our indebtedness and to fund other liquidity needs, including capital expenditure requirements. The indebtedness incurred by us under our senior secured credit facility bears interest at variable rates, and therefore if interest rates increase, our debt service requirements would increase. In such case, we may need to refinance or restructure all or a portion of our indebtedness on or before maturity. We may not be able to refinance any of our indebtedness, including the senior secured credit facility, on commercially reasonable terms, or at all. If we cannot service or refinance our indebtedness, we may have to take actions such as selling assets, seeking additional equity or reducing or delaying capital expenditures, any of which could have a material adverse effect on our operations and financial condition.

Our senior secured credit facility contains restrictive covenants that limit our liquidity and corporate activities, including our ability to pursue additional acquisitions. Our credit facility imposes operating and financial restrictions that limit our ability to:

incur additional indebtedness;

create additional liens on our assets;

make investments;

engage in mergers or acquisitions;

pay dividends; and

sell all or any substantial part of our assets.

In addition, our senior secured credit facility also imposes other restrictions on us. Therefore, we would need to seek permission from the lenders in order to engage in certain corporate actions. The lenders' interests may be different from ours, and no assurance can be given that we will be able to obtain the lenders' permission when needed. This may prevent us from taking actions that are in our best interest.

Our senior secured credit facility requires us to maintain certain financial ratios. The failure to maintain the specified ratios could result in an event of default if not cured or waived.

In the event of a default under our senior secured credit facility, the lenders generally would be able to declare all of such indebtedness, together with accrued interest, to be due and payable. In addition, borrowings under the credit facility are secured by a first priority lien on all of our assets and, in the event of a default under that facility the lenders generally would be entitled to seize the collateral. A default under any debt instrument, unless cured or waived, would likely have a material adverse effect on our business and financial condition.

If we fail to extend or renegotiate the collective bargaining agreements as they expire from time to time, or if our unionized employees were to engage in a strike or other work stoppage, our business and operating results could be materially harmed.

Most of our hourly paid employees are represented by trade unions. We are a party to collective bargaining contracts which apply to approximately 600 employees at the North Charleston mill, 400 employees at various corrugating manufacturing locations, and 400 employees at the Roanoke Rapids mill. No assurance can be given that we will be able to successfully extend or renegotiate the collective bargaining agreements as they expire from time to time. Currently, there is a collective bargaining agreement in effect with respect to Roanoke Rapids through August 2013. The North Charleston union

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contract expired in July of 2012 and remains under negotiations. If we are unable to extend or negotiate new agreements without work stoppages, it could negatively impact our ability to manufacture our products and adversely affect our results of operations.

Our operations are global in nature, and accordingly our business, results of operations, cash flows and financial position could be adversely affected by the political and economic conditions of the countries in which we conduct business, by fluctuations in exchange rates and other factors related to our international operations.

Approximately 23 percent and 35 percent, respectively, of each of our 2012 and 2011 revenues were derived from export sales. Our international operations and activities face increasing exposure to the risks of selling to customers in foreign countries. These factors include:

Changes in foreign currency exchange rates which could adversely affect selling prices for our products, and therefore our competitive position in a particular market.

Trade protection measures in favor of local producers of competing products, including government subsidies, tax benefits, trade actions (such as anti-dumping proceedings) and other measures giving local producers a competitive advantage over the Company.

Changes generally in political, regulatory or economic conditions in the countries in which we conduct business.

These risks could affect the cost of selling our products, our pricing, sales volume, and ultimately our financial performance. The likelihood of such occurrences and their potential effect on the Company vary from country to country and are unpredictable.

We may be required to record a charge to our earnings if our goodwill becomes impaired.

We test for impairment of goodwill annually in accordance with generally accepted accounting standards. When events or changes in circumstances indicate that the carrying value for such assets may not be recoverable, we review goodwill for impairment on an interim basis. Factors that may be considered a change in circumstances requiring our interim testing include a decline in stock price as compared to our book value per share, future cash flows and slower growth rates. In connection with future annual or interim tests, we may be required to record a non-cash charge to earnings during the period in which any impairment of goodwill is determined, which would adversely impact our results of operations.

See Note 2. "Significant Accounting Policies - Goodwill and Intangible Assets" in the Notes to the Consolidated Financial Statements for additional information related to testing for impairment of goodwill.

Our business depends on effective information management systems.

We rely on our enterprise resource planning (ERP) systems to support such critical business operations as processing sales orders and invoicing, inventory control, purchasing and supply chain management, payroll and human resources, and financial reporting. We periodically implement upgrades to such systems or migrate one or more of our affiliates, facilities or operations from one system to another. If we are unable to adequately maintain such systems to support our developing business requirements or effectively manage any upgrade or migration, we could encounter difficulties that could have a material adverse impact on our business, internal controls over financial reporting, financial results, or our ability to timely and accurately report such results.

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We are subject to cyber-security risks related to certain customer, employee, vendor or other company data.

We use information technologies to securely manage operations and various business functions. We rely upon various technologies to process, store and report on our business and interact with customers, vendors and employees. Despite our security design and controls, and those of our third party providers, we could become subject to cyber attacks which could result in operational disruptions or the misappropriation of sensitive data. There can be no assurance that such disruptions or misappropriations and the resulting repercussions will not be material to our results of operations, financial condition or cash flows.

We may incur business disruptions.

We take measures to minimize the risks of disruptions at our manufacturing facilities. However, the occurrence of a natural disaster, such as a hurricane, tropical storm, earthquake, tornado, flood, fire or other unanticipated problems such as labor difficulties, equipment failure or unscheduled maintenance could cause operational disruptions and could materially adversely affect our earnings and cash flows. Any losses due to these events may not be covered by our existing insurance policies or may be subject to certain deductibles.

Environmental regulations could materially adversely affect our results of operations and financial position.

We are subject to environmental regulation by federal, state, and local authorities in the United States, including requirements that regulate discharge into the environment, waste management, and remediation of environmental contamination. Maintaining compliance with existing and new environmental laws may require capital expenditures.

Due to past history of industrial operations at the Roanoke Rapids and North Charleston mills, the possibility of onsite and offsite environmental impact to the soil and groundwater may present a heightened risk of contamination. If we are required to make significant expenditures for remediation, the costs of such efforts may have a significant negative impact on our results of operations, cash flows and financial position.

MWV retained responsibility for certain offsite environmental conditions resulting from the operations at the North Charleston mill existing prior to the closing of the CKD acquisition. The overall indemnification by MWV for certain losses includes assumed environmental liabilities, subject to an \$8.5 million threshold and a cap equal to 15 percent of the purchase price of \$485 million. MWV's obligation to indemnify us for any historical onsite liability or breach of certain environmental representations and warranties terminates on December 31, 2013. MWV's indemnification for certain offsite historical liabilities survive indefinitely. Because we are unable to presently make a determination as to whether the environmental impact, if any, would be widespread or significant, the negotiated cap and survival period may not be sufficient to cover future losses.

Our operations are dependent upon certain operating agreements for fiber.

We rely on certain supply arrangements to provide us roundwood and woodchips. If one of these suppliers suffered a setback, KapStone's supply of roundwood and woodchips may not be adequate to cover customer needs.

Risks Associated with KapStone's Common Stock

The market price for our common stock may be highly volatile.

The market price of our common stock may be volatile due to certain factors, including, but not limited to; quarterly fluctuations in our financial and operating results; general conditions in the paper and packaging industries; or changes in earnings estimates.

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Shares available for future issuance, conversion and exercise could have an adverse effect on the earnings per share and the market price of our common stock.

Any future issuance of equity securities, including shares issued upon exercise of outstanding stock options, could dilute the interests of our existing stockholders and could adversely affect the trading price of our common stock.

Our executive officers and directors control a substantial percentage, approximately 13.9%, of our common stock and thus may influence certain actions requiring a stockholder vote.

At December 31, 2012, our executive officers and directors owned 6.6 million shares of our common stock, or approximately 13.9 percent of our total outstanding common stock. Accordingly, our executive officers and directors may have some influence over the outcome of all matters requiring approval by our stockholders, including future acquisitions and the election of directors. In addition, our board of directors is divided into three classes, each of which will generally serve for a term of three years with only one class of directors being elected in each year. At the annual meeting, as a consequence of our "staggered" board of directors, only a minority of the board of directors will be considered for election and our officers and directors, because of their ownership position, will have some influence regarding the outcome of the election.

Risks associated with the paper, packaging, forest products and related industries

The paper, packaging, forest products and related industries are highly cyclical. Fluctuations in the prices of and the demand for products could result in smaller profit margins and lower sales volumes.

Historically, economic and market shifts, fluctuations in capacity and changes in foreign currency exchange rates have created cyclical changes in prices, sales volume and margins for products in the paper, packaging, forest products and related industries. The length and magnitude of industry cycles have varied over time and by product, but generally reflect changes in macroeconomic conditions and levels of industry capacity. Most paper products and many wood products used in the packaging industry are commodities that are widely available from many producers. Because commodity products have few distinguishing qualities from producer to producer, competition for these products is based primarily on price, which is determined by supply relative to demand. The overall levels of demand for these commodity products reflect fluctuations in levels of end-user demand, which depend in large part on general macroeconomic conditions in North America and regional economic conditions in our markets (including Europe, Asia, and Central and South America), as well as foreign currency exchange rates. The foregoing factors could materially and adversely impact our sales and profitability and results of operations.

Difficulty obtaining wood fiber at favorable prices, or at all, may negatively impact companies in the paper and packaging industry.

Wood fiber (including OCC) is the principal raw material in many parts of the paper and packaging industry. Wood fiber is a commodity, and prices historically have been cyclical. Environmental litigation and regulatory developments have caused, and may cause in the future, significant reductions in the amount of timber available for commercial harvest in the United States. In addition, future domestic or foreign legislation and litigation concerning the use of timberlands, the protection of endangered species, the promotion of forest health and the response to and prevention of catastrophic wildfires could also affect timber supplies. Availability of harvested timber may further be limited by fire, insect infestation, disease, ice storms, wind storms, flooding and other causes, thereby reducing supply and increasing prices. Demand for OCC, especially from China, could result in shortages or spikes in the cost of OCC.

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Industry supply of commodity paper and wood products is also subject to fluctuation, as changing industry conditions can influence producers to idle or permanently close individual machines or entire mills. In addition, to avoid substantial cash costs in connection with idling or closing a mill, some producers will choose to continue to operate at a loss, sometimes even a cash loss, which could prolong weak pricing environments due to oversupply. Oversupply in these markets can also result from producers introducing new capacity in response to favorable short-term pricing trends. Industry supply of commodity papers and wood products is also influenced by overseas production capacity, which has grown in recent years and is expected to continue to grow. Wood fiber pricing is subject to regional market influences, and the cost of wood fiber may increase in particular regions due to market shifts in those regions. In addition, the ability to obtain wood fiber from foreign countries may be impacted by economic, legal and political conditions in those countries as well as transportation difficulties.

An increase in the cost of purchased energy and raw materials would lead to higher manufacturing costs, thereby reducing margins which would have an adverse effect on our profitability and results of operations.

Energy is a significant input cost for the paper and packaging industry. Increases in energy prices can be expected to adversely impact businesses. Energy prices, particularly for electricity, coal and fuel oil, have been volatile in recent years and currently coal and electricity prices exceed historical averages. These fluctuations have historically impacted manufacturing costs of companies in the industry, often contributing to reduced margins and increased earnings volatility. In addition, we could be materially adversely impacted by supply disruptions or the inability to pass on cost increases to our customers.

Paper and packaging companies face strong competition.

We face competition from numerous competitors, domestic as well as foreign. Some of our competitors will be large, vertically integrated companies that have greater financial and other resources, greater manufacturing economies of scale, greater energy self-sufficiency and/or lower operating costs.

Certain paper and wood products are vulnerable to long-term declines in demand due to competing technologies or materials.

Companies in the paper and packaging industry are subject to possible declines in demand for their products as the use of alternative materials and technologies grows and the prices of such alternatives become more competitive. Any substantial shift in demand from wood and paper products to competing technologies or materials could result in a material decrease in sales of our products and could adversely affect our results of operations, cash flows and financial position. We cannot ensure that any efforts we might undertake to adapt our product offerings to such changes would be successful or sufficient.

Paper and packaging companies are subject to significant environmental regulation and environmental compliance expenditures, as well as other potential environmental liabilities.

Companies in the paper and packaging industry are subject to a wide range of general and industry specific environmental laws and regulations, particularly with respect to air emissions, wastewater discharges, solid and hazardous waste management, site remediation, forestry operations and endangered species habitats. We may incur substantial expenditures to maintain compliance with applicable environmental laws and regulations, which could adversely affect our results of operations. Failure to comply with applicable environmental laws and regulations could expose us to civil or criminal fines or penalties or enforcement actions, including orders limiting operations or requiring corrective measures, installation of pollution control equipment or other remedial actions.

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Risks Associated with Acquisitions

We may fail to realize the anticipated synergies and cost savings expected from the USC acquisition.

Our success after the USC acquisition will depend, in part, on our ability to realize the anticipated \$8.0 million of growth opportunities and synergies, and \$8.0 million of cost savings from integrating our business with USC. To realize these anticipated benefits, we must successfully integrate our business with USC in a manner that permits these synergies to be realized. If we are not able to successfully achieve these objectives, such anticipated benefits may not be realized fully, or at all, or may take longer to realize than expected.

Future acquisitions of businesses by us would subject us to additional business, operating and industry risks, the impact of which cannot presently be evaluated, and could adversely impact our capital structure.

We intend to pursue other acquisition opportunities in an effort to diversify our investments and/or grow our business. Any business acquired by us may cause us to be affected by numerous risks inherent in the acquired business' operations. If we acquire a business in an industry characterized by a high level of risk, we may be adversely affected by the currently unascertainable risks of that industry. We cannot ensure that we would be able to properly ascertain or assess all of the significant risk factors with any such acquisitions.

In addition, the financing of any acquisition completed by us could adversely impact our capital structure as any such financing would likely include the issuance of additional equity securities and/or the borrowing of additional funds. The issuance of additional equity securities may significantly reduce the equity interest of our stockholders and/or adversely affect prevailing market prices for our common stock. Increasing our indebtedness could increase the risk of a default that would entitle the holder to declare all of such indebtedness due and payable and/or to seize any collateral securing the indebtedness. In addition, default under one debt instrument could in turn permit lenders under other debt instruments to declare borrowings outstanding under those other instruments to be due and payable pursuant to cross default clauses. Accordingly, the financing of future acquisitions could adversely impact our capital structure and the value of your equity interest in us.

Except as required by law or the rules of any securities exchange on which our securities might be listed at the time we seek to consummate a subsequent acquisition, stockholders will not be asked to vote on any such proposed acquisition and no redemption rights in connection with any such acquisition will exist.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The table below provides a summary of our paper mills, the principal products produced and each mill's annual practical maximum capacity based upon all of our paper machines' production capabilities, as reported to the AF&PA:

Location	Products	Capacity (tons)
North Charleston, SC	Unbleached Kraft	870,000
Roanoke Rapids, NC	Unbleached Kraft	440,000
Cowpens, SC	Recycled containerboard	240,000

Total 1,550,000

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We have granted mortgages on all of our owned real property, including our paper mills, to secure our obligations under our senior secured credit facility.

We own three of our 14 corrugated manufacturing plants. These plants are located in Georgia, Texas and Massachusetts and total 0.5 million square feet. The remaining 11 plant locations are leased. These plants are located in Georgia, New York, Kentucky, Iowa, Minnesota, Nebraska, North Dakota and Texas and total 2.1 million square feet. The majority of these leases expire in 2032. The equipment in the leased facilities is, in virtually all cases, owned by KapStone, except for forklifts, trailers and other rolling stock which are leased.

We currently lease space for our corporate headquarters in Northbrook, Illinois. The lease for this facility expires in 2020.

We currently believe that our owned and leased space for facilities and properties are sufficient to meet our operating requirements for the foreseeable future.

Item 3. Legal Proceedings

We are from time to time subject to various administrative and legal investigations, claims and proceedings incidental to our business, including environmental and safety matters, labor and employment matters, personal injury claims, contractual disputes and taxes. We establish reserves for claims and proceedings when it is probable that liabilities exist and where reasonable estimates can be made. We also maintain insurance that may limit our financial exposure for defense costs, as well as liability, if any, for claims covered by the insurance (subject also to deductibles and self-insurance amounts). While any investigation, claim or proceeding has an element of uncertainty, and we cannot predict or assure the outcome of any claim or proceeding involving the Company, we believe the outcome of any pending or threatened claim or proceeding (other than those that cannot be assessed due to their preliminary nature), or all of them combined, will not have a material adverse effect on our results of operations, cash flows or financial condition.

Item 4. Mine Safety Disclosure

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock, par value \$0.0001 per share, trades on the New York Stock Exchange under the symbol KS. As of December 31, 2012, the number of beneficial holders of record of our common stock was 5,980.

The following table sets forth the high and low sales price information for the Company's common stock from January 1, 2011 through December 31, 2012, as reported by the NYSE.

Quarter Ended	2012		2011	
	Low	High	Low	High
March 31	\$ 16.05	\$ 21.24	\$ 15.08	\$ 17.80
June 30	\$ 15.11	\$ 19.93	\$ 14.37	\$ 17.63
September 30	\$ 15.26	\$ 22.39	\$ 12.66	\$ 17.28
December 31	\$ 19.54	\$ 23.06	\$ 13.18	\$ 17.88

In November 2012 the Company's board of directors approved a special cash dividend of \$2.00 per share. The dividend was paid in December 2012. There were no cash dividends or other cash

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distributions made by us during the fiscal years 2011 or 2010. The Company does not currently have plans to pay any additional dividends.

At December 31, 2012, the closing share price on the NYSE was \$22.19. The value of Company stock as of December 31, 2012 includes the downward adjustment in the Company's stock price on the ex-dividend date equal to the \$2.00 per share special cash dividend payable to all shareholders of record as of December 10, 2012.

Stock Performance Graph

The performance graph shall not be deemed to be "soliciting material" or to be "filed" with the commission or subject to Regulation 14A or 14C, or to the liabilities of Section 18 of the Securities Exchange Act of 1934 as amended.

The following graph compares a \$100 investment in Company stock on December 31, 2007 with a \$100 investment in each of the S&P 500 and the S&P Paper and Packaging Index (the Company's peer group) also made on December 31, 2007. The graph portrays total return, 2007-2012, assuming reinvestment of dividends.

**Comparison of 5 Year Cumulative Total Return
Assumes Initial Investment of \$100
December 2012**

Item 6. Selected Financial Data

The following table sets forth KapStone's selected financial information derived from its audited consolidated financial statements as of, and for the years ended, December 31, 2012, 2011, 2010, 2009 and 2008.

The selected financial data presented below summarizes certain financial data which has been derived from and should be read in conjunction with Item 7. "Management's Discussion and Analysis

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of Financial Condition and Results of Operations" and KapStone's audited consolidated financial statements included in Item 8.

In thousands, except per share amounts	Years Ended December 31,				
	2012	2011	2010	2009	2008
Statement of Income Data:					
Net sales(1)	\$ 1,216,637	\$ 906,119	\$ 782,676	\$ 632,478	\$ 524,549
Operating income(2)	\$ 109,560	\$ 106,741	\$ 68,703	\$ 151,362	\$ 50,656
Net income(3)	\$ 62,505	\$ 123,981	\$ 65,041	\$ 80,280	\$ 19,665
Basic net income per share	\$ 1.34	\$ 2.68	\$ 1.42	\$ 2.32	\$ 0.74
Diluted net income per share	\$ 1.31	\$ 2.61	\$ 1.38	\$ 2.29	\$ 0.57
Balance Sheet Data:					
Cash and cash equivalents	\$ 16,488	\$ 8,062	\$ 67,358	\$ 2,440	\$ 4,165
Total assets	\$ 1,131,167	\$ 1,124,354	\$ 719,727	\$ 669,123	\$ 727,190
Long-term liabilities	\$ 414,628	\$ 442,269	\$ 185,539	\$ 213,637	\$ 419,545
Total stockholders' equity	\$ 517,948	\$ 546,278	\$ 418,634	\$ 348,790	\$ 180,767

- (1) 2011 results and later reflect the USC acquisition on October 31, 2011. 2008 results and later reflect the CKD acquisition from MeadWestvaco on July 1, 2008.
- (2) 2009 operating income includes \$164.0 million of alternative fuel mixture credits and \$16.4 million from the gain on the sale of the dunnage bag business.
- (3) 2011 net income includes a \$63.0 million benefit from the reversal of the tax reserve for alternative fuel mixture credits. 2010 net income includes a \$21.0 million cellulosic biofuel producers' tax credit.

See Note 3 to Notes to Consolidated Financial Statements for USC acquisition footnote.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive Summary

We have consummated three acquisitions since January 2007, including the USC acquisition consummated on October 31, 2011, as we drive towards our strategic objective of being a \$2 billion revenue company by 2015. We continue to evaluate additional acquisition opportunities.

Our mill operations had a strong year in 2012, producing a record 1.56 million tons of unbleached kraft paper compared to 1.35 million tons in 2011. Net sales in 2012 of \$1.2 billion reflect 1.7 million tons of product sold. Average selling prices for 2012 decreased by \$5 per ton to \$622. This decrease was a result of lower export containerboard and domestic kraft paper prices partially offset by a partial realization of our fourth quarter 2012 \$50 per ton containerboard price increase.

Some key highlights for 2012 include:

In June, we made a \$50.0 million voluntary prepayment of principal on our term loan using cash flow from operations.

In August, we announced a \$50 per ton selling price increase for domestic containerboard and an 8 and 10 percent increase for corrugated packaging boxes and sheets, respectively. These price increases were partially realized during the fourth quarter of 2012 and will be fully realized by mid 2013.

In September we announced a plan to invest \$29.0 million in our North Charleston, South Carolina paper mill to upgrade No. 3 paper machine and selected equipment in the fiber and

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utilities areas. This investment will increase capacity for ultra high performance linerboard grades.

In October we migrated 12 of 14 locations included in the USC acquisition to a common ERP platform.

In November our Board of Directors approved a \$2.00 per share special cash dividend which we paid on December 20, 2012.

In November we amended our Credit Agreement to, among other things, include a lower interest rate and a one year extension of our \$131.3 million final principal payment to November 28, 2017.

In January 2013, the Company announced the future opening a new manufacturing facility in Aurora, IL. The 192,000 square foot facility located 40 miles west of the city of Chicago will produce corrugated packaging and will also include a design lab and a technical center. The Company expects to invest approximately \$8 to \$10 million in the first phase and will begin production at the new facility in March of 2013.

Results of Operations for the Years Ended December 31, 2012, 2011, and 2010

The following table compares results of operations for the years ended December 31, 2012 and 2011:

(\$ in thousands)	Year Ended December 31,		%	% of Net Sales	
	2012	2011		Change	2012
Net sales	\$ 1,216,637	\$ 906,119	34.3%	100.0%	100.0%
Cost of sales, excluding depreciation and amortization	866,124	628,613	37.8%	71.2	69.4
Depreciation and amortization	63,124	51,036	23.7%	5.2	5.6
Freight and distribution expenses	108,438	79,643	36.2%	8.9	8.7
Selling, general and administrative expenses	70,055	41,265	69.8%	5.8	4.6
Other operating income	664	1,179	(43.7)%	(0.1)	(0.1)
Operating income	109,560	106,741	2.6%	9.0	11.8
Foreign exchange loss	303	319	(5.0)%		
Interest expense, net	11,774	6,081	93.6%	1.0	0.7
Income before provision (benefit) for income taxes	97,483	100,341	(2.8)%	8.0	11.1
Provision (benefit) for income taxes	34,978	(23,640)	(248.0)%	2.9	(2.6)
Net income	\$ 62,505	\$ 123,981	(49.6)%	5.1%	13.7%

Net sales for the year ended December 31, 2012 were \$1,216.6 million compared to \$906.1 million for the year ended December 31, 2011, an increase of \$310.5 million or 34.3 percent. The increase in net sales was driven by the USC acquisition which accounted for \$330.6 million of net sales. Excluding the USC acquisition, net sales decreased by \$20.1 million due to \$21.4 million of lower volume of paper sales as the Company used more tons for internal consumption rather than selling to third parties, \$4.8 million in lower average selling prices, \$4.0 million due to the unfavorable exchange rate effect of a stronger US dollar and \$2.2 million due to a less favorable product mix, partially offset by \$12.3 million of higher lumber and other sales. Average selling price per ton for 2012 was \$622 compared to \$627 for 2011. Average selling prices decreased primarily due to a \$45 per ton reduction in export containerboard prices and product mix, partially offset by the partial realization of a \$50 per ton containerboard price increase late in 2012.

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Average selling prices per ton of paper are expected to increase in 2013 as a \$50 per ton containerboard increase will be in place the entire year. The price increase was not fully implemented until the end of the fourth quarter in 2012. In addition, average selling prices for corrugated products are expected to increase in 2013 for the same reason.

The following represents the Company's tons of products sold:

Product Line (in tons):	Year Ended December 31,		Increase/ (Decrease)	%
	2012	2011		
Domestic containerboard	480,406	415,112	65,294	15.7
Corrugated products	383,415	57,186	326,229	570.5
Export containerboard	210,097	257,821	(47,724)	(18.5)
Kraft paper	250,280	275,461	(25,181)	(9.1)
DuraSorb®	253,239	266,571	(13,332)	(5.0)
Kraftpak®	103,028	96,947	6,081	6.3
Tons of product sold	1,680,465	1,369,098	311,367	22.7%

Tons of product sold in 2012 was 1,680,465 tons compared to 1,369,098 tons in 2011, an increase of 311,367 tons or 22.7 percent. The increase in tons of paper sold was primarily driven by the USC acquisition. Excluding the USC acquisition, tons of paper sold decreased by 14,862 tons or 1.1 percent.

Domestic containerboard sales increased 15.7 percent reflecting the impact of the USC acquisition and higher demand for lightweight containerboard grades.

Corrugated product sales volume increased 570.5 percent in 2012. Corrugated product sales, in billion square feet, was 6.2 billion in 2012 compared to 1.0 billion in 2011. Sales of corrugated products began with the USC acquisition which closed in the fourth quarter of 2011.

Export containerboard sales decreased 18.5 percent as more containerboard volume was shipped to domestic customers and used for internal consumption.

Kraft paper sales decreased 9.1 percent reflecting an overall decrease in demand in the industry and a transfer of volumes to lightweight containerboard grades.

Durasorb® sales declined 5.0 percent due to lower demand in copper clad laminate markets in Japan, Korea and Southeast Asia and in Europe due to lower demand for high pressure laminates.

Kraftpak® sales volume increased 6.3 percent due to higher volume with existing accounts.

Cost of sales, excluding depreciation and amortization expense, for the year ended December 31, 2012 was \$866.1 million compared to \$628.6 million for the year ended December 31, 2011, an increase of \$237.5 million, or 37.8 percent. The increase in cost of sales was mainly due to the \$246.4 million impact of the USC acquisition. Excluding the USC acquisition, cost of sales decreased by \$8.9 million due to \$19.7 million of lower sales volume and \$5.4 million of productivity gains, partially offset by \$12.0 million of inflation on labor, benefits and input costs. Other costs increased approximately \$2.9 million due to higher lumber and other sales and by \$1.3 million due to repairs and maintenance costs at the Roanoke Rapids paper mill due to a flood which occurred on August 25th. The mill received 11 inches of rain in less than six hours which resulted in a loss of 707 tons of production. Annual planned maintenance outages during 2012 and 2011 totaled \$18.4 million and \$18.8 million, respectively.

Depreciation and amortization expense for the year ended December 31, 2012 totaled \$63.1 million compared to \$51.0 million for the same period in 2011. The increase of \$12.1 million was primarily due to \$11.4 million from the USC acquisition, \$4.7 million of which is

amortization of

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identified intangibles. Excluding the USC acquisition, depreciation and amortization expense increased \$0.7 million.

Freight and distribution expenses for the year ended December 31, 2012 totaled \$108.4 million compared to \$79.6 million for the year ended December 31, 2011. The increase of \$28.8 million was primarily due to \$26.5 million from the USC acquisition. Excluding the USC acquisition, freight and distribution expenses increased \$2.3 million primarily due to product mix reflecting a higher percentage of domestic containerboard shipments where the Company pays for freight and inflation on fuel costs.

Selling, general and administrative expenses for the year ended December 31, 2012 totaled \$70.1 million compared to \$41.3 million in 2011. The increase of \$28.8 million was primarily due to \$24.9 million from the USC acquisition. Excluding the USC acquisition, selling, general and administrative expenses increased \$3.9 million due to the higher compensation related expenses and \$1.5 million of higher acquisition integration related expenses. As a percentage of net sales, selling, general and administrative expenses increased to 5.8 percent in 2012 from 4.6 percent in 2011.

Interest expense, net for the years ended December 31, 2012 and 2011 was \$11.8 million and \$6.1 million, respectively. Interest expense reflects interest on borrowings under the Company's Credit Agreement and amortization of debt issuance costs. Interest expense was \$5.7 million higher in 2012 due to a higher term loan balance to fund the USC acquisition and \$1.0 million of higher debt amortization costs.

Provision (benefit) for income taxes for the years ended December 31, 2012 and 2011 was \$35.0 million expense and \$23.6 million benefit, respectively, reflecting an effective tax rate of 35.9 percent for 2012 compared to (23.6) percent for the similar period in 2011. The higher benefit for income taxes in 2011 mainly reflects \$63.0 million for the reversal of tax reserves relating to alternative fuel mixture tax credits upon completion of the 2009 IRS examination in the fourth quarter of 2011.

The following table compares results of operations for the years ended December 31, 2011 and 2010:

(\$ in thousands)	Year Ended December 31,		% Change	% of Net Sales	
	2011	2010		2011	2010
Net sales	\$ 906,119	\$ 782,676	15.8%	100.0%	100.0%
Cost of sales, excluding depreciation and amortization	628,613	565,185	11.2%	69.4	72.2
Depreciation and amortization	51,036	45,245	12.8%	5.6	5.7
Freight and distribution expenses	79,643	73,406	8.5%	8.7	9.4
Selling, general and administrative expenses	41,265	31,129	32.6%	4.6	4.0
Other operating income	1,179	992	18.9%	(0.1)	(0.1)
Operating income	106,741	68,703	55.4%	11.8	8.8
Foreign exchange loss	319	666	(52.1)%		(0.1)
Interest expense, net	6,081	5,403	12.5%	0.7	0.7
Income before income taxes	100,341	62,634	60.2%	11.1	8.0
Provision (benefit) for income taxes	(23,640)	(2,407)	882.1%	(2.6)	(0.3)
Net income	\$ 123,981	\$ 65,041	90.6%	13.7%	8.3%

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Net sales for the year ended December 31, 2011 were \$906.1 million compared to \$782.7 million for the year ended December 31, 2010, an increase of \$123.4 million or 15.8 percent. Net sales in 2011 included two months (of USC sales after the closing of the USC acquisition on October 31, 2011) which accounted for \$58.4 million of the increase in net sales. Excluding the acquisition, the increase in net sales was driven by \$50.5 million of higher average selling prices in 2011 compared to 2010 mainly due to full realization of price increases implemented in 2010 and in the first half of 2011. Average selling price per ton for 2011 was \$627 compared to \$586 for 2010. Net sales also increased by \$11.8 million due to higher unit sales and \$1.0 million of more favorable product mix partially offset by \$2.2 million of lower lumber sales. Exchange rates positively impacted net sales by \$3.9 million.

The following represents the Company's tons of product sold:

Product Line (in tons):	Year Ended December 31,		Increase/ (Decrease)	%
	2011	2010		
Domestic containerboard	415,112	377,505	37,607	10.0
Corrugated products	57,186		57,186	NM
Export containerboard	257,821	272,719	(14,898)	(5.5)
Kraft Paper	275,461	273,216	2,245	0.8
DuraSorb®	266,571	268,852	(2,281)	(0.8)
Kraftpak®	96,947	92,853	4,094	4.4
Tons of product sold	1,369,098	1,285,145	83,953	6.5%

Tons of product sold in 2011 was 1,369,098 tons compared to 1,285,145 tons in 2010, an increase of 83,953 tons or 6.5 percent. The increase in tons of paper sold was primarily driven by the USC acquisition. Excluding the USC acquisition, tons of paper sold increased by 26,767 tons or 2.1 percent.

Domestic containerboard sales volume increased 10.0 percent reflecting higher demand for lightweight grades.

Sales of corrugated products began with the USC acquisition which closed in the fourth quarter of 2011. Corrugated product sales, in million square feet, were 950 million in 2011.

Export containerboard volume decreased 5.5 percent due to higher domestic shipments.

DuraSorb® sales volume declined 0.8 percent due to a reduction in export shipments, mainly in Asia.

Kraftpak® sales volume increased 4.4 percent reflecting higher penetration in folding carton markets.

Cost of sales, excluding depreciation and amortization expense, for the year ended December 31, 2011 was \$628.6 million compared to \$565.2 million for the year ended December 31, 2010, an increase of \$63.4 million or 11.2 percent. Excluding \$44.8 million of cost of sales for the sales of the acquired USC business, the increase in cost of sales was mainly due to a \$22.2 million decrease in alternative fuel mixture tax credits (the tax credit expired December 31, 2009), \$5.8 million due to inflation of input costs and \$5.3 million of higher sales volume. Partially offsetting the increase in cost of sales was \$11.9 million from productivity gains and other cost savings and \$2.8 million of lower planned maintenance outage costs.

Depreciation and amortization for the year ended December 31, 2011 totaled \$51.0 million compared to \$45.2 million for the same period in 2010. Excluding \$2.2 million for the acquisition, the increase of \$3.6 million was primarily due to \$38.3 million of capital spending in 2010 and \$0.8 million of accelerated depreciation in 2011.

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Freight and distribution expenses for the year ended December 31, 2011 totaled \$79.6 million compared to \$73.4 million for the year ended December 31, 2010, an increase of \$6.2 million. Excluding \$4.2 million for the addition of two months of USC's results, the increase was primarily due to \$1.5 million of inflation on fuel costs and \$1.1 million of higher sales volume partially offset by \$0.6 million of lower warehousing costs.

Selling, general and administrative expenses for the year ended December 31, 2011 totaled \$41.3 million compared to \$31.1 million in 2010. Excluding \$4.5 million for the addition of two months of USC's results, the increase of \$5.7 million reflects \$3.3 million of acquisition related expenses, \$1.0 million of higher incentive compensation and \$1.4 million of other cost increases. As a percentage of net sales, selling, general and administrative expenses increased from 4.0 percent in 2010 to 4.6 percent in 2011.

Foreign exchange losses for the years ended December 31, 2011 and 2010 were \$0.3 million and \$0.7 million, respectively. The change reflects fluctuations in the U.S. dollar to Euro exchange rate.

Interest expense, net for the years ended December 31, 2011 and 2010 was \$6.1 million and \$5.4 million, respectively. Interest expense reflects interest on the Credit Agreement and amortization of debt issuance costs. Interest expense was \$0.7 million higher in 2011 compared to 2010 due to higher term loan balances in the fourth quarter of 2011 as a result of entering into a new credit agreement in conjunction with the USC acquisition on October 31, 2011.

The benefit for income taxes for the years ended December 31, 2011 and 2010 was \$23.6 million and \$2.4 million, respectively, reflecting an effective tax rate of (23.6) percent in 2011 compared to (3.8) percent in 2010. The higher benefit for income taxes in 2011 mainly reflects \$63.0 million for the reversal of tax reserves relating to alternative fuel mixture tax credits upon completion of the 2009 IRS examination in the fourth quarter of 2011. The 2010 benefit for income taxes included a \$21.0 million benefit related to the Cellulosic Biofuel credit and a refundable tax credit from the inorganic content of black liquor.

Liquidity and Capital Resources

Amendment to Credit Agreement

On May 10, 2012, the Company entered into a First Amendment to the Credit Agreement (the "First Amendment"), which amended the Credit Agreement, dated as of October 31, 2011. The First Amendment, among other things, expanded the "accordion" feature under the Credit Agreement, removed certain mandatory prepayment events, and modified the calculation methodology of the financial covenants. The "accordion" feature in the Credit Agreement now permits the Company, subject to certain terms and conditions, to request an increase in the revolving commitments and/or additional term loans in an aggregate principal amount of up to \$450.0 million.

On November 28, 2012, the Company entered into a Second Amendment to the Credit Agreement ("Second Amendment"), further amending the Company's Credit Agreement. The Second Amendment amended the definition of "Fixed Charge Coverage Ratio", changed the applicable rate grid, extended the Maturity Date from October 31, 2016 to November 28, 2017, and permitted a one-time special cash dividend to be paid by the Company on or before December 31, 2012, in an aggregate amount not to exceed \$100.0 million.

Voluntary and Mandatory Prepayments

For the years ended December 31, 2012 and 2011, the Company made \$50.0 million and \$15.0 million of voluntary principal prepayments, respectively to the term loan under the Credit Agreement. No mandatory prepayments were required under the Credit Agreement.

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In 2012 and 2011, the Company entered into financing agreements of \$3.4 million and \$2.3 million, respectively, at an annual interest rate of 2.00 percent and 1.75 percent, respectively, for its annual property insurance premium. The agreements required the Company to make consecutive monthly repayments through the term of the financing agreement ending on December 1 of each year. As of December 31, 2012, there was no balance outstanding under the current agreement. The Company entered into a similar agreement in 2013 with similar terms and conditions.

Debt Covenants

Under the financial covenants of the Credit Agreement, KapStone must comply on a quarterly basis with a maximum permitted leverage ratio. The leverage ratio is calculated by dividing KapStone's debt by its rolling twelve month total earnings before interest expense, taxes, depreciation and amortization and allowable adjustments. The maximum permitted leverage ratio declines over the life of the Credit Agreement. On December 31, 2012, the maximum permitted leverage ratio was 3.25 to 1.00. On December 31, 2012, KapStone was in compliance with the Credit Agreement with a leverage ratio of 2.06 to 1.00.

The Credit Agreement also includes a financial covenant requiring a minimum fixed charge coverage ratio. This ratio is calculated by dividing KapStone's twelve month total earnings before interest expense, taxes, depreciation and amortization and allowable adjustments less cash payments for income taxes and capital expenditures by the sum of our cash interest and required principal payments during the twelve month period. From the closing date of the Credit Agreement through the quarter ending December 31, 2012 the fixed charge coverage ratio was required to be at least 1.25 to 1.00. On December 31, 2012, KapStone was in compliance with the Credit Agreement with a fixed charge coverage ratio of 12.93 to 1.00.

As of December 31, 2012, KapStone was also in compliance with all other applicable covenants in the Credit Agreement.

Income Taxes

Income taxes paid, net of refunds, were \$7.0 million, \$0.3 million, and (\$13.2) million in 2012, 2011 and 2010, respectively. The Company expects to pay a higher amount of income taxes in 2013.

Sources and Uses of Cash

Years ended December 31 (\$ in thousands)	2012	2011	2010
Operating activities	\$ 157,829	\$ 136,376	\$ 136,076
Investing activities	(67,551)	(423,863)	(35,180)
Financing activities	(81,852)	228,191	(35,978)
Total change in cash and cash equivalents	\$ 8,426	\$ (59,296)	\$ 64,918

2012

Cash and cash equivalents increased by \$8.4 million from December 31, 2011, reflecting \$157.8 million of net cash provided by operating activities offset by \$67.5 million of net cash used in investing activities and \$81.9 million of net cash used in financing activities.

Net cash provided by operating activities was \$157.8 million, primarily due to \$62.5 million of net income, \$88.1 million of non-cash charges and \$7.2 million due to changes in operating assets and liabilities. Net cash provided by operating activities increased by \$21.5 million during the year ended

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December 31, 2012 compared to the same period in 2011 due to operating assets and liabilities using \$93.6 million of less cash offset by \$61.4 million of lower net income in 2012 than 2011 and \$10.7 million of lower non-cash charges.

Net cash used in investing activities was \$67.6 million reflecting \$67.2 million of capital expenditures. For the year ended December 31, 2012, capital expenditures for legacy operations were \$50.5 million related to spending on equipment upgrades and replacements at the paper mills and were \$16.7 million for our mill and corrugated operations acquired in the USC acquisition, primarily related to investments in information technology. Net cash used in investing activities decreased by \$356.3 million in 2012 compared to 2011, mainly due to the \$331.3 million paid for the USC acquisition and a \$49.7 million contingent earn-out payment in 2011 for the KPB acquisition, partially offset by \$24.7 million of higher capital expenditures in 2012.

Net cash used in financing activities was \$81.9 million reflecting the \$94.9 million special cash dividend payment in December 2012 and \$50.0 million voluntary prepayment on the term loan in June 2012, partially offset by \$63.5 million of short-term borrowings under the revolving credit. Net cash used in financing activities increased by \$310.0 million for 2012 compared to the same period in 2011, primarily due to \$375.0 million of 2011 loan proceeds and \$94.9 million for the 2012 special cash dividend payment. These amounts were partially offset by \$63.5 million in 2012 short-term borrowings, lower debt repayment in 2012 of \$84.6 million, and \$13.8 million for the 2011 debt issuance costs.

2011

Cash and cash equivalents of \$8.1 million at December 31, 2011 decreased by \$59.3 million from December 31, 2010, reflecting cash provided by operations of \$136.4 million and cash provided by financing activities of \$228.2 million, offset by cash used in investing activities of \$423.9 million.

Net cash provided by operating activities was \$136.4 million due to \$124.0 million of net income and \$98.8 million of non-cash charges. Changes in operating assets and liabilities used \$86.5 million of cash. Net cash provided by operating activities increased by \$0.3 million during the year ended December 31, 2011 compared to the year ended December 31, 2010 due to a \$58.9 million increase in net income and \$71.5 million of higher non-cash charges partially offset by a \$130.2 million increase in cash used in operating assets and liabilities. Non-cash charges increased by \$71.5 million, primarily due to \$65.8 million of higher deferred income taxes. The \$130.2 million increase of cash used in operating assets and liabilities was mainly due to a reversal of a \$63.0 million tax reserve for the AFMTC, \$13.2 million tax refund received in June 2010, \$13.1 million of AFMTC payments received in the first six months of 2010 and \$9.7 million of incentive compensation paid in 2011.

Net cash used in investing activities included \$331.6 million for the USC acquisition, \$49.7 million reflecting a contingent earn-out payment made to IP in connection with the KPB acquisition and \$42.5 million of capital expenditures. Capital expenditures were mainly spent on equipment upgrades and replacements at the paper mills. Net cash used in investing activities increased by \$388.7 million during the year ended December 31, 2011 compared to the year ended December 31, 2010 mainly due to the \$331.6 million paid for the USC acquisition and the \$49.7 million contingent earn-out payment.

Net cash provided by financing activities totaled \$228.2 million reflecting \$375.0 million of loan proceeds from the Credit Agreement entered into in October 2011, partially offset by the \$114.9 million payoff of the Company's prior credit facility, \$19.7 million of term loan repayments including a \$15.0 million voluntary payment, and \$13.8 million of debt issuance costs for the Credit Agreement. Net cash provided by financing activities changed by \$264.2 million during the year ended December 31, 2011 compared to the year ended December 31, 2010 mainly due to the loan proceeds received under the Credit Agreement, partially offset by the payoff of the Company's prior credit facility and payment of debt issuance costs.

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Future Cash Needs

We expect that cash on hand at December 31, 2012 and cash generated from operating activities in 2013 and, if needed, the ability to draw from our \$150.0 million revolving credit facility under our Credit Agreement and our \$450.0 million accordion provision under our Credit Agreement will be sufficient to meet anticipated cash needs, which primarily consist of \$69.9 million repaying our short-term borrowings and interest on our term loans, approximately \$73.0 million of expected capital expenditures, \$4.4 million of pension plan funding and any additional working capital or acquisition needs. At December 31, 2012, the Company had \$63.5 million in borrowings and \$79.6 million of remaining availability under the revolving credit facility.

On a long term basis, we expect that cash generated from operating activities and, if needed, the ability to draw from our revolving credit facility and accordion provision will be sufficient to meet long term obligations, which primarily consist of \$393.1 million of debt service and interest, which includes a \$131.3 million final payment on our term loan in November 2017, capital expenditures of \$45.0 to \$60.0 million annually, annual defined benefit pension plan contributions, working capital needs and acquisitions.

Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet arrangements and have not established any special purpose entities. We have not guaranteed any debt or commitments of other non-related entities or entered into any options on non-financial assets.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates. We believe our critical accounting policies are those described below. The Company's audit committee has reviewed the policies listed below. For a detailed discussion of these and other accounting policies, see Note 2 of the Notes to the Consolidated Financial Statements.

Revenue Recognition The Company recognizes revenue in accordance with Accounting Standards Codification ("ASC") 605 *Revenue Recognition*. Revenue is recognized when the customer takes title and assumes the risks and rewards of ownership. Sales with terms designated f.o.b. (free on board) shipping point are recognized at the time of shipment. For sales transactions with terms f.o.b. destination, revenue is recorded when the product is delivered to the customer's site and when title and risk of loss are transferred. Sales on consignment are recognized in revenue at the earlier of the month that the goods are consumed or after a period of time subsequent to receipt by the customer as specified by contract terms. Incentive rebates are typically paid in cash and are netted against revenue on an accrual basis as qualifying purchases are made by the customer to earn and thereby retain the rebate.

The Company recognizes revenue from the sale of shaft horsepower, generated by its cogeneration facility, on a gross basis and is included in net sales.

Freight charged to customers is recognized in net sales.

Goodwill and Intangible Assets Goodwill is the excess of cost over the fair value of the net assets of businesses acquired. On an annual basis and in accordance with ASC 350, *Intangibles - Goodwill and Other*, the Company tests for goodwill impairment using a two-step process, unless there is a triggering event, in which case a test would be performed at the time that such triggering event occurs. The first step is to identify a potential impairment by comparing the fair value of a reporting unit with its

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carrying amount. A reporting unit is an operating segment or one level below an operating segment (referred to as a "component"). A component is considered a reporting unit for purposes of goodwill testing if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. For 2012, the Company has identified two reporting units. The estimates of fair value of a reporting unit are determined based on a market approach as well as an income approach using a discounted cash flow analysis. A discounted cash flow analysis requires the Company to make various judgmental assumptions, including assumptions about future cash flows, growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the forecast and long-term business plans of the Company's operating segment. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting units. If necessary, the second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination.

Pension and Postretirement Benefits The Company provides pension and postretirement benefits to certain employees and accounts for these benefits in accordance with ASC 715, *Compensation Retirement Benefits*. For financial reporting purposes, long-term assumptions are developed through consultations with actuaries. Such assumptions include the expected long-term rate of return on plan assets, discount rates, health care trend rates and mortality rates. The discount rate for the current year is based on long-term high quality bond rates.

Income Taxes The Company accounts for income taxes under the liability method in accordance with ASC 740 *Income Taxes*. Accordingly, deferred income taxes are provided for the future tax consequences attributable to differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets and liabilities are measured using tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized. The Company recognizes the benefit of tax positions when it is more likely than not to be sustained on its technical merits. The Company records interest and penalties on unrecognized tax benefits in the provision for income taxes.

Stock Based Compensation Costs The Company accounts for stock compensation expense in accordance with ASC 718, *Compensation Stock Compensation*. The compensation expense for stock options is recorded on an accelerated basis over the awards' vesting periods. The compensation expense for restricted stock is recorded on a straight-line basis over the awards' vesting periods. Forfeitures are estimated on the date of grant and revised if actual or expected forfeiture activity differs materially from the original estimate.

Recent Accounting Pronouncements

See Note 2 in the Notes to Consolidated Financial Statements for a discussion of recent accounting pronouncements.

Table of ContentsContractual Obligations

The following table summarizes our contractual obligations as of December 31, 2012, (\$000s):

Contractual Obligations	Total	Payments Due by Period					
		1 Year	2 Years	3 Years	4 Years	5 Years	Thereafter
Short-term borrowings(1)	\$ 63,500	\$ 63,500	\$	\$	\$	\$	\$
Long-term debt(2)	305,313		26,406	49,219	56,250	173,438	
Interest on long-term debt(3)	24,316	6,389	5,836	5,147	4,236	2,708	
Operating lease obligations(4)	106,316	10,616	9,745	8,665	8,337	6,942	62,011
Purchase obligations(5)	247,009	39,054	30,018	29,268	27,433	24,308	96,928
Minimum pension plan funding(6)	4,410	4,410					
Total	\$ 750,864	\$ 123,969	\$ 72,005	\$ 92,299	\$ 96,256	\$ 207,396	\$ 158,939

- (1) These obligations do not become due until November 28, 2017 but it is management's intention to use cash flow from operations to settle this obligation in 2013.
- (2) These obligations are reflected on our Consolidated Balance Sheet at December 31, 2012, in long-term debt net of current portion, as appropriate. See Note 9 of Notes to Consolidated Financial Statements.
- (3) Assumes debt is carried to full term. Debt bears interest at variable rates and the amounts above assume future interest will be incurred at the rates in effect on December 31, 2012. These obligations are not reflected on our Consolidated Balance Sheet at December 31, 2012.
- (4) These obligations are not reflected on our Consolidated Balance Sheet at December 31, 2012.
- (5) Purchase obligations are agreements to purchase goods that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased. These obligations are not reflected on our Consolidated Balance Sheet at December 31, 2012. See Note 14 of Notes to Consolidated Financial Statements regarding the Company's purchase obligation relating to the Long Term Fiber Supply with MWV.
- (6) The Company's pension and postretirement liabilities total \$13.2 million as of December 31, 2012. The minimum pension plan funding represents the Company's expected 2013 contributions and was determined in consultation with our actuary in accordance with IRS guidelines. See Note 10 of Notes to Consolidated Financial Statements.

Due to the uncertainty of the timing of settlement with taxing authorities, we are unable to make reasonably reliable estimates of the period of cash settlement of unrecognized tax benefits. Therefore, \$5.0 million of unrecognized tax benefits as of December 31, 2012 has been excluded from the table above.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the sensitivity of income to changes in interest rates, commodity prices and foreign currency changes. The Company is exposed to the following types of market risk: interest rates, commodity prices and foreign currency.

Interest Rates

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Under our Credit Agreement, at December 31, 2012, we have an outstanding credit facility consisting of a term loan and revolving credit facility totaling \$455.3 million. The initial term loan and the revolving credit facility have a maturity date of November 28, 2017. Depending on the type of

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borrowing, the applicable interest rate under the Credit Agreement is calculated at a per annum rate equal to (a) LIBOR plus an applicable margin, which is currently 1.50% for Eurodollar loans, or (b) (i) the greatest of (x) the prime rate, (y) the federal funds effective rate plus 0.5% or (z) one-month LIBOR plus 1.00% plus (ii) an applicable margin, which is currently 0.50% for base rate loans. The unused portion of the revolving credit facility is subject to an unused fee that is calculated at a per annum rate (the "Unused Fee Rate"), which is currently 0.35%. With the delivery of the financial statements for the fiscal quarter ending December 31, 2012, the applicable margin for borrowings under the Credit Agreement and the Unused Fee Rate is determined by reference to a pricing grid based on the Company's total leverage ratio. Under such pricing grid, the applicable margins for the Credit Agreement ranges from 1.25% to 2.25% for Eurodollar loans and from 0.25% to 1.250% for base rate loans, and the Unused Fee Rate ranges from 0.30% to 0.50%.

Changes in market rates may impact the base or LIBOR rate in our Credit Agreement. For instance, if the bank's LIBOR rate was to increase or decrease by one percentage point (1.0%), our annual interest expense would change by approximately \$3.1 million based upon our expected future monthly term loan balances per our existing repayment schedule.

Commodity Prices

We are exposed to price fluctuations of certain commodities used in production. Key materials and energy used in the production process include roundwood and woodchips, recycled fiber (OCC), containerboard, fuel oil, natural gas, electricity and caustic soda. We generally purchase these materials and energy at market prices, and do not use forward contracts or other financial instruments to hedge our exposure to price risk related to these commodities. We have three contracts to purchase coal at fixed prices through December 31, 2013.

We are exposed to price fluctuations in the price of our finished goods. The prices we charge for our products are primarily based on market conditions.

Foreign Currency

We are exposed to currency fluctuations as we invoice certain European customers in Euros. The Company used foreign currency forward contracts and foreign exchange forward contracts to manage some of the foreign currency exchange risks associated with foreign sales of its U.S. operations during 2010. Using such foreign currency forward contracts, the Company received or paid the difference between the contracted forward rate and the exchange rate at the settlement date. These contracts were used to hedge the variability of exchange rates on the Company's cash flows. No such contracts were outstanding at December 31, 2012 or 2011.

Item 8. Financial Statements and Supplementary Data

Financial statements are attached hereto beginning on Page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures.

An evaluation of the effectiveness of our disclosure controls and procedures as of December 31, 2012 was made by our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

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Internal Control over Financial Reporting.

Management Annual Report on Internal Control over Financial Reporting. Our management's report on internal control over financial reporting is set forth on page F-2 of this report.

Changes in Internal Control over Financial Reporting. Effective October 1, 2012 the Company migrated the paper mill and fourteen corrugating manufacturing plants acquired as part of the USC acquisition to a new ERP system. There were no other changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item is incorporated by reference from our definitive proxy statement to be filed on or about April 1, 2013 with the Securities and Exchange Commission ("SEC").

Additional information required by this Item (i) with respect to members of our Board of Directors will be contained in the Company's Proxy Statement to be filed with the SEC on or about April 1, 2013 under the caption "Election of Directors," (ii) with respect to our audit committee will be contained in the Company's Proxy Statement under the caption "Governance Structure What Committees has the Board of Directors Established?," (iii) with respect to compliance under Section 16(a) of the Securities Exchange Act of 1934 will be contained in Company's Proxy Statement under the caption "Section 16(a) Beneficial Ownership Reporting Compliance," and (iv) with respect to our code of ethics will be contained in the Company's Proxy Statement under the caption "Code of Ethics," and is incorporated herein by this reference.

KapStone adopted a code of ethics that applies to its CEO and CFO, as well as all other officers and employees of the Company and its affiliates. This code of ethics, entitled "Code of Conduct and Ethics", is posted on the Company's website at www.kapstonepaper.com under "Governance." The Code of Conduct and Ethics is administered by the Chief Compliance Officer of the Company. Any amendment to, or waiver of, a provision of the code of ethics that applies to the CEO, CFO, or persons performing similar functions will be disclosed on the Company's website a under "Governance."

Item 11. Executive Compensation

The information required by this Item will be contained in the Company's Proxy Statement to be filed with the SEC on or about April 1, 2013 under the captions "Executive Compensation," "Summary Compensation Table," "Grants of Plan-Based Awards," "Outstanding Equity Awards at 2012 Fiscal Year End," "Potential Payments upon Termination or Change-in-Control," and "2012 Director Compensation" and is incorporated herein by this reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item will be contained in the Company's Proxy Statement to be filed with the SEC on or about April 1, 2013 under the captions "Securities Authorized for Issuance Under Equity Compensation Plan", "Security Ownership of Management" and "Security Ownership of Certain Beneficial Stockholders" and is incorporated herein by this reference.

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Item 13. Certain Relationships and Related Persons Transactions and Director Independence

The information required by this Item will be contained in the Company's Proxy Statement to be filed with the SEC on or about April 1, 2013 under the captions "Certain Relationships and Related Person Transactions," and "Governance Structure" is incorporated herein by this reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item will be contained in the Company's Proxy Statement to be filed with the SEC on or about April 1, 2013 under the caption "Independent Registered Public Accounting Firm" and is incorporated herein by this reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

- (a)
 (1) *Financial Statements*

An index to Consolidated Financial Statements appears on page F-1.

- (a)
 (2) *Financial Statement Schedules*

Certain financial statement schedules have been omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

- (b)
 Exhibits.

The following Exhibits are filed as part of this report:

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated as of September 22, 2011, by and among KapStone Kraft Paper Corporation, U.S. Corrugated Acquisition Inc., Pine Merger Corp., Dennis Dorian Mehiel, for purposes of Section 10.3, and Dennis Mehiel, for purposes of Section 10.3 and as the Representative. Incorporated by reference to the Registrant's Current Report on Form 8-K filed on September 22, 2011.
3.1	Restated Certificate of Incorporation of KapStone Paper and Packaging Corporation (as amended through January 2, 2007). Incorporated by reference to the Registrant's Annual Report on Form 10-K for the period ended December 31, 2009, filed on March 10, 2010.
3.2	Amended and Restated By-laws. Incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 5, 2009.
4.1	Specimen Common Stock Certificate. Incorporated by reference to the Registrant's Registration Statement on Form S-1/A (File No. 333-124601) filed on June 14, 2005.
10.1	Form of Letter Agreement among the Registrant, Morgan Joseph & Co. Inc. and each of the Initial Stockholders. Incorporated by reference to the Registrant's Registration Statement on Form S-1/A (File No. 333-124601) filed on June 14, 2005.
10.2*	2006 Incentive Plan amended and restated as of May 18, 2012.
10.3*	

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Performance Incentive Plan of KapStone Paper and Packaging Corporation. Incorporated by reference to the Registrant's Current Report on Form 8-K filed on April 14, 2008.

10.4* Form of Restricted Stock Unit Agreement. Incorporated by reference to the Registrant's Current Report on Form 8-K filed on April 14, 2008.

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Exhibit No.	Description
10.5*	2009 Employee Stock Purchase Plan. Incorporated by reference to the Registrant's Form S-8 filed on December 11, 2009.
10.6*	Restricted Stock Unit Agreement Amendment November 28, 2012 issued on or about May 27, 2012 between KapStone Paper and Packaging Corporation and Grantee.
10.7	Long-Term Fiber Supply Agreement, dated July 1, 2008, by and among MeadWestvaco Forestry LLC and KapStone Charleston Kraft LLC (with certain confidential information deleted there from). Incorporated by reference to the Registrant's Current Report on Form 8-K filed on July 2, 2008.
10.8	Credit Agreement, dated as of October 31, 2011, by and among KapStone Paper and Packaging Corporation, KapStone Kraft Paper Corporation, as Borrower, the subsidiaries of Borrower named therein, as Guarantors, the lenders named therein, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, Barclays Bank PLC, as Syndication Agent, and Fifth Third Bank and TD Bank, as co-Documentation Agents. Incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 31, 2011.
10.9	First Amendment to Credit Agreement dated May 10, 2012 by and among Kapstone Kraft Paper Corporation, as Borrower, the Company and certain subsidiaries of the Company as Guarantors, the lenders party thereto, and Bank of America N.A., as Administrative Agent, which amends the Credit Agreement, dated as of October 31, 2011, by and among the Borrower, the Company and certain subsidiaries of the Company as Guarantors, the lenders party thereto and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer. Incorporated by reference to the Registrant's Current Report on Form 8-K filed on May 10, 2012.
10.10	Second Amendment to Credit Agreement dated November 28, 2012, by and among KapStone Kraft Paper Corporation, as Borrower, the Company and certain of its subsidiaries, as Guarantors, the lenders who are a party thereto and Bank of America, N.A., as Administrative Agent, amending the Company's Credit Agreement, dated as of October 31, 2011, as previously amended. Incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 28, 2012.
14.0	Code of Ethics.
21.1	Subsidiaries.
23.1	Consent of Ernst & Young LLP.
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.
31.2	Certification of the Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Principal Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.

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Exhibit No.	Description
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Extension Presentation Linkbase.

*
Management compensatory plan or arrangement.

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