

KAPSTONE PAPER & PACKAGING CORP

Form 10-Q

November 10, 2008

[Table of Contents](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

For the quarterly period ended September 30, 2008

Commission File Number: 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 including zip code)

Edgar Filing: KAPSTONE PAPER & PACKAGING CORP - Form 10-Q

(847) 239-8800

(Registrant's Telephone Number, Including Area Code)

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

Yes No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

There were 28,370,248 shares of the Registrant's Common Stock, \$0.0001 par value, outstanding at October 31, 2008, excluding 40,000 shares held as treasury shares.

Table of Contents

KapStone Paper and Packaging Corporation Index to Form 10-Q

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

<u>Item 1. Condensed Consolidated Financial Statements (Unaudited) and Notes to Condensed Consolidated Financial Statements</u>	1
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	24
<u>Item 4. Controls and Procedures</u>	25

PART II. OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	26
<u>Item 1A. Risk Factors</u>	26
<u>Item 6. Exhibits</u>	29

<u>SIGNATURE</u>	30
------------------	----

Table of Contents**Part 1. Financial Information****Item 1. Financial Statements****KapStone Paper and Packaging Corporation****Condensed Consolidated Balance Sheets****(In thousands, except share and per share amounts)**

	September 30, 2008 (Unaudited)	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 41,874	\$ 56,635
Trade accounts receivable, net	83,955	30,208
Inventories	74,203	19,846
Refundable and prepaid income taxes	11,416	
Deferred income taxes	2,599	1,263
Prepaid expenses and other current assets	12,650	735
Total current assets	226,697	108,687
Plant, property and equipment, net	481,987	104,858
Other assets	2,160	3,735
Intangible assets, net	48,972	5,875
Goodwill	8,902	2,295
Total assets	\$ 768,718	\$ 225,450
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt and notes	\$ 35,752	\$ 19,578
Accounts payable	37,128	11,050
Accrued expenses	32,963	4,867
Accrued compensation costs	12,839	6,625
Accrued income taxes		1,477
Total current liabilities	118,682	43,597
Other liabilities:		
Long-term debt and notes	443,357	32,922
Pension and post-retirement benefits	7,315	3,420
Deferred income taxes	14,222	1,047
Other liabilities	6,853	279
Total other liabilities	471,747	37,668
Commitments and contingencies		
Stockholders' equity:		
Preferred stock \$.0001 par value; 1,000,000 shares authorized; no shares issued and outstanding	3	3

Edgar Filing: KAPSTONE PAPER & PACKAGING CORP - Form 10-Q

Common stock \$.0001 par value, 175,000,000 shares authorized; 28,309,377 shares issued and outstanding (40,000 treasury shares outstanding) at September 30, 2008 and 25,280,197 issued and outstanding (40,000 treasury shares outstanding) at December 31, 2007			
Additional paid-in capital		131,336	115,002
Retained earnings		46,887	29,101
Accumulated other comprehensive income		63	79
Total stockholders' equity		178,289	144,185
Total liabilities and stockholders' equity	\$	768,718	\$ 225,450

See notes to condensed consolidated financial statements

Table of Contents

KapStone Paper and Packaging Corporation
Condensed Consolidated Statements of Income
(In thousands, except share and per share amounts)

(unaudited)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008		2007		2008		2007	
Net sales	\$	207,671	\$	66,188	\$	342,962	\$	191,857
Cost of sales, excluding depreciation and amortization		151,064		39,910		233,422		123,704
Freight and distribution		19,969		6,116		33,480		17,476
Selling, general and administrative expenses		9,757		4,529		19,251		12,552
Depreciation and amortization		12,953		3,178		18,381		8,272
Other operating income		218		399		589		987
Operating income		14,146		12,854		39,017		30,840
Foreign exchange losses		607				607		
Interest income		51		585		891		1,467
Interest expense		8,772		1,044		9,985		3,317
Income before provision for income taxes		4,818		12,395		29,316		28,990
Provision for income taxes		2,513		4,593		11,530		10,661
Net income	\$	2,305	\$	7,802	\$	17,786	\$	18,329
Weighted-average number of shares outstanding:								
Basic		26,904,070		24,968,097		25,859,149		24,967,143
Diluted		38,012,635		36,674,697		36,429,893		35,723,847
Net income per share:								
Basic	\$	0.09	\$	0.31	\$	0.69	\$	0.73
Diluted	\$	0.06	\$	0.21	\$	0.49	\$	0.51

See notes to condensed consolidated financial statements

Table of Contents**KapStone Paper and Packaging Corporation****Condensed Consolidated Statements of Cash Flows****(In thousands)****(unaudited)**

	Nine Months Ended September 30,	
	2008	2007
Operating activities		
Net income	\$ 17,786	\$ 18,329
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,381	8,272
Stock based compensation expense	1,189	459
Amortization of debt issuance costs	1,170	193
Deferred income taxes	12,999	628
Changes in operating assets and liabilities:		
Trade accounts receivable, net	(17,367)	(5,089)
Interest receivable on short-term investments		(379)
Inventories	438	5,280
Refundable and prepaid income taxes	(11,416)	
Prepaid expenses and other current assets	(4,937)	(573)
Accounts payable	(3,516)	2,496
Accrued expenses	13,818	(881)
Accrued compensation costs	936	5,609
Accrued income taxes	(1,477)	1,927
Net cash provided by operating activities	28,004	36,271
Investing activities		
CKD acquisition (net of cash acquired)	(470,451)	(1,200)
KPB acquisition		(150,303)
Capital expenditures	(12,714)	(9,070)
Purchase of short-term investments		(35,000)
Net cash (used in) investing activities	(483,165)	(195,573)
Financing activities		
Proceeds from long-term debt and notes	455,000	60,000
Borrowings under revolving credit facility	71,800	
Debt issuance costs paid	(12,593)	(855)
Repayment of long-term debt	(88,953)	(3,750)
Receipt of cash held in trust		115,239
Redemption of shares		(230)
Proceeds from the exercises of common stock warrants	15,146	40
Investment banking fee paid		(1,200)
Net cash provided by financing activities	440,400	169,244
Net increase in cash and cash equivalents	(14,761)	9,942
Cash and cash equivalents-beginning of period	56,635	
Cash and cash equivalents-end of period	\$ 41,874	\$ 9,942

See notes to condensed consolidated financial statements

Table of Contents

**KAPSTONE PAPER AND PACKAGING CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(In thousands, except share and per share amounts)

(unaudited)

1. Financial Statements

The accompanying unaudited condensed consolidated financial statements of KapStone Paper and Packaging Corporation (the Company, we, us, our or KapStone) have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and related footnotes included in our Annual Report on Form 10-K/A for the year ended December 31, 2007.

KapStone Paper and Packaging Corporation (formerly Stone Arcade Acquisition Corporation) or the Company was incorporated in Delaware on April 15, 2005. On May 25, 2006, the Company formed a wholly-owned subsidiary, KapStone Kraft Paper Corporation, or KapStone Kraft. The Company was formed to serve as a vehicle for the acquisition through a merger, capital stock exchange, asset acquisition, or other similar business combination (Business Combination) of an operating business in the paper, packaging, forest products and related industries.

On January 2, 2007, the Company acquired substantially all of the assets and assumed certain liabilities of the Kraft Papers Business (KPB) from International Paper Company (IP). Prior to the acquisition of KPB, the Company had no operations and was considered a development stage company.

On July 1, 2008, the Company consummated an asset purchase agreement with MeadWestvaco Corporation (MWV) to purchase substantially all of the assets and assume certain liabilities of the Charleston Kraft Division (CKD) for \$485 million, subject to certain post-closing adjustments. The accompanying condensed consolidated financial statements include the results of CKD since the date of acquisition.

2. Reclassification

Certain 2007 balances have been reclassified to conform to 2008 presentation, including freight and distribution from cost of sales, and amortization expense from selling, general and administrative expenses in the statements of income for the three and nine month periods ended September 30, 2007. In addition, deferred income taxes have been reclassified from accrued expenses in the statements of cash flows.

3. Accounting Pronouncements

In April 2008, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) 142-3, *Determination of the Useful Life of Intangible Assets*, which amends the factors that should be considered in developing renewal or extension assumptions used in determining the useful life of a recognized intangible asset. This FSP is effective for financial statements issued for fiscal years (and interim periods) beginning after December 15, 2008 (calendar year 2009). The Company is currently evaluating the impact of the provisions of this FSP on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements but does not change existing guidance as to whether or not an instrument is carried at fair value. In February 2008, the FASB released a FASB Staff Position, which delayed the effective date of SFAS No. 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in the condensed consolidated financial statements on a recurring basis. SFAS No. 157 was first effective for the Company on January 1, 2008.

Table of Contents

The impact of the adoption of SFAS No. 157 on our financial assets and liabilities, which are principally comprised of cash equivalents, did not have a significant impact on their fair value measurements or require expanded disclosures.

4. CKD Acquisition

On July 1, 2008, the Company consummated an asset purchase agreement with MeadWestvaco Corporation (MWV) to purchase substantially all of the assets and assume certain liabilities of MWV 's Charleston Kraft Division (CKD), for \$485 million, subject to certain adjustments. CKD consists of an unbleached kraft paper manufacturing facility in North Charleston, South Carolina, chip mills located in Elgin, Hampton, Andrews and Kinards, South Carolina and a lumber business located in Summerville, South Carolina.

The acquisition was financed by cash on hand and by a new senior secured credit facility of \$515 million consisting of a LIBOR based five-year term loan of \$390 million, a LIBOR based seven-year term loan of \$25 million and a \$100 million revolving credit facility. In addition, \$40 million of seven-year 8.30% senior notes were issued. A portion of the proceeds were used to redeem the Company 's prior credit facility.

The CKD business was deemed an attractive acquisition candidate based upon meeting the Company 's objectives of being a North American-based, profitable company in the paper and packaging industry and for its synergies with the Company 's existing operations.

In connection with the CKD acquisition, the Company entered into a Long Term Fiber Supply Agreement (Supply Agreement) with MWV. Pursuant to the Supply Agreement, the Company will purchase, on a take or pay basis, certain amounts of pine pulpwood and saw timber at market prices for a period of 15 years. The purchases will be accounted for as raw materials.

The CKD acquisition was accounted for in accordance with the provisions of SFAS No. 141, *Business Combinations* and the accompanying condensed consolidated financial statements include the results of CKD since the date of acquisition.

The excess of the purchase price over the aggregate fair value of net assets acquired was allocated to goodwill. The following table summarizes the purchase price (\$000 s):

Purchase price (net of cash acquired of \$10,572)	\$	474,428
Preliminary working capital adjustment		(7,525)
Transaction costs		4,748
Total purchase price	\$	471,651

The excess of the purchase price over the aggregate fair value of net assets acquired was allocated to goodwill. Th

The following table summarizes the preliminary estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (\$000 s):

Trade accounts receivable	\$
---------------------------	----