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

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

For the fiscal year ended December 31, 2012

o **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 o No ý

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 o No ý

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 ý No o

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 ý No o

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. o

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 o	Accelerated Filer ý	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

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

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:

	2012		2011	
Product Line:	**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 2011version 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 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 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.