

KAPSTONE PAPER & PACKAGING CORP
Form 10-Q
May 09, 2007

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

FORM 10-Q

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

For the quarterly period ended March 31, 2007

Commission File Number: 000-51444

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, One Northfield Plaza, Suite 480
Northfield, IL 60093**

(Address of Principal Executive Offices including zip code)

(847) 441-0929

(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 or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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 24,960,000 shares of the Registrant's Common Stock, \$0.0001 par value, outstanding at May 1, 2007, excluding 40,000 shares held as treasury shares.

KapStone Paper and Packaging Corporation Index to Form 10-Q

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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)

	March 31, 2007 (unaudited)	December 31, 2006	Predecessor KPB December 31, 2006
Assets			
Current assets:			
Cash and cash equivalents	\$ 35,233	\$	\$ 1
Restricted cash and cash equivalents, held in trust		115,239	
Accounts receivable, less allowances of \$1,022 at March 31, 2007	31,753		25,824
Inventories	21,953		24,087
Prepaid expenses and other current assets	1,920	120	1,425
Total current assets	90,859	115,359	51,337
Plant, property and equipment, net	110,267		201,593
Deferred income taxes	1,491	689	
Deferred acquisition costs	187	3,058	
Other assets	3,326	151	4,452
Goodwill	936		
Total assets	\$ 207,066	\$ 119,257	\$ 257,382
Liabilities and Stockholders Equity			
Current liabilities:			
Accounts payable	\$ 10,243	\$ 196	\$ 7,931
Accrued expenses	2,096	2,562	7,144
Accrued compensation costs	4,893		
Accrued income taxes	2,976		
Accrued taxes other than income	705	224	
Deferred income taxes	566		
Current portion of long-term debt	9,500		
Total current liabilities	30,979	2,982	15,075
Other liabilities:			
Long-term debt	50,500		22,357
Asset retirement obligations	268		265
Pension and post retirement benefits	3,397		
Total other liabilities	54,165		22,622
Common stock, subject to redemption-40,000 shares at December 31, 2006		230	
Stockholders equity:			
Preferred stock \$.0001 par value; 1,000,000 shares authorized; no shares issued and outstanding			
Common stock \$.0001 par value, 175,000,000 shares authorized; 25,000,000 shares issued less 40,000 treasury shares outstanding at March 31, 2007 and 25,000,000 at December 31, 2006 (including 40,000 shares subject to possible redemption at December 31, 2006)	2	3	
Additional paid-in capital	112,934	113,904	
Divisional control			219,685
Common stock held in treasury	(230)	
Retained earnings	9,216	2,138	
Total stockholders equity	121,922	116,275	219,685

Total liabilities and stockholders equity	\$ 207,066	\$ 119,257	\$ 257,382
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See notes to condensed consolidated financial statements.

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

(unaudited)

	Three Months Ended March 31,		Predecessor KPB Three Months Ended March 31, 2006
	2007	2006	
Net sales	\$ 65,427	\$	\$ 64,012
Cost of sales	48,122		48,296
Depreciation and amortization, excluding amortization of intangibles	2,173		4,731
Gross profit	15,132		10,985
Selling, general and administrative expenses	3,728	155	3,094
Operating income / (loss)	11,404	(155	) 7,891
Other income / (expense):			
Other income	461		
Interest income	397	1,207	
Interest expense	(1,156	)	(334
Total other income / (expense)	(298	)	1,207
Income before provision for income taxes	11,106	1,052	7,557
Provision for income taxes	4,028	361	2,920
Net income	7,078	691	4,637
Deferred interest, net of taxes, attributable to common stock subject to possible redemption		(156)
Net income allocable to holders of nonredeemable common stock	\$ 7,078	\$ 535	\$ 4,637
Weighted-average number of shares outstanding:			
Basic	24,973,333	25,000,000	
Diluted	33,868,933	28,768,116	
Net income per share:			
Basic	\$ 0.28	\$ 0.03	\$
Diluted	\$ 0.21	\$ 0.02	\$
Weighted-average number of shares outstanding exclusive of shares subject to possible redemption:			
Basic	24,960,000	21,002,000	
Diluted	33,855,600	24,770,116	
Net income per share exclusive of shares and related deferred interest subject to possible redemption:			
Basic	\$ 0.28	\$ 0.03	\$
Diluted	\$ 0.21	\$ 0.02	\$

See notes to condensed consolidated financial statements.

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

(unaudited)

	Three Months Ended March 31,		Predecessor KPB
	2007	2006	Three Months Ended March 31, 2006
Operating activities			
Net income	\$ 7,078	\$ 691	\$ 4,637
Depreciation and amortization	2,245		4,731
Changes in operating assets and liabilities:			
Accounts receivable, net	(5,929	)	(3,540
Inventories	3,660		1,387
Prepaid expenses and other current assets	(711	) 291	(282
Accounts payable	2,116		570
Accrued expenses	(2,920	) 457	(55
Accrued compensation costs	4,893		
Accrued taxes other than income	481		
Accrued income taxes	2,976		
Deferred income taxes	958	(134	) 63
Net cash provided by operating activities	14,847	1,305	7,511
Investing activities			
Acquisition costs paid	(187)	
KPB acquisition, net of cash acquired	(150,303)	
Capital expenditures	(2,078	)	(1,236
Restricted cash and other			539
Purchase of U.S. government securities held in trust		(451,089)
Maturities of U.S. government securities held in trust		450,241	
Net cash used in investing activities	(152,568	) (848	) (697
Financing activities			
Proceeds from long-term debt	60,000		
Debt issuance costs paid	(855)	
Receipt of funds held in trust	115,239		
Redemption of shares	(230)	
Investment banking fee paid	(1,200)	
Other			(6,814
Net cash provided by financing activities	172,954		(6,814
Net increase in cash and cash equivalents	35,233	457	
Cash and cash equivalents-beginning of period		2,157	1
Cash and cash equivalents-end of period	\$ 35,233	\$ 2,614	\$ 1

See notes to condensed consolidated financial statements.

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 months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and related footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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). The accompanying condensed consolidated financial statements include the results of KPB since this date. Prior to the acquisition of KPB, the Company had no operations and was considered a development stage enterprise. For periods prior to the acquisition, KPB is deemed to be the Predecessor to the Company. As a result, for the period ended March 31, 2006, the statement of operations and statement of cash flows of KPB are presented for comparative purposes. The accompanying condensed consolidated statements of operations and cash flows present the results of operations and cash flows for i) the period preceding the acquisition of KPB, exclusive of KPB results of operations and cash flows and ii) for the periods succeeding the acquisition our consolidated results of operations including KPB. The results of operations and cash flows on a consolidated basis subsequent to the acquisition of KPB is not comparative to the Predecessor KPB results of operations and cash flows as i) the basis of the acquired assets and liabilities from KPB have been adjusted to fair value pursuant to Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations and ii) KPB was a division of IP and not a stand alone business.

2. Summary of Significant Accounting Policies

Use of Estimates The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

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 designated f.o.b. destination, which generally include export sales, 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. Cash incentive rebates are netted against revenue on an accrual basis as qualifying purchases are made by the customer to earn and thereby retain the rebate. Prepaid rebates are recorded in prepaid expenses and other current assets in the accompanying condensed consolidated balance sheets until earned. Discounts for prompt payments are accrued at the time of sale and adjusted when qualifying payments are made by customers. Accrued discounts are netted against account receivables, net.

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Cost of sales Cost of sales includes the following: the cost of inventory sold during the period, warehousing costs which include distribution costs and distribution center occupancy costs and freight expenses to customers.

Freight charged to customers is recognized in net sales.

Annual Maintenance Costs The Company recognizes the cost of major maintenance activities in the period in which they occur under the direct expense method of FSP No. AUG AIR-1, Accounting for Planned Major Maintenance Activities. Previously, the Predecessor accrued major planned maintenance ratably over the year for interim reporting. Predecessor results have been restated to account for major maintenance activities under the direct expense method. Cost of sales has been lowered by \$1,158 while operating income has been increased by \$1,158 for the period ended March 31, 2006. As a result, net income has been increased by \$711 for the period ended March 31, 2006. Other maintenance costs are expensed as incurred.

Earnings per common share Basic income per share is based on the weighted average number of common shares outstanding during the period. Diluted income per share reflects the potential dilution assuming common shares were issued upon the exercise of outstanding in-the-money warrants and the proceeds thereof were used to purchase common shares at the average market price during the period.

Concentrations of Credit Risk Financial instruments that potentially expose the Company to concentrations of credit risk, as defined by SFAS No. 105, *Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, consist primarily of trade accounts receivable. Trade accounts receivable balances (net of allowances for doubtful accounts) for net sales to unaffiliated customers were approximately \$31.8 million and \$29.3 million at March 31, 2007 and 2006, respectively.

The Company establishes its allowance for doubtful accounts based upon factors surrounding the credit risks of specific customers, historical trends, and other information. The allowance for doubtful accounts was approximately \$0.7 million and \$0.2 million at March 31, 2007 and 2006, respectively.

Inventories Inventories are valued at the lower of cost or market and include all costs directly associated with manufacturing products: materials, labor, and manufacturing overhead. These values are presented at the lower of cost or market. Costs of raw materials, work-in-process, and finished goods are determined using the first-in, first-out method. Replacement parts and other supplies are stated using the average cost method.

Plant, Property, and Equipment, net Plant and equipment is stated at cost less accumulated depreciation. Plant and equipment acquired in the KPB acquisition is originally recorded at fair value (see note 4) and depreciated.

Depreciation is computed using the straight-line method over the assets' estimated useful lives. Estimated useful lives are as follows: