

KAPSTONE PAPER & PACKAGING CORP
Form 10-Q
July 29, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

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 Number: 001-33494

KapStone Paper and Packaging Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware

20-2699372

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(State or Other Jurisdiction of
Incorporation or Organization)

(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)

Registrant's Telephone Number, including area code **(847) 239-8800**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 96,313,868 shares of the Registrant's Common Stock, \$0.0001 par value, outstanding at July 22, 2015.

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KAPSTONE PAPER AND PACKAGING CORPORATION

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Table of Contents**PART 1. FINANCIAL INFORMATION****ITEM 1. - FINANCIAL STATEMENTS****KAPSTONE PAPER AND PACKAGING CORPORATION****Consolidated Balance Sheets****(In thousands, except share and per share amounts)**

	June 30, 2015 (unaudited)	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 28,737	\$ 28,467
Trade accounts receivable (Includes \$413,899 at June 30, 2015, and \$225,577 at December 31, 2014, associated with the securitization facility)	427,942	228,740
Other receivables	13,951	12,833
Inventories	339,065	238,329
Prepaid expenses and other current assets	14,455	7,172
Total current assets	824,150	515,541
Plant, property and equipment, net	1,407,829	1,386,670
Other assets	12,353	10,135
Intangible assets, net	359,318	110,077
Goodwill	701,554	533,851
Total assets	\$ 3,305,204	\$ 2,556,274
Liabilities and Stockholders Equity		
Current liabilities:		
Current portion of long-term debt	\$ 51,750	\$
Short-term borrowings	15,000	
Other current borrowings	4,420	
Dividend payable	9,776	9,911
Accounts payable	208,611	149,600
Accrued expenses	59,228	48,340
Accrued compensation costs	63,217	62,491
Accrued income taxes	573	6,477
Deferred income taxes	1,836	1,990
Total current liabilities	414,411	278,809
Other liabilities:		
Long-term debt, net of current portion (Includes \$265,774 at June 30, 2015, and \$167,000 at December 31, 2014, associated with the securitization facility)	1,604,967	1,046,063
Pension and postretirement benefits	27,058	32,800
Deferred income taxes	415,562	412,293
Other liabilities	16,854	8,182
Total other liabilities	2,064,441	1,499,338
Commitments and contingencies		
Stockholders equity:		
Preferred stock \$0.0001 par value; 1,000,000 shares authorized; no shares issued and outstanding		
Common stock \$0.0001 par value; 175,000,000 shares authorized; 96,294,366 shares issued and outstanding (excluding 40,000 treasury shares) at June 30, 2015 and 96,046,554 shares issued and outstanding (excluding 40,000 treasury shares) at December 31, 2014	10	10

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Additional paid-in-capital	262,298	255,505
Retained earnings	615,627	574,601
Accumulated other comprehensive loss	(51,583)	(51,989)
Total stockholders' equity	826,352	778,127
Total liabilities and stockholders' equity	\$ 3,305,204	\$ 2,556,274

See notes to consolidated financial statements.

Table of Contents**KAPSTONE PAPER AND PACKAGING CORPORATION****Consolidated Statements of Comprehensive Income****(In thousands, except share and per share amounts)****(unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net sales	\$ 671,255	\$ 590,449	\$ 1,217,544	\$ 1,139,401
Cost of sales, excluding depreciation and amortization	470,478	392,245	852,676	775,493
Depreciation and amortization	36,996	33,874	72,117	66,583
Freight and distribution expenses	53,891	44,924	97,318	85,656
Selling, general, and administrative expenses	48,481	34,093	86,675	68,238
Operating income	61,409	85,313	108,758	143,431
Foreign exchange gain / (loss)	(53)	125	(938)	101
Interest expense, net	8,515	7,971	14,928	17,200
Income before provision for income taxes	52,841	77,467	92,892	126,332
Provision for income taxes	18,585	26,008	32,536	42,774
Net income	\$ 34,256	\$ 51,459	\$ 60,356	\$ 83,558
Other comprehensive income, net of tax				
Pension and postretirement plan reclassification adjustments:				
Amortization of prior service costs	12	30	24	62
Amortization of net (gain) / loss	191	(1)	382	(3)
Other comprehensive income, net of tax	203	29	406	59
Total comprehensive income	\$ 34,459	\$ 51,488	\$ 60,762	\$ 83,617
Weighted average number of shares outstanding:				
Basic	96,269,619	95,892,033	96,196,889	95,806,181
Diluted	97,664,781	97,418,941	97,647,666	97,367,354
Net income per share:				
Basic	\$ 0.36	\$ 0.54	\$ 0.63	\$ 0.87
Diluted	\$ 0.35	\$ 0.53	\$ 0.62	\$ 0.86
Dividends declared per common share	\$ 0.10	\$	\$ 0.20	\$

See notes to consolidated financial statements.

Table of Contents**KAPSTONE PAPER AND PACKAGING CORPORATION****Consolidated Statements of Cash Flows****(In thousands)****(unaudited)**

	Six Months Ended June 30,	
	2015	2014
Operating activities		
Net income	\$ 60,356	\$ 83,558
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	72,117	66,583
Stock-based compensation expense	6,537	4,229
Pension and postretirement	(5,416)	(6,834)
Excess tax benefit from stock-based compensation	(1,511)	(2,612)
Amortization of debt issuance costs	3,047	2,933
Loss on disposal of fixed assets	210	1,016
Deferred income taxes	2,451	2,179
Changes in assets and liabilities:		
Trade accounts receivable, net	(59,007)	(30,851)
Other receivables	7,486	2,570
Inventories	(10,194)	(9,664)
Prepaid expenses and other current assets	(5,537)	(2,999)
Other assets	747	(110)
Accounts payable	8,765	(638)
Accrued expenses and other liabilities	4,120	5,144
Accrued compensation costs	(8,052)	(7,975)
Accrued income taxes	(3,532)	2,125
Net cash provided by operating activities	72,587	108,654
Investing activities		
Victory acquisition, net of cash acquired	(616,564)	
Capital expenditures	(63,711)	(73,676)
Net cash used in investing activities	(680,275)	(73,676)
Financing activities		
Proceeds from revolving credit facility	266,200	97,900
Repayments on revolving credit facility	(251,200)	(97,900)
Proceeds from receivables credit facility	103,735	
Repayments on receivables credit facility	(4,962)	
Proceeds from long-term debt	519,763	
Payment on long-term debt		(2,350)
Payment of loan amendment and debt issuance costs	(10,790)	(706)
Proceeds from other current borrowings	6,615	6,300
Repayments on other current borrowings	(2,195)	(3,402)
Cash dividend paid	(19,464)	
Payment of withholding taxes on stock awards	(2,448)	(1,641)
Proceeds from exercises of stock options	778	389
Proceeds from shares issued to ESPP	415	205
Excess tax benefit from stock-based compensation	1,511	2,612
Net cash provided by financing activities	607,958	1,407

Net increase (decrease) in cash and cash equivalents	270	36,385
Cash and cash equivalents-beginning of period	28,467	12,967
Cash and cash equivalents-end of period	\$ 28,737	\$ 49,352

See notes to consolidated financial statements.

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

(In thousands, except share and per share amounts)

(unaudited)

1. Financial Statements

The accompanying unaudited 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 (GAAP) 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 notes required by GAAP 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 six months ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. For further information, refer to the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2014.

We report our business in two reportable segments: Paper and Packaging and Distribution. Our Paper and Packaging segment manufactures and sells a wide variety container board, corrugated products, and specialty paper for industrial and consumer markets. The Distribution segment was acquired June 1, 2015 through the acquisition of Victory Packaging, L.P. and its subsidiaries (Victory). See Note 3, Victory Packaging Acquisition, for further detail. Victory is a North American distributor of packaging materials. For more information about our consolidated segments, see Note 12, Segment Information.

In these consolidated financial statements, certain amounts in prior periods consolidated financial statements have been reclassified to conform with the current period presentation. In accordance with Accounting Standards Codification (ASC) 280, Segment Reporting, we recast 2015 and 2014 segment information to conform with the current year presentation. For more information see Note 12, Segment Information. None of the reclassifications affected our results of operations, financial position, or cash flows.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09 Revenue from Contracts with Customers . The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The guidance in this update supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) Topic 605, Revenue Recognition , and most industry-specific guidance throughout the Industry Topics of the Codification. Additionally, this update supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition Construction-Type and Production-Type Contracts . For a public entity, the amendments are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. In July 2015, the FASB approved a one-year deferral of the effective date for its new revenue standard for public and nonpublic entities reporting under GAAP. The standard will be effective for public entities for annual reporting

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periods beginning after December 15, 2017 and interim periods therein. Additionally the FASB approved the option to early adopt up to the original effective date (fiscal years beginning after December 15, 2016). We are currently evaluating the impact that the adoption of ASU 2014-09 will have on our financial condition, results of operations and disclosures.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs* which changes the presentation of debt issuance costs in financial statements. ASU 2015-03 requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. It is effective for annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The new guidance will be applied retrospectively to each prior period presented. The Company does not expect the adoption of this standard to have a material impact on its consolidated balance sheets.

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On June 1, 2015, the Company purchased all of the partnership interests in Victory Packaging, L.P. and its subsidiaries (Victory) for \$615 million in cash, subject to certain post-closing adjustments. \$40.0 million of the purchase price was placed into escrow to fund certain limited indemnity obligations of Victory. Victory, headquartered in Houston, TX, is a North American distributor of packaging materials. The Company will also be obligated to pay up to an additional \$25.0 million of contingent consideration to the former owners of Victory if certain financial performance criteria are satisfied during the thirty month period following the closing. As of June 30, 2015, the contingent consideration is included in other non-current liabilities on the Company's Consolidated Balance Sheets at a fair value of \$8.4 million.

The acquisition was financed by borrowings under a Second Amended and Restated Credit Agreement dated June 1, 2015 (Credit Agreement), which provides for a senior secured credit facility (the Credit Facility) in an initial aggregate principal amount of \$1.915 billion, consisting of a Term Loan A-1 in the aggregate amount of \$940.0 million, a Term Loan A-2 in the aggregate amount of \$475.0 million, and a \$500.0 million revolving credit facility (Revolver), which includes an accordion feature that provides for, subject to certain terms and conditions, up to \$600.0 million of additional commitments. A portion of the funds borrowed under the Credit Facility were used to pay \$10.6 million of debt issuance costs. See Note 6, Short-term Borrowings and Long-term Debt, for more information on the Credit Agreement and Credit Facility.

The Victory acquisition represented an opportunity to acquire a distributor of packaging products with a strong historical growth track record and meaningful expected synergies with the Company's paper mills and corrugated products manufacturing plants.

Transaction fees and expenses for the Victory acquisition related to due diligence, advisory and legal services have been expensed as incurred. These costs were \$2.6 million for the three and six month periods ended June 30, 2015 and were recorded as selling, general and administrative expenses in the Consolidated Statements of Comprehensive Income.

The Victory acquisition was accounted for in accordance with the provisions of ASC 805, Business Combinations, and the accompanying consolidated financial statements include the results of Victory since June 1, 2015. The Company estimated the fair value of the assets and liabilities of Victory on a preliminary basis at the time of acquisition based on third-party appraisals used to assist in determining the fair market value for acquired tangible and intangible assets and a contingent earnout arrangement. Changes to these allocations may occur as additional information becomes available. The appraisal process for determining the fair value of the acquired assets included a valuation of the acquired assets with a consideration of the three traditional valuation approaches to fair value: cost, market and income. A cost valuation approach was used for equipment and the income valuation approach was used for intangible assets.

The excess of the purchase price paid at the time of the acquisition over the aggregate estimated fair value of net assets acquired was allocated to goodwill. The purchase price allocation is preliminary and subject to final review.

Purchase price (net of \$0.4 million of cash acquired)	\$	614,610
Preliminary working capital adjustments (1)		1,954
Cash paid at closing	\$	616,564
Fair value of contingent consideration		8,400
Total acquisition consideration	\$	624,964

-
- (1) Subject to a final post-closing net working capital adjustment within 90 days of the acquisition date.

The following table summarizes the preliminary allocation of the Victory acquisition consideration to the fair value of the assets acquired and liabilities assumed at the date of acquisition:

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Trade accounts receivable	\$	144,497
Other receivables		4,302
Inventories		90,542
Prepaid expenses and other current assets		1,746
Plant, property and equipment		18,865
Other assets		3,104
Intangible assets		257,700
Accounts payable		(47,795)
Accrued expenses		(6,905)
Accrued compensation costs		(8,778)
Other noncurrent liabilities		(17)
Goodwill		167,703
Total acquisition consideration	\$	624,964

The acquisition of Victory resulted in the recognition of \$167.7 million of goodwill and will be allocated to both the Paper and Packaging and the Distribution segments. The final assignment of goodwill to the segments has not been completed as of the date of these financial statements. Goodwill represents expected synergies with the Company's existing operations by transferring 115,000 tons of corrugated products currently being produced by Victory's existing suppliers to the Company's paper mills and corrugated manufacturing plants. All of the goodwill recognized from the transaction will be deductible for tax purposes.

The following table summarizes the acquired identified intangible assets and their respective fair values and estimated useful lives at the date of acquisition:

	Estimated Useful Life in Years	Fair Value
Customer relationships	14	\$ 210,000
Definite-lived trademarks	10 - 25	33,500
Favorable / unfavorable leases	6	11,200
Non-compete agreements	3 - 5	3,000
Total fair value of intangible assets		\$ 257,700

The customer relationships were valued using the excess earnings method under the income approach. This method reflects the present value of the projected cash flows that are expected to be generated by the customer relationships, less charges representing the contribution of other assets to those cash flows, and an appropriate discount rate to reflect the time value and risk associated with the cash flows. The discount rate applied to the customer relationships' cash flow reflects the risk of the cash flows of the business plus a premium for the risk inherent in intangible assets. The Company utilized a discount rate of 15.0 percent in the valuation of the customer relationships. The 14 year term for customer relationships reflects the period of time at which the present value of cash flows are expected to approximate 90% of the initial value.

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The fair value of the acquired identified intangible assets is amortized on a straight-line basis over the remaining useful life. The estimated amortization expense for the next five years is as follows:

2015	\$	11,392
2016		19,528
2017		19,528
2018		19,518
2019		19,409
Thereafter		168,325
Total	\$	257,700

In conjunction with the Victory acquisition the Company assumed leases for approximately 70 distribution centers located in the United States, Mexico and Canada of which five are with related parties. The future cash flow payments due under these non-cancellable lease arrangements are as follows:

2015	\$	10,713
2016		17,598
2017		16,374
2018		12,602
2019		10,789
Thereafter		28,223
Total	\$	96,299

Included in the lease commitments above are payments due for the five related party leases, as follows:

2015	\$	1,769
2016		3,777
2017		3,657
2018		2,816
2019		2,816
Thereafter		12,960
Total	\$	27,795

Since the June 1, 2015 acquisition date, the Company's consolidated statement of comprehensive income for the three and six months ended June 30, 2015 includes \$93.4 million of net sales and \$1.7 million of operating income from the operations acquired with the Victory acquisition.

The following unaudited pro forma consolidated results of operations assume that the acquisition of Victory occurred as of January 1, 2014. The unaudited pro forma consolidated results include the accounting effects of the business combination, including the application of the Company's accounting policies, amortization of intangible assets and depreciation of equipment related to preliminary fair value adjustments, interest expense on acquisition related debt, elimination of intercompany sales and income tax effects of the adjustments. The pro forma adjustments are directly attributable to the Victory acquisition, factually supportable and are expected to have a continuing impact on the Company's combined results. Unaudited pro forma data is based on historical information and does not necessarily reflect the actual results that would have occurred,

nor is it indicative of future results of operations.

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	Six Months Ended June 30, (unaudited)	
	2015	2014
Net sales	\$ 1,594,924	\$ 1,595,792
Net income	\$ 59,346	\$ 89,478
Net income per share - diluted	\$ 0.62	\$ 0.92

4. Annual Planned Maintenance Outages

Annual planned maintenance outage costs for the three months ended June 30, 2015 and 2014 totaled \$11.1 million and \$5.2 million, respectively, and are included in cost of sales. Outage costs for the three months ended June 30, 2015 included an annual planned maintenance outage at the Company's paper mill in Roanoke Rapids, North Carolina. The outage lasted approximately 8 days with a cost of approximately \$8.0 million and a 10,400 reduction in tons produced. In 2014, the planned Roanoke Rapids, North Carolina paper mill outage occurred in October over a similar number of days and cost.

Annual planned maintenance outage costs for the six months ended June 30, 2015 and 2014 totaled \$19.7 million and \$20.0 million, respectively.

5. Inventories

Inventories consist of the following at June 30, 2015 and December 31, 2014, respectively:

	(unaudited) June 30, 2015	December 31, 2014
Raw materials	\$ 100,151	\$ 99,390
Work in process	3,520	3,634
Finished goods	157,847	63,639
Replacement parts and supplies	77,091	70,026
Inventory at FIFO costs	338,609	236,689
LIFO inventory reserves	456	1,640
Inventories	\$ 339,065	\$ 238,329

As of June 30, 2015, Victory's finished goods inventories included in the Consolidated Balance Sheets were \$87.4 million.

6. Short-term Borrowings and Long-term Debt

Second Amended and Restated Credit Agreement

In conjunction with the Victory acquisition, the Company entered into its amended and restated Credit Agreement. The Credit Agreement, dated June 1, 2015, provides for a senior secured credit facility in an initial aggregate principal amount of \$1.915 billion, consisting of a Term Loan A-1 in the aggregate amount of \$940.0 million, a Term Loan A-2 in the aggregate amount of \$475.0 million, and the Revolver consisting of \$500.0 million (including a \$75.0 million letter of credit sub-facility and a \$45.0 million swing line loan sub-facility). The Credit Facility includes an accordion feature that allows the Company, subject to certain terms and conditions, to increase the commitments under the Credit Facility, to the extent that it shall maintain a pro forma total leverage ratio equal to or less than 2.50 to 1.00 and otherwise, by up to \$600.0 million. The incremental borrowings from the Credit Agreement, consisting of proceeds from Term Loan A-1, Term Loan A-2, and \$115.0 million of borrowings under the Revolver were used to finance the acquisition of Victory and pay certain transaction fees and expenses.

Depending on the type of borrowing, the applicable interest rate under the Credit Facility is calculated at a per annum rate equal to (a) LIBOR plus an applicable margin or (b) the base rate that is calculated as (i) the greatest of (x) the prime rate, (y) the federal funds effective rate plus 0.50% or (z) a daily rate equal to one

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month LIBOR plus 1% plus (ii) an applicable margin. The unused portion of the Revolver is subject to an unused fee that is calculated at a per annum rate (the Unused Fee Rate), which initially is 0.30%.

Commencing with the delivery of the unaudited financial statements for the quarter ending September 30, 2015, the applicable margin for borrowings under the Credit Facility and the Unused Fee Rate will be determined by reference to the pricing grid based on the Company's total leverage ratio. Under such pricing grid, the applicable margins for Term Loan A-1 and Revolver will range from 1.00% to 1.75% for Eurodollar loans and from 0.00% to 0.75% for base rate loans, and the Unused Fee Rate will range from 0.20% to 0.30%. The applicable margins for Term Loan A-2 will range from 1.125% to 1.875% for Eurodollar loans and from 0.125% to 0.875% for base rate loans.

Long-term debt consists of the following at June 30, 2015 and December 31, 2014, respectively:

	(unaudited) June 30, 2015	December 31, 2014
Term loan A-1 under Second Amended and Restated Credit Agreement with interest payable monthly at LIBOR plus 1.75% at June 30, 2015	\$ 940,000	\$ 664,125
Term loan A-2 under Second Amended and Restated Credit Agreement with interest payable monthly at LIBOR plus 1.875% at June 30, 2015	475,000	231,113
Receivable Credit Facility with interest payable monthly at LIBOR plus 0.75% at June 30, 2015	265,774	167,000
Total long-term debt	1,680,774	1,062,238
Less current portion of debt	(51,750)	
Less unamortized debt issuance costs	(24,057)	(16,175)
Long-term debt, net of current portion and debt issuance costs	\$ 1,604,967	\$ 1,046,063

Annual principal repayments, paid in quarterly installments, are as follows:

Fiscal year ending:	
2015	\$ 25,875
2016	51,750
2017	51,750
2018	51,750
2019	51,750
2020	999,024
2021	4,750
2022	444,125
Total	\$ 1,680,774

The Company incurred approximately \$10.6 million of debt issuance costs associated with the Credit Agreement, which are being amortized using the effective interest method.

Short-term Borrowings

As of June 30, 2015, the Company had \$15.0 million of short-term borrowings with an interest rate of 1.93 percent under its \$500 million Revolver.

As of June 30, 2015, the Company had \$466.3 million available for borrowings under the Revolver.

Receivables Credit Facility

In June 2015, the Company entered into Amendment No. 1 to Receivables Purchase Agreement (the Amendment) amending its Receivables Purchase Agreement dated as of September 26, 2014 (the Receivables Purchase Agreement), which is part of an accounts receivable securitization program (the Securitization Program). The Amendment included the following changes to the Receivable Purchase Agreement:

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- Victory has been added as an Originator under the Receivables Sale Agreement;
- the principal amount of undivided interests in the receivables the financial institutions that are parties to the Receivables Purchase Agreement (the Purchaser) are committed to purchase has been increased from up to \$175.0 million to up to \$275.0 million; and
- the Facility Termination Date (as defined in the Receivables Purchase Agreement) has been extended from September 26, 2015 to June 8, 2016 (the date by which the Purchasers commitment to purchase receivables will terminate).

Under our Securitization Program, we sell, on an ongoing basis without recourse, certain trade receivables (Receivables) to KapStone Receivables, LLC (KAR), which is considered a wholly-owned, bankruptcy-remote variable interest entity (VIE). The Company has the authority to direct the activities of the VIE and, as a result, we have concluded that we maintain control of the VIE, are the primary beneficiary (as defined by accounting guidance) and, therefore, consolidate the account balances of KAR. As of June 30, 2015, \$413.9 million of our receivables were sold to KAR. KAR in turn assigns a collateral interest in these receivables to a financial institution under a one-year facility (the Receivables Credit Facility) for proceeds up to \$275.0 million. The assets of KAR are not available to us until all obligations of KAR are satisfied in the event of bankruptcy or insolvency proceedings.

The Company incurred approximately \$0.2 million of debt issuance costs associated with the Amendment, which is being amortized using the effective interest method.

Debt Covenants

Our Credit Agreement governing our Credit Facility contains, among other provisions, covenants with which we must comply. The covenants limit our ability to, among other things, incur indebtedness, create additional liens on our assets, make investments, engage in mergers and acquisitions and sell any assets outside the normal course of business.

As of June 30, 2015, the Company was in compliance with all applicable covenants in the Credit Agreement.

Fair Value of Debt

As of June 30, 2015, the fair value of the Company s debt approximates the carrying value of \$1.7 billion as the variable interest rates re-price frequently at current market rates. The debt was valued using Level 2 inputs in the fair value hierarchy, which are significant observable inputs including quoted prices for debt of similar terms and maturities. Our weighted-average cost of borrowings was 1.82 percent and 2.00 percent for the six months ended June 30, 2015 and June 30, 2014, respectively.

Other Borrowing

In 2015 and 2014, the Company entered into short-term financing agreements of \$6.6 million and \$6.3 million, respectively, at an annual interest rate of 1.70 percent and 1.69 percent, respectively, for its annual property insurance premiums. The 2015 agreement requires the Company to pay three quarterly payments through the term of the financing agreement ending on December 31, 2015. As of June 30, 2015 and 2014, there was \$4.4 million and \$2.9 million, respectively, outstanding under these agreements which is included in Other current borrowings on the Consolidated Balance Sheets.

7. Income Taxes

The Company's effective income tax rate for the six months ended June 30, 2015 and 2014 was 35.0 percent and 33.9 percent, respectively. Our tax rate is affected by recurring items such as state income taxes as well as discrete items that may occur in any given period but are not consistent from period to period. In addition to state income taxes, the domestic manufacturing deduction (which largely offset the impact of state income taxes) had the most significant impact on the difference between our statutory U.S. federal income tax rate of 35 percent and our effective income tax rate for both periods.

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In the normal course of business, the Company is subject to examination by taxing authorities. The Company's open federal tax years are 2011 and 2013. The Company has open tax years for state income tax filings generally starting in 2011.

8. Net Income per Share

The Company's basic and diluted net income per share is calculated as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	\$ 34,256	\$ 51,459	\$ 60,356	\$ 83,558
Weighted-average number of common shares for basic net income per share	96,269,619	95,892,033	96,196,889	95,806,181
Incremental effect of dilutive common stock equivalents:				
Unexercised stock options	1,124,212	1,186,789	1,153,586	1,199,319
Unvested restricted stock awards	270,950	340,119	297,191	361,854
Weighted-average number of shares for diluted net income per share	97,664,781	97,418,941	97,647,666	97,367,354
Net income per share - basic	\$ 0.36	\$ 0.54	\$ 0.63	\$ 0.87
Net income per share - diluted	\$ 0.35	\$ 0.53	\$ 0.62	\$ 0.86

Approximately 800,000 and 78,000 of unexercised stock options were outstanding at June 30, 2015 and 2014, respectively, but were not included in the computation of diluted earnings per share because the options were anti-dilutive.

9. Pension Plan and Post-Retirement Benefits

Defined Benefit Plan

Net pension benefit recognized for the three and six months ended June 30, 2015 and 2014 for the Company's defined benefit plan (the Pension Plan) are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Service cost for benefits earned	\$ 1,215	\$ 2,449	\$ 2,430	\$ 4,898
Interest cost on projected benefit obligations	6,901	7,180	13,801	14,360
Expected return on plan assets	(10,236)	(11,030)	(20,472)	(22,061)

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Amortization of net loss	534		1,068	
Amortization of prior service cost	69	100	138	201
Net pension benefit - Company plan	(1,517)	(1,301)	(3,035)	(2,602)
Net pension cost - multi -employer plan	88	81	175	165
Total net pension benefit	\$ (1,429)	\$ (1,220)	\$ (2,860)	\$ (2,437)

KapStone funds the Pension Plan according to IRS funding requirements. Based on those requirements, KapStone funded \$0.7 million for the six months ended June 30, 2015 and expects to fund an additional \$0.4 million in 2015.

Defined Contribution Plan

We offer a 401(k) Defined Contribution Plan (Contribution Plan) to eligible employees. The Company s monthly contributions are based on the matching of certain employee contributions or based on a union negotiated formula. For the three months ended June 30, 2015 and 2014, the Company recognized expense of \$5.0 million and \$4.0 million, respectively, for the Company contributions to the Contribution Plan. For the six months ended June 30, 2015 and 2014, the Company recognized expense of \$10.0 million and \$8.2 million, respectively, for the Company contributions to the Contribution Plan. The amounts for the three and

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six month periods ended June 30, 2015 include \$0.3 million attributable to Victory. Effective in 2015, Longview Fibre Paper and Packaging, Inc. (Longview) salaried personnel received a 401(k) contribution rather than a cash balance plan contribution.

10. Stock-Based Compensation

In March, 2015, the Company's compensation committee of the board of directors approved stock-based awards to executive officers, certain employees and directors. The 2015 awards consisted of the grant of 555,451 stock options and 181,590 restricted stock units.

In May, 2015, the Company's compensation committee of the board of directors approved new stock awards for certain employees. In total, 7,494 stock options and 2,346 restricted stock units were awarded.

The Company accounts for stock-based awards in accordance with ASC 718, *Compensation - Stock Compensation*, which requires that the cost resulting from all share-based payment transactions be recognized as compensation cost over the vesting period based on the fair value of the instrument on the date of grant.

Total stock-based compensation expense related to the stock option and restricted stock unit grants for the three and six months ended June 30, 2015 and 2014 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Stock option compensation expense	\$ 1,272	\$ 674	\$ 3,222	\$ 2,198
Restricted stock unit compensation expense	1,485	637	3,315	2,031
Total stock-based compensation expense	\$ 2,757	\$ 1,311	\$ 6,537	\$ 4,229

Total unrecognized stock-based compensation cost related to the stock options and restricted stock units as of June 30, 2015 and December 31, 2014 is as follows:

	June 30,	December 31,
	2015	2014
Unrecognized stock option compensation expense	\$ 5,426	\$ 3,243
Unrecognized restricted stock unit compensation expense	6,180	3,923
Total unrecognized stock-based compensation expense	\$ 11,606	\$ 7,166

As of June 30, 2015, total unrecognized compensation cost related to non-vested stock options and restricted stock units is expected to be recognized over a weighted average period of 2.3 years and 2.2 years, respectively.

Stock Options

Stock option awards vest as follows: 50% after two years and the remaining 50% upon the earlier of after three years or upon a grantee of such stock options attaining the age 65. The stock options awarded in 2015 have a contractual term of ten years and are subject to forfeiture should the recipient terminate his or her employment with the Company for certain reasons prior to vesting in his or her awards, or the occurrence of certain other events such as termination with cause. The exercise price of these stock options is based on the closing market price of our common stock on the date of grant (\$31.89 for March 2015 awards and \$27.44 for May 2015 awards) and compensation expense is recorded on an accelerated basis over the awards' vesting periods.

The weighted average fair value of the stock options granted in March 2015, May 2015 and March 2014 was \$10.08, \$8.59 and \$10.36, respectively. The fair value was calculated using the Black-Scholes option-pricing model based on the market price at the grant date and the weighted average assumptions specific to the underlying options. The expected term used by the Company is based on the historical average life of stock option awards. The expected volatility assumption is based on the volatility of our common stock from the same time period as the expected term of the stock options. The risk-free interest rate was selected based upon yields of U.S. Treasury issues with a term similar to the expected life of the stock options.

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The assumptions utilized for calculating the fair value of stock options during the period are as follows:

	Six Months Ended June 30,	
	2015	2014
Stock Options Black-Scholes assumptions (weighted average):		
Expected volatility	39.08%	39.93%
Expected life (years)	4.90	4.30
Risk-free interest rate	1.35%	1.34%
Expected dividend yield	1.25%	%

The following table summarizes stock options amounts and activity:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Life (Years)	Intrinsic Value (dollars in thousands)
Outstanding at January 1, 2015	2,759,306	\$ 11.81	6.8	\$ 48,799
Granted	562,945	31.83		
Exercised	(85,802)	10.11		
Forfeited	(34,353)	23.54		
Outstanding at June 30, 2015	3,202,096	\$ 15.28	6.9	\$ 33,156
Exercisable at June 30 2015	1,936,643	\$ 7.26	5.5	\$ 30,855

For the three and six months ended June 30, 2015, cash proceeds from the exercise of stock options totaled \$0.3 million and \$0.8 million, respectively. For the three and six months ended June 30, 2014, cash proceeds from the exercise of stock options totaled \$0.2 million and \$0.4 million, respectively.

Restricted Stock

Restricted stock units are restricted as to transferability until the earlier of their vesting three years from the grant date or a grantee of such restricted stock units attaining the age 65. These restricted stock units are subject to forfeiture should applicable employees terminate their employment with the Company for certain reasons prior to vesting in their awards, or the occurrence of certain other events. The value of these restricted stock units is based on the closing market price of our common stock on the date of grant and compensation expense is recorded on a straight-line basis over the awards' vesting periods.

The following table summarizes unvested restricted stock units amounts and activity:

Weighted
Average
Grant Date

	Units		Fair Value
Outstanding at January 1, 2015	588,067	\$	16.98
Granted	183,936		31.83
Vested	(227,125)		10.94
Forfeited	(16,707)		20.81
Outstanding at June 30, 2015	528,171	\$	24.71

11. **Commitments and Contingencies**

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 employments matters, personal injury claims, contractual disputes and taxes. We establish reserves for claims and

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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.

The Company's subsidiary, Longview, is a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act with respect to the Lower Duwamish Waterway Superfund Site in the State of Washington (the Site). The U.S. Environmental Protection Agency (EPA) asserts that the Site is contaminated as a result of discharges from various businesses and government entities located along the Lower Duwamish Waterway, including a corrugated converting plant owned and operated by Longview. In November 2014, the EPA issued a Record of Decision (ROD) for the Site. The ROD includes a selected remedy for the Site. In the ROD, EPA states that the total estimated net present value costs (discounted at 2.3%) for the selected remedy are \$342 million. At least 40 potentially responsible parties, including Longview, have entered into an Allocation Agreement. Pursuant to the Allocation Agreement, the parties will attempt to determine each party's portion of the cost to remediate the site. The allocation process is not expected to be completed until 2017. Based on available information provided to the Company to date, the Company cannot reasonably estimate its potential liability.

The Longview union contract expired in June 2014. On June 12, 2015, the union representing the Longview facility provided a 10 Day Notice, which made it possible for the union to go out on legal strike at any time after June 22, 2015. To date, the union has not exercised that right and the bargaining process is continuing with the Longview union on their contract. 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.

There have been no material changes in any of our legal proceedings since December 31, 2014.

12. Segment Information

Prior to the acquisition of Victory on June 1, 2015, we manufactured and sold packaging products and reported the Company's consolidated results as one reportable segment. In connection with the acquisition, we began reporting in two reportable segments: Paper and Packaging and Distribution. These segments represent distinct businesses that are managed separately because of differing products and services. Each of these businesses requires distinct operating and marketing strategies.

Paper and Packaging: This segment manufactures and sells a wide variety of container board, corrugated products, and specialty paper for industrial and consumer markets.

Distribution: Through Victory, a North American distributor of packaging materials, and its approximately 70 distribution centers located in the United States, Mexico and Canada, the Company provides packaging materials and related products to a wide variety of customers.

Each segment's profits and losses are measured on operating profits before interest expense and interest income.

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								Total
Three Months Ended June 30, 2015	Trade	Net Sales Inter- segment	Total	Operating Income (Loss)	Depreciation and Amortization	Capital Expenditures	Assets at June 30, 2015	
Paper and Packaging	\$ 577,857	\$ 788	\$ 578,645	\$ 71,844	\$ 34,187	\$ 30,256	\$ 2,553,708	
Distribution (a)	93,398		93,398	1,720	1,945	243	527,704	
Corporate (b)				(12,155)	864	4,450	223,792	
Intersegment eliminations		(788)	(788)					
	\$ 671,255	\$	\$ 671,255	\$ 61,409	\$ 36,996	\$ 34,949	\$ 3,305,204	Total

								Total
Three Months Ended June 30, 2014	Trade	Net Sales Inter- segment	Total	Operating Income (Loss)	Depreciation and Amortization	Capital Expenditures	Assets at June 30, 2014	
Paper and Packaging	\$ 590,449	\$	\$ 590,449	\$ 94,392	\$ 32,937	\$ 37,540	\$ 2,664,290	
Distribution (a)								
Corporate				(9,079)	937	3,716	71,208	
Intersegment eliminations								
	\$ 590,449	\$	\$ 590,449	\$ 85,313	\$ 33,874	\$ 41,256	\$ 2,735,498	Total

Six Months Ended June 30, 2015	Trade	Net Sales Inter- segment	Total	Operating Income (Loss)	Depreciation and Amortization	Capital Expenditures		
Paper and Packaging	\$ 1,124,146	\$ 788	\$ 1,124,934	\$ 130,136	\$ 68,664	\$ 56,506		
Distribution (a)	93,398		93,398	1,720	1,945	243		
Corporate				(23,098)	1,508	6,962		
Intersegment eliminations		(788)	(788)					
	\$ 1,217,544	\$	\$ 1,217,544	\$ 108,758	\$ 72,117	\$ 63,711		

Six Months Ended June 30, 2014	Trade	Net Sales Inter- segment	Total	Operating Income (Loss)	Depreciation and Amortization	Capital Expenditures		
Paper and Packaging	\$ 1,139,401	\$	\$ 1,139,401	\$ 161,842	\$ 64,859	\$ 68,880		
Distribution (a)								
Corporate				(18,411)	1,724	4,796		
Intersegment eliminations								
	\$ 1,139,401	\$	\$ 1,139,401	\$ 143,431	\$ 66,583	\$ 73,676		

(a) The 2015 results include Victory for the period of June 1 through June 30, 2015

(b) Goodwill associated with the Victory acquisition is currently included in Corporate and will be allocated between the Paper and Packaging and Distribution segments upon completion of the Company's analysis to determine the assignment of goodwill.

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ITEM 2.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

This Quarterly Report on Form 10-Q 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 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, 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 Part I Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 and in our other Securities and Exchange Commission filings. The information contained in this Form 10-Q represents our best judgment at the date of this report based on information currently available. In providing forward-looking statements, KapStone does not intend, and does not undertake any duty or obligation, to update its statements as a result of new information, future events or otherwise.

The following discussion should be read in conjunction with our Consolidated Financial Statements and related Notes thereto included elsewhere in this report.

Comparison of Results of Operations for the Three Months Ended June 30, 2015 and 2014

(In thousands)

	Three Months Ended June 30,		Increase/ (Decrease)
	2015	2014	
Paper and packaging	\$ 578,645	\$ 590,449	\$ (11,804)
Distribution	93,398		93,398
Intersegment eliminations	(788)		(788)
Net sales	\$ 671,255	\$ 590,449	\$ 80,806
Paper and packaging	71,844	94,392	(22,548)
Distribution	1,720		1,720
Corporate	(12,155)	(9,079)	(3,076)
Income from operations	\$ 61,409	\$ 85,313	\$ (23,904)
Foreign exchange gain / (loss)	(53)	125	(178)
Interest expense, net	8,515	7,971	544
Income before taxes	52,841	77,467	(24,626)
Provision for income taxes	18,585	26,008	(7,423)
Net income	\$ 34,256	\$ 51,459	\$ (17,203)

Consolidated net sales for the quarter ended June 30, 2015 were \$671.3 million compared to \$590.4 million for the second quarter of 2014, an increase of \$80.8 million, or 13.7 percent. The increase in net sales was driven primarily by the Victory acquisition on June 1, 2015, which accounted for \$93.4 million of net sales.

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Paper and Packaging segment net sales decreased by \$11.8 million to \$578.6 for the quarter ended June 30, 2015, due to \$6.4 million of lower prices and a less favorable product mix, \$3.5 million due to a stronger U.S. dollar compared to the Euro and \$1.9 million due to lower volume. Average mill selling price per ton for the quarter ended June 30, 2015 was \$667 compared to \$685 for the prior year's quarter reflecting a stronger U.S. dollar compared to the Euro, lower export containerboard prices and a less favorable product mix partially offset by higher domestic kraft paper prices.

Paper and Packaging segment sales to external customers by product line were as follow:

Product Line Revenue:	Net Sales (in thousands)		Increase/		Tons Sold		Increase/	
	2015	2014	(Decrease)	%	2015	2014	(Decrease)	%
Containerboard /								
Corrugated products	\$ 366,578	\$ 373,223	\$ (6,645)	(1.8)%	442,746	450,525	(7,779)	(1.7)%
Specialty paper	189,504	193,077	(3,573)	(1.9)%	266,911	269,224	(2,313)	(0.9)%
Other	22,563	24,149	(1,586)	(6.6)%				
Product sold	\$ 578,645	\$ 590,449	\$ (11,804)	(2.0)%	709,657	719,749	(10,092)	(1.4)%

Tons of product sold for the quarter ended June 30, 2015 was 709,657 tons compared to 719,749 tons for the quarter ended June 30, 2014, a decrease of 10,092 tons, or 1.4 percent, as follows: