

Clearwater Paper Corp
Form 10-Q
May 05, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2009

Or

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 001-34146

CLEARWATER PAPER CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-3594554
(I.R.S. Employer
Identification No.)

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601 West Riverside, Suite 1100
Spokane, Washington
(Address of principal executive offices)

(509) 344-5900

99201
(Zip Code)

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 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 (section 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

The number of shares of common stock of the registrant outstanding as of April 29, 2009 was 11,354,542.

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CLEARWATER PAPER CORPORATION

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Part I

ITEM 1.

Financial Statements

Clearwater Paper Corporation

Statements of Operations

Unaudited (Dollars in thousands - except per-share amounts)

	Three Months Ended March 31,	
	2009	2008
Net sales	\$ 286,700	\$ 307,437
Costs and expenses:		
Cost of sales	245,645	288,105
Selling, general and administrative expenses	15,830	12,734
	261,475	300,839
Earnings before interest and income taxes	25,225	6,598
Interest expense, net	(3,563)	(3,250)
Earnings before income taxes	21,662	3,348
Income tax provision	8,015	1,102
Net earnings	\$ 13,647	\$ 2,246
Net earnings per common share:		
Basic	\$ 1.20	\$ 0.20
Diluted	1.19	0.20

The accompanying notes are an integral part of these financial statements.

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Clearwater Paper Corporation

Condensed Balance Sheets

Unaudited (Dollars in thousands)

	March 31, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash	\$ 2,852	\$ 3,218
Short-term investments	12,977	10,800
Receivables, net	95,052	104,030
Inventories	160,261	154,351
Deferred tax assets	14,772	14,772
Prepaid expenses	5,872	2,408
Total current assets	291,786	289,579
Land	4,729	4,729
Plant and equipment, at cost less accumulated depreciation	377,386	385,138
Other assets	4,512	3,820
	\$ 678,413	\$ 683,266
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	\$ 40,000	\$ 50,000
Note payable to Potlatch	100,000	100,000
Accounts payable and accrued liabilities	99,990	116,471
Current liability for pensions and other postretirement employee benefits	9,086	9,086
Total current liabilities	249,076	275,557
Liability for pensions and other postretirement employee benefits	222,854	221,649
Other long-term obligations	3,645	3,234
Deferred taxes	6,312	1,837
Accumulated other comprehensive loss	(124,949)	(126,149)
Stockholders' equity excluding accumulated other comprehensive loss	321,475	307,138
	\$ 678,413	\$ 683,266

The accompanying notes are an integral part of these financial statements.

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Clearwater Paper Corporation

Condensed Statements of Cash Flows

Unaudited (Dollars in thousands)

	Three Months Ended March 31,	
	2009	2008
CASH FLOWS FROM CONTINUING OPERATIONS		
Net earnings	\$ 13,647	\$ 2,246
Adjustments to reconcile net earnings to net operating cash flows:		
Depreciation and amortization	11,721	11,843
Deferred taxes	4,475	(2,031)
Equity-based compensation expense	689	797
Employee benefit plans	3,240	371
Loss on disposal of plant and equipment		81
Working capital changes	1,400	9,218
Increase in other assets	(401)	
Net cash provided by operating activities	34,771	22,525
CASH FLOWS FROM INVESTING		
Change in short-term investments	(2,177)	
Additions to plant and equipment	(3,559)	(2,291)
Net cash used for investing activities	(5,736)	(2,291)
CASH FLOWS FROM FINANCING		
Net payments to Potlatch		(20,253)
Change in book overdrafts	(2,781)	
Repayment of notes payable	(10,000)	
Repayment to Potlatch	(16,529)	
Other, net	(91)	20
Net cash used for financing activities	(29,401)	(20,233)
Increase (decrease) in cash	(366)	1
Balance at beginning of period	3,218	9
Balance at end of period	\$ 2,852	\$ 10

Net interest payments for the three months ended March 31, 2009 were \$0.5 million. Net income tax payments for the three months ended March 31, 2009 were \$0.2 million. We paid no interest or income taxes, nor did we receive any income tax refunds, for the three months ended March 31, 2008, due to Potlatch's centralized approach to cash management prior to the spin-off.

The accompanying notes are an integral part of these financial statements.

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Clearwater Paper Corporation

Notes to Condensed Financial Statements

Unaudited

NOTE 1.

Spin-off from Potlatch Corporation

On December 1, 2008, the board of directors of Potlatch Corporation, which we refer to in this report as Potlatch, approved the distribution of our common stock to Potlatch's stockholders in a tax-free spin-off, which we refer to in this report as the spin-off. On December 16, 2008, Potlatch distributed 100% of the issued and outstanding shares of our common stock to the holders of record of Potlatch common stock as of the close of business on December 9, 2008. Each Potlatch stockholder received one share of our common stock for every 3.5 shares of Potlatch common stock held on the record date.

Unless the context otherwise requires or unless otherwise indicates, references in this report to Clearwater Paper, we, our company and us refer

For all periods prior to the spin-off, to the Consumer Products, Pulp and Paperboard and Wood Products businesses separated from Potlatch Corporation in the spin-off; and

For all periods following the spin-off, to Clearwater Paper Corporation.

NOTE 2.

General

Clearwater Paper is principally engaged in the manufacturing and selling of pulp-based products. We are a leading producer of private label tissue products sold in grocery stores in the United States, and we manufacture and market bleached paperboard for the high-end segment of the packaging industry. We also manufacture and market bleached pulp and wood products, including appearance grade cedar and dimensional framing lumber products.

Our businesses were owned by, and we were a subsidiary of, Potlatch until our spin-off on December 16, 2008.

The accompanying Condensed Balance Sheets at March 31, 2009 and December 31, 2008, and the Statements of Operations and the Condensed Statements of Cash Flows for the three months ended March 31, 2009 and 2008, have been prepared in conformity with accounting principles generally accepted in the United States of America. We believe that all adjustments necessary for a fair statement of the results of the interim periods presented have been included. The results of operations for any interim period are not necessarily indicative of the results of operations to be expected for the full year.

This Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the Securities and Exchange Commission on March 18, 2009.

NOTE 3.

Recent Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. SFAS No. 157 (as amended by

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FASB Staff Position, or FSP, FAS No. 157-2) is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, for financial assets and liabilities, and nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). For nonfinancial assets and nonfinancial liabilities that are not remeasured at fair value on a recurring basis in the financial statements, the statement is effective for fiscal years beginning after November 15, 2008. With the exception of the deferred portion of SFAS No. 157, we adopted this Statement effective January 1, 2008, which did not have a material effect on our financial condition and results of operations. Adoption of the deferred portion of this Statement on January 1, 2009, did not have a material effect on our financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51*. This Statement requires all companies to report noncontrolling or minority interests in subsidiaries as equity in the financial statements. The intention of SFAS No. 160 is to eliminate the diversity in

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practice regarding the accounting for transactions between a company and noncontrolling interests. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Adoption of this Statement on January 1, 2009, did not have a material effect on our financial condition and results of operations.

In December 2007, the FASB also issued SFAS No. 141 (Revised 2007), *Business Combinations*. This revised Statement, which we refer to as SFAS No. 141R, is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. SFAS No. 141R will significantly change the accounting for business combinations in a number of areas, including the treatment of contingent consideration, contingencies, acquisition costs and restructuring costs. Also under this Statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008. Adoption of this Statement on January 1, 2009 did not have a material effect on our financial condition and results of operations.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of SFAS No. 133*. This Statement amends and expands the disclosure requirements by requiring qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of, and gains and losses on, derivative instruments, and disclosures about credit risk-related contingent features in derivative agreements. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We adopted SFAS No. 161 effective January 1, 2009. See Note 9 – Derivatives.

In December 2008, the FASB issued Staff Position, or FSP, FAS 132(R)-1, *Employers’ Disclosures about Postretirement Benefit Plan Assets*, which amends SFAS 132(R), *Employers’ Disclosures about Pensions and Other Postretirement Benefits* to provide guidance on an employer's disclosures about assets of a defined pension or other postretirement plan. The additional disclosures include investment policies and strategies, categories of plan assets, and information about the fair value measurements of plan assets. The disclosures required by this FSP are effective for fiscal years ending after December 15, 2009. Adoption of this Statement is not expected to have a material effect on our financial condition and results of operations. However, we are currently reviewing what effect this FSP will have on our financial statement disclosures.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. This FSP requires disclosures about fair value of financial instruments whenever summarized financial information for interim reporting periods is presented. Entities shall disclose the methods and significant assumptions used to estimate the fair value of financial instruments, as well as describe changes in methods and significant assumptions, if any, during the period. This FSP is effective for interim reporting periods ending after June 15, 2009. We are currently reviewing what effect this FSP will have on our financial statement disclosures.

NOTE 4.

Income Taxes

The income tax provisions presented in the Statements of Operations have been computed by applying an estimated annual effective tax rate. This estimated rate was 37.0% for the three months ended March 31, 2009, and 32.9% for the three months ended March 31, 2008. The tax provision for the first quarter of 2008 was calculated on a carve-out basis, whereas the 2009 tax provision is reflective of the company's operations and tax attributes as a stand-alone entity.

We reflect accrued interest related to tax obligations, as well as penalties, in our provision for income taxes. During the first quarters of 2009 and 2008, no such amounts were reflected in our provision for income taxes.

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NOTE 5.

Earnings per Common Share

Earnings per common share are computed by dividing net earnings by the weighted average number of common shares outstanding in accordance with SFAS No. 128, *Earnings Per Share*. The following table reconciles the number of common shares used in calculating the basic and diluted net earnings per share:

(Dollars in thousands - except per-share amounts)	Three Months Ended March 31,	
	2009	2008
Net earnings	\$ 13,647	\$ 2,246
Basic average common shares outstanding	11,354,542	11,354,542
Incremental shares due to:		
Restricted stock units	159,155	
Diluted average common shares outstanding	11,513,697	11,354,542
Basic net earnings per common share	\$ 1.20	\$ 0.20
Diluted net earnings per common share	\$ 1.19	\$ 0.20

For the three months ended March 31, 2009, 137,829 shares of common stock underlying outstanding restricted stock units, or RSUs, and 267,300 shares of common stock underlying outstanding performance shares were excluded from the computation of diluted net earnings per share because their effect was anti-dilutive. There were no RSUs or performance shares outstanding during the three months ended March 31, 2008. The basic average common shares outstanding as of the spin-off date were utilized for the 2008 period presented above.

NOTE 6.

Equity-Based Compensation

In connection with the spin-off, our Board approved and adopted, and Potlatch, in its capacity as our sole stockholder, approved, the Clearwater Paper Corporation 2008 Stock Incentive Plan, or Stock Plan. The Stock Plan provides for equity-based awards in the form of restricted shares, RSUs, performance shares, stock options or stock appreciation rights to selected employees, outside directors and consultants of the Company. Under the Stock Plan, we are authorized to issue up to approximately 1.7 million shares. The Stock Plan became effective on December 16, 2008. At March 31, 2009, approximately 668,000 shares were available for future issuance under the 2008 Stock Incentive Plan.

As of the spin-off date, the performance share and RSU awards previously granted to our employees by Potlatch were automatically cancelled, per the terms of the awards, as a result of the spin-off. Under the employee matters agreement we entered into with Potlatch in connection with the spin-off, we agreed to issue new equity awards of equivalent value to replace the equity awards previously received from Potlatch. Replacement awards were granted in the form of RSU grants. The awards will accrue dividend equivalents, if any are paid, based on dividends paid during the RSU vesting period. The dividend equivalents will be converted into additional RSUs that will vest in the same manner as the underlying RSUs to which they relate. The terms of the awards state that the awards will vest after a set period of time has passed, which approximates the remaining vesting or settlement period associated with the cancelled Potlatch equity awards.

As required by SFAS No. 123R, we prepared a calculation as of the date of the spin-off to determine whether any additional compensation cost existed for any excess of the fair value of the modified replacement awards granted by us over the fair value of the original Potlatch performance share and RSU awards. The resulting additional expense of \$0.5 million is being recognized over the remaining vesting period for the outstanding replacement grants.

We recorded equity-based compensation expense of \$0.7 million for the three months ended March 31, 2009, of which \$0.6 million related to RSUs and \$0.1 million related to performance shares. The equity-based compensation expense we recorded for the three months ended

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March 31, 2008, which was allocated to us by Potlatch, was \$0.8 million. The net income tax benefit associated with equity-based compensation totaled \$0.3 million for each of the three months ended March 31, 2009 and 2008.

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In connection with joining our Board, in January 2009 our outside directors were granted an award of phantom common stock units, which were credited to an account established on behalf of each director and will vest ratably over a three-year period. These accounts will be credited with additional common stock units equal in value to dividends paid, if any, on the same amount of common stock. Upon separation from service as a director, the vested portion of the common stock units held by the director in his stock unit account will be converted to cash based upon the then market price of the common stock and paid to the director. Due to the cash-settlement feature of the awards, we recognize equity-based compensation expense or income at the end of each reporting period based on the portion of the award that is vested and the increase or decrease in the value of our common stock.

Directors of the company also can each elect to defer compensation in the form of stock units. We record compensation expense or income during each reporting period based on the amount of compensation deferred during the period and the increase or decrease in the value of the company's common stock. We recorded director equity-based compensation and deferred expense totaling \$0.1 million for the three months ended March 31, 2009. We were a wholly owned subsidiary of Potlatch prior to our spin-off, and thus there was no director equity-based compensation or deferred expense or income in the three months ended March 31, 2008.

RESTRICTED STOCK UNITS

RSUs granted under our Stock Plan are generally subject to a vesting period. During the first quarter of 2009, certain officers and other employees of the company were granted RSU awards that will accrue dividend equivalents based on dividends paid, if any, during the RSU vesting period. The dividend equivalents will be converted into additional RSUs that will vest in the same manner as the underlying RSUs to which they relate. The terms of certain awards state that 20% of the RSUs vest on each of the first and second anniversaries of the grant date of the awards, with the remaining 60% vesting on the third anniversary. The terms of certain other RSUs provide for vesting of such RSUs upon the expiration of a set period of approximately three years.

A summary of the status of outstanding RSU awards as of March 31, 2009 is presented below:

	Shares	Weighted Avg. Grant Date Fair Value	Aggregate Intrinsic Value (in Thousands)
Unvested shares outstanding at January 1	282,469	\$ 17.25	
Granted	209,765	9.67	
Vested	(680)	17.25	
Forfeited			
Unvested shares outstanding at March 31	491,554	14.02	\$ 3,947

For RSU awards granted during the period, the fair value of each share was estimated on the date of grant using the grant date market price of our common stock.

As of March 31, 2009, there was \$3.9 million of total unrecognized compensation cost related to outstanding RSU awards. The cost is expected to be recognized over a weighted average period of 1.8 years.

PERFORMANCE SHARES

Performance share awards granted under our Stock Plan have a three-year performance period, and shares are issued after the end of the period if the performance measure is met. The performance measure is a comparison of the percentile ranking of our total shareholder return compared to the total shareholder return performance of a selected peer group. The number of shares actually issued, as a percentage of the amount subject to the performance share award, could range from 0% - 200%. Performance share awards granted under our stock incentive plan do not represent common stock, and therefore the holders do not have voting rights unless and until shares are issued upon settlement. During the performance period, dividend equivalents accrue based on dividends

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paid and are converted into additional performance shares, which vest or are forfeited in the same manner as the underlying performance shares to which they relate.

The fair value of performance share awards is estimated using a Monte Carlo simulation model. A summary of the status of outstanding performance share awards as of March 31, 2009, and changes during the first quarter of 2009 is presented below:

	Shares	Weighted Avg. Grant Date Fair Value	Aggregate Intrinsic Value (in Thousands)
Unvested shares outstanding at January 1		\$	
Granted	267,300	8.22	
Vested			
Forfeited			
Unvested shares outstanding at March 31	267,300	8.22	\$ 1,893

As of March 31, 2009, there was \$1.9 million of unrecognized compensation cost related to outstanding performance share awards. The cost is expected to be recognized over a weighted average period of 2.8 years.

NOTE 7.

Inventories

Inventories at the balance sheet dates consist of:

(Dollars in thousands)	March 31, 2009	December 31, 2008
Raw materials	\$ 65,039	\$ 77,670
Finished goods	95,222	76,681
	\$ 160,261	\$ 154,351

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NOTE 8.

Pension and Other Postretirement Employee Benefit Plans

The following table details the components of net periodic cost (benefit) of our pension and other postretirement employee benefit plans for the three months ended March 31, 2009 and 2008: