

Edgar Filing: Clearwater Paper Corp - Form 10-Q

Clearwater Paper Corp  
Form 10-Q  
November 05, 2012  
Table of Contents

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 September 30, 2012

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.)

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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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 October 24, 2012 was 23,203,668.

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Table of Contents

CLEARWATER PAPER CORPORATION

Index to Form 10-Q

	Page Number
<b>PART I. <u>FINANCIAL INFORMATION</u></b>	
<b>ITEM 1. <u>Condensed Consolidated Financial Statements</u></b>	
<u>Condensed Consolidated Statements of Operations for the three months and nine months ended September 30, 2012 and 2011</u>	<u>2</u>
<u>Condensed Consolidated Statements of Comprehensive Income for the three months and nine months ended September 30, 2012 and 2011</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>6 - 20</u>
<b>ITEM 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b><u>21 - 31</u></b>
<b>ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b><u>31 - 32</u></b>
<b>ITEM 4. <u>Controls and Procedures</u></b>	<b><u>32</u></b>
<b>PART II. <u>OTHER INFORMATION</u></b>	
<b>ITEM 1. <u>Legal Proceedings</u></b>	<b><u>32 - 33</u></b>
<b>ITEM 1A. <u>Risk Factors</u></b>	<b><u>33</u></b>
<b>ITEM 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b><u>33</u></b>
<b>ITEM 6. <u>Exhibits</u></b>	<b><u>33</u></b>
<b><u>SIGNATURES</u></b>	<b><u>34</u></b>
<b><u>EXHIBIT INDEX</u></b>	<b><u>35</u></b>

Table of Contents

## Part I

## ITEM 1.

## Condensed Consolidated Financial Statements

## Clearwater Paper Corporation

## Condensed Consolidated Statements of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net sales	\$480,233	\$501,125	\$1,411,603	\$1,461,582
Costs and expenses:				
Cost of sales	(409,822)	(448,927)	(1,211,444)	(1,297,205)
Selling, general and administrative expenses	(30,649)	(26,815)	(90,252)	(81,655)
Total operating costs and expenses	(440,471)	(475,742)	(1,301,696)	(1,378,860)
Income from operations	39,762	25,383	109,907	82,722
Interest expense, net	(7,900)	(12,100)	(26,775)	(34,425)
Other, net	—	1,290	—	585
Earnings before income taxes	31,862	14,573	83,132	48,882
Income tax provision	(12,798)	(5,928)	(38,853)	(20,710)
Net earnings	\$19,064	\$8,645	\$44,279	\$28,172
Net earnings per common share:				
Basic	\$0.82	\$0.38	\$1.90	\$1.23
Diluted	0.80	0.37	1.87	1.19

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

# Table of Contents

## Clearwater Paper Corporation Condensed Consolidated Statements of Comprehensive Income Unaudited (Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net earnings	\$ 19,064	\$ 8,645	\$ 44,279	\$ 28,172
Other comprehensive income:				
Defined benefit pension and other postretirement employee benefits:				
Amortization of actuarial loss included in net periodic cost, net of tax expense of \$1,190, \$818, \$3,571 and \$2,452	1,831	1,278	5,493	3,834
Amortization of prior service credit included in net periodic cost, net of tax benefit of \$202, \$59, \$605 and \$176	(310	) (91	) (930	) (275
Foreign currency translation adjustment	—	(3,666	) —	(2,377
Amortization of deferred taxes related to actuarial gain on other postretirement employee benefit obligations	—	(58	) —	(173
Other comprehensive income (loss), net of tax	1,521	(2,537	) 4,563	1,009
Comprehensive income	\$ 20,585	\$ 6,108	\$ 48,842	\$ 29,181

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

Table of Contents

Clearwater Paper Corporation  
Condensed Consolidated Balance Sheets  
Unaudited (Dollars in thousands – except per-share amounts)

	September 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash	\$ 19,564	\$ 8,439
Restricted cash	—	769
Short-term investments	37,000	55,001
Receivables, net	175,587	176,189
Taxes receivable	11,918	10,000
Inventories	224,435	244,071
Deferred tax assets	24,857	39,466
Prepaid expenses	8,570	11,396
Total current assets	501,931	545,331
Property, plant and equipment, net	840,981	735,566
Goodwill	229,533	229,533
Intangible assets, net	44,854	49,748
Other assets, net	9,603	11,140
<b>TOTAL ASSETS</b>	<b>\$ 1,626,902</b>	<b>\$ 1,571,318</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 171,195	\$ 144,631
Current liability for pensions and other postretirement employee benefits	9,861	9,861
Total current liabilities	181,056	154,492
Long-term debt	523,872	523,694
Liability for pensions and other postretirement employee benefits	197,222	215,932
Other long-term obligations	48,560	48,474
Accrued taxes	78,625	74,464
Deferred tax liabilities	70,972	69,358
Stockholders' equity:		
Preferred stock, par value \$0.0001 per share, 5,000,000 authorized shares, no shares issued	—	—
Common stock, par value \$0.0001 per share, 100,000,000 authorized shares, 23,825,750 and 23,101,710 shares issued	2	2
Additional paid-in capital	318,168	315,964
Retained earnings	339,832	295,553
Treasury stock, at cost, common shares-622,082 and 333,300 shares repurchased	(20,705)	(11,350)
Accumulated other comprehensive loss, net of tax	(110,702)	(115,265)
Total stockholders' equity	526,595	484,904
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,626,902</b>	<b>\$ 1,571,318</b>

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

Table of Contents

Clearwater Paper Corporation  
Condensed Consolidated Statements of Cash Flows  
Unaudited (Dollars in thousands)

	Nine Months Ended September 30,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net earnings	\$44,279	\$28,172
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	58,477	57,108
Deferred tax expense	13,257	12,311
Equity-based compensation expense	7,681	5,117
Employee benefit plans	6,697	6,252
Changes in working capital, net	51,434	(32,621)
Change in taxes receivable, net	(1,918)	(2,028)
Excess tax benefits from equity-based payment arrangements	(9,193)	—
Change in non-current accrued taxes	4,161	1,873
Funding of qualified pension plans	(17,625)	(9,800)
Change in restricted cash, net	769	4,429
Other, net	2,564	1,490
Net cash provided by operating activities	160,583	72,303
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Change in short-term investments, net	18,001	41,094
Additions to plant and equipment	(155,365)	(87,251)
Proceeds from sale of assets	1,035	—
Net cash used for investing activities	(136,329)	(46,157)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayment of Cellu Tissue debt	—	(15,595)
Purchase of treasury stock	(9,355)	(10,003)
Excess tax benefits from equity-based payment arrangements	9,193	—
Payment of tax withholdings on equity-based payment arrangements	(12,965)	(1,498)
Other, net	(2)	2,940
Net cash used for financing activities	(13,129)	(24,156)
Effect of exchange rate changes	—	153
Increase in cash	11,125	2,143
Cash at beginning of period	8,439	18,928
Cash at end of period	\$19,564	\$21,071
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid for interest, net of amounts capitalized	\$12,366	\$22,303
Cash paid for income taxes	17,740	40,045
Cash received from income tax refunds	1,607	29,282
<b>SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING ACTIVITIES:</b>		
Increase in accrued plant and equipment	\$3,258	\$5,087
Property acquired under capital lease	—	12,687
The accompanying notes are an integral part of these condensed consolidated financial statements.		



Table of Contents

Clearwater Paper Corporation

Notes to Condensed Consolidated Financial Statements

Unaudited

NOTE 1 Nature of Operations and Basis of Presentation

**GENERAL**

We manufacture and sell pulp-based products. We currently manufacture quality consumer tissue, away-from-home tissue, parent roll tissue, machine-glazed tissue, bleached paperboard and pulp at 15 manufacturing locations in the U.S. and Canada. Our private label tissue products, such as facial and bath tissue, paper towels and napkins, are used primarily at home and are principally sold to major retailers and wholesale distributors, which include grocery, drug, mass merchant and discount stores. Our paperboard is sold primarily in the high-end segment of the packaging industry and is ultimately used by our customers to make packaging for products ranging from liquids to pharmaceuticals to consumer goods packaging, all of which demand high quality construction and print surfaces for graphics. Our products primarily utilize pulp made from wood fiber. In addition to wood fiber, other major cost categories include chemicals, transportation, energy, packaging, and costs associated with our manufacturing facilities.

On December 27, 2010, we acquired Cellu Tissue Holdings, Inc., or Cellu Tissue, and consolidated the acquisition in our financial statements as of that date. The financial position and results of Cellu Tissue's operations and cash flows are fully reflected in these condensed consolidated financial statements.

On November 28, 2011, we sold our Lewiston, Idaho sawmill to Idaho Forest Group of Coeur d'Alene, Idaho. The transaction included the sale of our sawmill, planer mill, dry kilns and related assets along with log and finished goods inventories and timber under contract, in the aggregate amount of approximately \$30 million. This sawmill was our only wood products facility.

**FINANCIAL STATEMENT PREPARATION AND PRESENTATION**

The accompanying Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011, the related Condensed Consolidated Statements of Operations and Comprehensive Income for the three months and nine months ended September 30, 2012 and 2011, and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011, have been prepared in conformity with accounting principles generally accepted in the United States of America, or GAAP. 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, 2011, as filed with the Securities and Exchange Commission, or SEC, on February 24, 2012.

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**SIGNIFICANT ESTIMATES**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. Significant areas requiring the use of estimates and measurement of uncertainty include determination of net realizable value for deferred tax assets, assessment of impairment of long-lived assets and goodwill, assessment of environmental matters, equity-based compensation and pension and postretirement obligation assumptions. Actual results could differ from those estimates and assumptions.

**RESTRICTED CASH AND SHORT-TERM INVESTMENTS**

At September 30, 2012, we had no restricted cash balance. At December 31, 2011, all restricted cash was classified as current and included in "Restricted cash" on our Condensed Consolidated Balance Sheet. Our short-term investments are invested largely in demand deposits, which have very short maturity periods, and they therefore earn an interest rate commensurate with low-risk instruments.





Table of Contents**TRADE ACCOUNTS RECEIVABLE**

Trade accounts receivable are stated at the amount we expect to collect. Trade accounts receivable do not bear interest. The allowance for doubtful accounts is our best estimate of the losses we expect will result from the inability of our customers to make required payments. We generally determine the allowance based on a combination of actual historical write-off experience and an analysis of specific customer accounts. As of September 30, 2012 and December 31, 2011, we had an allowance for doubtful accounts of \$1.8 million and \$1.7 million, respectively.

**PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment are stated at cost, including any interest costs capitalized, less accumulated depreciation. Depreciation of buildings, equipment and other depreciable assets is determined using the straight-line method. Assets we acquire through business combinations have estimated lives that are typically shorter than the assets we construct or buy new. Accumulated depreciation totaled \$1,395.4 million and \$1,342.7 million at September 30, 2012 and December 31, 2011, respectively.

For the three months and nine months ended September 30, 2012, we capitalized \$4.1 million and \$9.0 million, respectively, of interest expense associated with the construction of our new tissue manufacturing and converting facilities in Shelby, North Carolina, and improvements to our tissue manufacturing facility in Las Vegas, Nevada, compared to \$0.8 million and \$2.3 million for the same periods in 2011, respectively.

**STOCKHOLDERS' EQUITY**

On July 28, 2011, our Board of Directors authorized the repurchase of up to \$30.0 million of our common stock. Under our stock repurchase program, we may repurchase shares in the open market or as otherwise may be determined by management, subject to market conditions, business opportunities and other factors. During the three and nine months ended September 30, 2012, we repurchased 50,300 and 288,782 shares, respectively, of our outstanding common stock. As of September 30, 2012, we had \$9.3 million of authorization remaining pursuant to our share repurchase program. We account for share repurchases under the program as treasury stock and record the amounts paid to repurchase shares at cost as a component of stockholders' equity. We have not retired any treasury shares and may choose to reissue shares held in treasury stock in a future period.

**DERIVATIVES**

We had no activity during the three months and nine months ended September 30, 2012 and 2011 that required hedge or derivative accounting treatment. However, to partially mitigate our exposure to market risk for changes in utility commodity pricing, we use firm price contracts to supply a portion of the natural gas requirements for our manufacturing facilities. As of September 30, 2012, these contracts covered approximately 18% of our expected average monthly natural gas requirements for the remainder of 2012, plus lesser amounts for 2013.

We also have agreements with suppliers to purchase pulp and chemicals at market-based prices covering approximately 33% and 42%, respectively, of our current expected remaining 2012 pulp and chemical needs. These contracts for natural gas, pulp and chemicals qualify for treatment as "normal purchases or normal sales" under authoritative guidance and thus require no mark-to-market adjustment.

**NOTE 2 Recently Adopted and New Accounting Standards**

There were no new accounting standards adopted during the three months ended September 30, 2012. We reviewed all new accounting pronouncements issued in the period and concluded that there are none that we believe will have a significant or material impact to our current or future financial statements or disclosures.

**NOTE 3 Inventories**

Inventories at the balance sheet dates consist of:

(In thousands)	September 30, 2012	December 31, 2011
Pulp, paperboard and tissue products	\$142,631	\$162,426
Materials and supplies	64,181	62,376
Logs, pulpwood, chips and sawdust	17,623	17,713
Lumber	—	1,556
	\$224,435	\$244,071



Table of Contents

Inventories are stated at the lower of market or cost using the average cost method. The last-in, first-out, or LIFO, method was previously used to determine cost of logs, wood fiber and the majority of lumber until the sale of our sawmill in November 2011. During the three months ended March 31, 2012, the remaining lumber inventory from the sawmill was sold. The sale of this inventory, which was valued at costs prevailing in prior years under the LIFO method, had the effect of increasing earnings in the period ended March 31, 2012 by an immaterial amount.

**NOTE 4 Intangible Assets**

Intangible assets at the balance sheet dates are comprised of the following:

(Dollars in thousands, lives in years)	September 30, 2012			
	Useful Life	Historical Cost	Accumulated Amortization	Net Balance
Customer relationships	9.0	\$50,000	\$(9,849 )	\$40,151
Trade names and trademarks	10.0	5,300	(927 )	4,373
Non-compete agreements	2.5	1,100	(770 )	330
Total intangible assets		\$56,400	\$(11,546 )	\$44,854

(Dollars in thousands, lives in years)	December 31, 2011			
	Useful Life	Historical Cost	Accumulated Amortization	Net Balance
Customer relationships	9.0	\$50,000	\$(5,682 )	\$44,318
Trade names and trademarks	10.0	5,300	(530 )	4,770
Non-compete agreements	2.5	1,100	(440 )	660
Total intangible assets		\$56,400	\$(6,652 )	\$49,748

**NOTE 5 Taxes**

Consistent with authoritative guidance, our estimated annual effective tax rate is used to allocate expected annual income tax expense to interim periods. The rate is the ratio of estimated annual income tax expense to estimated pre-tax ordinary income, and excludes “discrete items”, which are significant, unusual or infrequent items reported separately net of their related tax effect. The estimated annual effective tax rate is applied to the current interim period’s ordinary income to determine the income tax expense allocated to the interim period. The income tax effects of discrete items are then determined separately and recognized in the interim period in which the income or expense items arise.

We recorded income tax expense of \$12.8 million and \$38.9 million in the three and nine months ended September 30, 2012 compared to \$5.9 million and \$20.7 million in the three and nine months ended September 30, 2011. The effective rates for the three months and nine months ended September 30, 2012 were 40.2% and 46.7%, respectively, compared to rates of 40.7% and 42.4% for the same periods of 2011. As discussed below, the rates for the nine month periods included the net impact of reporting discrete items in each reporting period totaling net expense of \$9.7 million and \$4.0 million, respectively.

The net increase to our tax expense and effective tax rate for the nine months ended September 30, 2012 was primarily the result of \$6.5 million in tax expense related to our decision to convert certain gallons of alternative fuel originally claimed in 2009 under the Alternative Fuel Mixture Tax Credit, or AFMTC, which had been converted by us in 2010 to the Cellulosic Biofuel Producer Credit, or CBPC, back to gallons under the AFMTC. The tax expense attributable to the AFMTC conversion was comprised of \$3.4 million relating to the conversion back to the AFMTC and a resulting additional \$3.1 million increase in our liabilities for uncertain tax positions. The remaining discrete expense of \$3.2 million recorded in the nine months ended September 30, 2012 was primarily interest accrued on uncertain tax positions.

The net increase to our tax expense and effective tax rate in the nine months ended September 30, 2011 was primarily the result of discrete expenses for interest accrued on uncertain tax positions and the impact of reevaluating our state tax structure as Cellu Tissue was being integrated into our operations, partially offset by a benefit associated with certain transaction costs relating to the Cellu Tissue acquisition that were determined to be deductible under the

Internal Revenue Code, or IRC.

8

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Table of Contents

We have tax benefits relating to excess equity-based compensation that are being utilized to reduce our U.S. taxable income. Our Condensed Consolidated Balance Sheets reflect deferred tax assets comprised of net operating losses and tax credit carryforwards excluding amounts impacted by excess equity-based compensation. We have historically elected to follow the “with-and-without” or “incremental” method for ordering tax benefits derived from employee equity-based compensation awards. As a result of this method, net operating loss carryforwards and tax credit carryforwards not generated from equity-based compensation are utilized before the current period’s equity-based tax deduction (excess tax benefits from equity-based compensation awards are recognized last). Excess tax benefits from equity-based compensation awards that are determined to reduce U.S. taxable income following this method are recognized when realized as increases to additional paid-in capital as a component of stockholders’ equity. During the nine months ended September 30, 2012, we generated additional excess tax benefits of \$13.9 million relating to the release of vested performance share and restricted stock unit awards to employees. For the nine months ended September 30, 2012, \$9.2 million of excess tax benefits have been allocated to additional paid-in capital and reduced income taxes payable based on the incremental method. As of September 30, 2012, we had a total amount of excess tax benefits that are not recognized on our condensed consolidated balance sheet of \$8.0 million.

Subsequent to September 30, 2012, the Internal Revenue Service has undertaken an audit of the company for the 2009 through 2011 tax years. Other audits opened during the third quarter of 2012 include a Canada Revenue Agency audit of our Canadian subsidiary, which we acquired in the Cellu Tissue acquisition, for the fiscal year ended February 2010 and calendar years 2010 and 2011.

**NOTE 6 Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities at the balance sheet dates consist of:

(In thousands)	September 30, 2012	December 31, 2011
Trade accounts payable	\$78,704	\$65,040
Accrued wages, salaries and employee benefits	40,805	37,430
Accrued interest	15,879	5,245
Accrued taxes other than income taxes payable	9,158	11,257
Accrued discounts and allowances	7,564	5,588
Accrued utilities	7,225	7,265
Accrued transportation	4,380	3,801
Other	7,480	9,005
	\$171,195	\$144,631

**NOTE 7 Debt****\$375 MILLION SENIOR NOTES DUE 2018**

On October 22, 2010, we sold \$375.0 million aggregate principal amount of senior notes, which we refer to as the 2010 Notes. The 2010 Notes mature on November 1, 2018, have an interest rate of 7.125% and were issued at their face value.

The 2010 Notes are guaranteed by certain of our existing and future direct and indirect domestic subsidiaries. The 2010 Notes are equal in right of payment with all other existing and future unsecured senior indebtedness and are senior in right of payment to any future subordinated indebtedness. The 2010 Notes are effectively subordinated to all of our existing and future secured indebtedness, including borrowings under our secured revolving credit facility, which is secured by certain of our accounts receivable, inventory and cash. The terms of the 2010 Notes limit our ability and the ability of any restricted subsidiaries to borrow money; pay dividends; redeem or repurchase capital stock; make investments; sell assets; create restrictions on the payment of dividends or other amounts to us from any restricted subsidiaries; enter into transactions with affiliates; enter into sale and lease back transactions; create liens; and consolidate, merge or sell all or substantially all of our assets.

Prior to November 1, 2013, we may redeem up to 35% of the 2010 Notes at a redemption price equal to 107.125% of the principal amount plus accrued and unpaid interest with the proceeds from one or more qualified equity offerings. We have the option to redeem all or a portion of the 2010 Notes at any time before November 1, 2014 at a redemption

price equal to 100% of the principal amount plus accrued and unpaid interest and a “make whole” premium. On or after November 1, 2014, we may redeem all or a portion of the 2010 Notes at specified redemption prices plus accrued and unpaid interest. In addition, we may be required to make an offer to purchase the 2010 Notes upon the sale of certain assets and upon a change of control.

Table of Contents**\$150 MILLION SENIOR NOTES DUE 2016**

In June 2009, we issued senior unsecured notes, which we refer to as the 2009 Notes, in the aggregate principal amount of \$150.0 million. The 2009 Notes are due on June 15, 2016 and have an interest rate of 10.625%. The 2009 Notes were issued at a price equal to 98.792% of their face value.

The 2009 Notes are guaranteed by each of our existing and future direct and indirect domestic subsidiaries. The 2009 Notes are general unsecured obligations and are therefore not secured by our assets and are effectively subordinated to all of our existing and future secured indebtedness, including borrowings under our secured revolving credit facility, which is secured by certain of our accounts receivable, inventory and cash. The terms of the 2009 Notes limit our ability and the ability of any restricted subsidiaries to borrow money; pay dividends; redeem or repurchase capital stock; make investments; sell assets; create restrictions on the payment of dividends or other amounts to us from any restricted subsidiaries; enter into transactions with affiliates; enter into sale and lease back transactions; create liens; and consolidate, merge or sell all or substantially all of our assets.

We have the option to redeem all or a portion of the 2009 Notes at any time prior to June 15, 2013 at a redemption price equal to 100% of the principal amount thereof plus a “make whole” premium and accrued and unpaid interest. On or after June 15, 2013, we may redeem all or a portion of the 2009 Notes at specified redemption prices plus accrued and unpaid interest. In addition, we may be required to make an offer to purchase the 2009 Notes upon the sale of certain assets and upon a change of control.

**REVOLVING CREDIT FACILITY**

On November 26, 2008, we entered into a \$125 million revolving credit facility with certain financial institutions. On September 28, 2011, we amended our revolving credit facility, among other things, (i) to extend the term of the revolving loan to the earlier of September 30, 2016 or 90 days prior to the maturity date of the 2009 Notes; (ii) to increase permitted capital expenditures limits; and (iii) to change the interest rate margins applicable to base rate loans and LIBOR loans in circumstances based on our fixed charge coverage ratio from time to time, and to reduce the fees paid by us on undrawn amounts. The amount available to us under the revolving credit facility is based on the lesser of 85% of our eligible accounts receivable plus approximately 65% of our eligible inventory, or \$125 million.

As of September 30, 2012, there were no borrowings outstanding under the credit facility, but approximately \$5.9 million of the credit facility was being used to support outstanding standby letters of credit. Loans under the credit facility bear interest at LIBOR plus between 1.75% and 2.25% for LIBOR loans, and a base rate effectively equal to the agent bank’s prime rate plus between 0.25% and 0.75% for other loans. The percentage margin on all loans is based on our fixed charge coverage ratio for the last twelve months, which is recalculated on a quarterly basis. As of September 30, 2012, we would have been permitted to draw approximately \$119.1 million under the credit facility at LIBOR plus 1.75%.

A minimum fixed charge coverage ratio is the only financial covenant requirement under our credit facility and is triggered when there are any commitments or obligations outstanding and availability falls below 12.5% or an event of default exists, at which time the minimum fixed charge coverage ratio must be at least 1.0-to-1.0. As of September 30, 2012, the fixed charge coverage ratio for the last twelve months was 3.4-to-1.0.

Our obligations under the revolving credit facility are secured by certain of our accounts receivable, inventory and cash. The terms of the credit facility agreement contain various provisions that limit our discretion in the operations of our business by restricting our ability to, among other things pay dividends; redeem or repurchase capital stock; create, incur or guarantee certain debt; incur liens on certain properties; make capital expenditures in amounts in excess of those permitted under the revolving credit agreement; enter into certain affiliate transactions; enter into certain hedging arrangements; and consolidate with or merge with another entity.

**NOTE 8 Other Long-Term Obligations**

Other long-term obligations at the balance sheet dates consist of:

(In thousands)	September 30, 2012	December 31, 2011
Long-term lease obligations, net of current portion	\$25,336	\$25,546
Deferred proceeds	11,411	13,040



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Deferred compensation	10,254	8,100
Other	1,559	1,788
	\$48,560	\$48,474

10

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Table of Contents

## NOTE 9 Pension and Other Postretirement Employee Benefit Plans

The following table details the components of net periodic cost of our pension and other postretirement employee benefit, or OPEB, plans for the periods presented:

	Three months ended September 30:			
	Pension Benefit Plans		Other Postretirement Employee Benefit Plans	
(In thousands)	2012	2011	2012	2011
Service cost	\$622	\$1,931	\$173	\$175
Interest cost	3,673	3,773	1,454	1,714
Expected return on plan assets	(4,921 )	(4,883 )	—	—
Amortization of prior service cost (credit)	158	299	(670 )	(449 )
Amortization of actuarial loss	3,021	2,096	—	—
Net periodic cost	\$2,553	\$3,216	\$957	\$1,440

  

	Nine months ended September 30:			
	Pension Benefit Plans		Other Postretirement Employee Benefit Plans	
(In thousands)	2012	2011	2012	2011
Service cost	\$1,864	\$5,794	\$520	\$526
Interest cost	11,020	11,319	4,361	5,143
Expected return on plan assets	(14,764 )	(14,649 )	—	—
Amortization of prior service cost (credit)	475	895	(2,010 )	(1,346 )
Amortization of actuarial loss	9,064	6,286	—	—
Net periodic cost	\$7,659	\$9,645	\$2,871	\$4,323

As discussed in the notes to our consolidated financial statements in our 2011 Form 10-K, our company-sponsored pension plans were underfunded by \$89.1 million at December 31, 2011. The underfunded status as of December 31, 2011 increased by \$33.7 million over the underfunded status as of December 31, 2010, primarily due to lower discount rates and low returns on pension asset investments. As a result of being underfunded, we are required to make contributions to our qualified pension plans. During the nine months ended September 30, 2012, we contributed \$17.6 million to these pension plans. In October 2012, we contributed an additional \$3.0 million, which was the remaining contribution we were required to make in 2012.

During the nine months ended September 30, 2012, we made contributions of approximately \$0.2 million to our non-qualified pension plan, which substantially fulfills our estimated 2012 annual contributions to our non-qualified pension plan. We do not anticipate funding our OPEB plans in 2012 except to pay benefit costs as incurred during the year by plan participants.

Table of Contents

## NOTE 10 Earnings per Common Share

Earnings per common share is computed by dividing net earnings by the weighted average number of common shares outstanding in accordance with accounting guidance related to earnings per share. The following table reconciles the number of common shares used in calculating basic and diluted net earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Basic average common shares outstanding <sup>1</sup>	23,360,967	22,865,233	23,337,323	22,975,847
Incremental shares due to:				
Restricted stock units	51,230	281,782	43,580	273,821
Performance shares	287,491	444,161	264,021	442,124
Diluted average common shares outstanding	23,699,688	23,591,176	23,644,924	23,691,792
Basic net earnings per common share	\$0.82	\$0.38	\$1.90	\$1.23
Diluted net earnings per common share	0.80	0.37	1.87	1.19
Anti-dilutive shares excluded from calculation	29,382	88,674	132,273	104,212

<sup>1</sup> Basic average common shares outstanding include restricted stock awards that are fully vested, but are deferred for future issuance. See Note 11 "Equity-Based Compensation" for further discussion.

## NOTE 11 Equity-Based Compensation

We recognize equity-based compensation expense for all equity-based payment awards made to employees and directors, including restricted stock units and performance shares, based on estimated fair values.

Employee equity-based compensation expense was recognized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2012	2011	2012	2011
Restricted stock units	\$297	\$321	\$693	\$888
Performance shares	1,953	1,359	5,284	3,594
Total employee equity-based compensation	\$2,250	\$1,680	\$5,977	\$4,482

As provided for in the Clearwater Paper Corporation 2008 Stock Incentive Plan, the performance measure used to determine the number of performance shares ultimately issued is a comparison of the percentile ranking of our total stockholder return compared to the total stockholder 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%.

On December 31, 2011, the service and performance period for 499,680 outstanding performance shares granted in 2009 ended. Those performance shares were settled and distributed in the first quarter of 2012. The number of shares actually settled, as a percentage of the outstanding amount, was 200%. An additional 257,112 shares of restricted stock units vested in the first quarter of 2012, of which 90,856 shares were settled and distributed during the period and 166,256 shares that would have resulted in certain executive compensation being above the IRC section 162(m) threshold were deferred to preserve tax deductibility for the company. After adjusting for the related minimum tax withholdings, and excluding the deferred restricted stock units, a net 724,040 shares were issued in the first quarter of 2012. The related minimum tax withholdings payment made in the first quarter of 2012 in connection with issued shares was \$13.0 million. Subsequent to the first quarter of 2012, no performance shares or restricted stock units have vested, and no related minimum tax withholding payments have been made.



Table of Contents

The following table summarizes the number of share-based awards granted under our 2008 Stock Incentive Plan during the nine months ended September 30, 2012 and the grant-date fair value of the awards:

	Nine Months Ended September 30, 2012	
	Number of awards	Average fair value of award per share
Restricted stock units	52,294	\$ 34.59
Performance shares	150,865	40.24

**DIRECTOR AWARDS**

Each year our directors receive equity-based awards that are deferred, measured in units of our common stock and ultimately converted to cash at the time of payment. Accordingly, this compensation is subject to fluctuations based on mark-to-market adjustments at each reporting period in line with changes in the market price of our common stock. As a result of the mark-to-market adjustment, we recorded director equity-based compensation expense of \$1.8 million and \$1.7 million for the three and nine months ended September 30, 2012, compared to compensation expense of \$0.5 million and \$0.6 million for the same periods ended September 30, 2011.

**NOTE 12 Fair Value Measurements**

The estimated fair values of our financial instruments at the dates presented below are as follows:

	September 30, 2012		December 31, 2011	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash, restricted cash, and short-term investments (Level 1)	\$56,564	\$56,564	\$64,209	\$64,209
Long-term debt (Level 1)	523,872	573,563	523,694	556,313

Accounting guidance establishes a framework for measuring the fair value of financial instruments, providing a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities, or “Level 1” measurements, followed by quoted prices of similar assets or observable market data, or “Level 2” measurements, and the lowest priority to unobservable inputs, or “Level 3” measurements.

The asset’s or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used should seek to maximize the use of observable inputs and minimize the use of unobservable inputs.

Table of Contents

## NOTE 13 Segment Information

The table below presents information about our reportable segments:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Segment net sales:				
Consumer Products	\$292,959	\$285,237	\$853,911	\$823,607
Pulp and Paperboard <sup>1</sup>	187,274	215,888	557,692	637,975
Total segment net sales	\$480,233	\$501,125	\$1,411,603	\$1,461,582
Operating income:				
Consumer Products	\$18,453	\$7,075	\$70,420	\$27,758
Pulp and Paperboard <sup>1</sup>	34,449	26,266	78,108	76,370
	52,902	33,341	148,528	104,128
Corporate and eliminations	(13,140)	) (7,958	) (38,621	) (21,406
Income from operations	\$39,762	\$25,383	\$109,907	\$82,722
Depreciation and amortization:				
Consumer Products	\$13,275	\$12,920	\$39,692	\$37,115
Pulp and Paperboard	5,525	6,536	17,547	19,646
Corporate	399	113	1,238	347
Total depreciation and amortization	\$19,199	\$19,569	\$58,477	\$57,108

Results for Pulp and Paperboard for the nine months ended September 30, 2012 include income and expenses

<sup>1</sup> associated with the November 2011 sale of the Lewiston, Idaho sawmill, the effects of which were immaterial in the aggregate.

Table of Contents

## NOTE 14 Supplemental Guarantor Financial Information

On October 22, 2010 we issued the 2010 Notes. Certain of our 100% owned, domestic subsidiaries guarantee the 2010 Notes on a joint and several basis. The 2010 Notes are not guaranteed by Interlake Acquisition Corporation Limited or Cellu Tissue-CityForest, LLC. There are no significant restrictions on the ability of the guarantor subsidiaries to make distributions to Clearwater Paper, the issuer of the 2010 Notes. The following tables present the results of operations, financial position and cash flows of Clearwater Paper and its subsidiaries, the guarantor and non-guarantor entities, and the eliminations necessary to arrive at the information for Clearwater Paper on a consolidated basis.

## Clearwater Paper Corporation

## Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

Three Months Ended September 30, 2012

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	\$351,309	\$118,592	\$16,388	\$(6,056)	\$480,233
Cost and expenses:					
Cost of sales	(287,715)	(116,033)	(12,130)	6,056	(409,822)
Selling, general and administrative expenses	(9,143)	(16,638)	(4,868)	—	(30,649)
Total operating costs and expenses	(296,858)	(132,671)	(16,998)	6,056	(440,471)
Income (loss) from operations	54,451	(14,079)	(610)	—	39,762
Interest expense, net	(7,900)	—	—	—	(7,900)
Earnings (loss) before income taxes	46,551	(14,079)	(610)	—	31,862
Income tax provision	(20,364)	4,980	(1,523)	4,109	(12,798)
Equity in (loss) income of subsidiary	(11,232)	(2,133)	—	13,365	—
Net earnings (loss)	\$14,955	\$(11,232)	\$ (2,133)	\$17,474	\$19,064
Other comprehensive income, net of tax	1,521	—	—	—	1,521
Comprehensive income (loss)	\$16,476	\$(11,232)	\$ (2,133)	\$17,474	\$20,585

## Clearwater Paper Corporation

## Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

Nine Months Ended September 30, 2012

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	\$1,035,596	\$346,397	\$48,762	\$(19,152)	\$1,411,603
Cost and expenses:					
Cost of sales	(866,127)	(329,125)	(35,344)	19,152	(1,211,444)
Selling, general and administrative expenses	(65,483)	(19,463)	(5,306)	—	(90,252)
Total operating costs and expenses	(931,610)	(348,588)	(40,650)	19,152	(1,301,696)
Income (loss) from operations	103,986	(2,191)	8,112	—	109,907
Interest expense, net	(26,775)	—	—	—	(26,775)
Earnings before income (loss) taxes	77,211	(2,191)	8,112	—	83,132
Income tax provision	(37,002)	1,478	(3,545)	216	(38,853)
Equity in income (loss) of subsidiary	3,854	4,567	—	(8,421)	—
Net earnings (loss)	\$44,063	\$3,854	\$4,567	\$(8,205)	\$44,279
Other comprehensive income, net of tax	4,563	—	—	—	4,563
Comprehensive income (loss)	\$48,626	\$3,854	\$4,567	\$(8,205)	\$48,842

Table of Contents

## Clearwater Paper Corporation

## Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

Three Months Ended September 30, 2011

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	\$362,347	\$123,524	\$15,254	\$—	\$501,125
Cost and expenses:					
Cost of sales	(313,942)	(119,820)	(15,165)	—	(448,927)
Selling, general and administrative expenses	(22,147)	(3,933)	(735)	—	(26,815)
Total operating costs and expenses	(336,089)	(123,753)	(15,900)	—	(475,742)
Income (loss) from operations	26,258	(229)	(646)	—	25,383
Interest expense, net	(11,927)	(24)	(149)	—	(12,100)
Other, net	—	—	1,290	—	1,290
Earnings (loss) before income taxes	14,331	(253)	495	—	14,573
Income tax provision	(11,116)	3,381	(341)	2,148	(5,928)
Equity in income (loss) of subsidiary	3,282	154	—	(3,436)	—
Net earnings (loss)	\$6,497	\$3,282	\$154	\$(1,288)	\$8,645
Other comprehensive loss, net of tax	(2,537)	—	—	—	(2,537)
Comprehensive income (loss)	\$3,960	\$3,282	\$154	\$(1,288)	\$6,108

## Clearwater Paper Corporation

## Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

Nine Months Ended September 30, 2011

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	\$1,063,657	\$348,559	\$49,366	\$—	\$1,461,582
Cost and expenses:					
Cost of sales	(915,786)	(335,018)	(46,401)	—	(1,297,205)
Selling, general and administrative expenses	(64,699)	(14,459)	(2,497)	—	(81,655)
Total operating costs and expenses	(980,485)	(349,477)	(48,898)	—	(1,378,860)
Income (loss) from operations	83,172	(918)	468	—	82,722
Interest expense, net	(33,805)	(90)	(530)	—	(34,425)
Other, net	—	—	585	—	585
Earnings (loss) before income taxes	49,367	(1,008)	523	—	48,882
Income tax provision	(24,136)	2,734	(1,456)	2,148	(20,710)
Equity in income (loss) of subsidiary	793	(933)	—	140	—
Net earnings (loss)	\$26,024	\$793	\$(933)	\$2,288	\$28,172
Other comprehensive income, net of tax	1,009	—	—	—	1,009
Comprehensive income (loss)	\$27,033	\$793	\$(933)	\$2,288	\$29,181



Table of Contents

Clearwater Paper Corporation  
Condensed Consolidating Balance Sheet  
At September 30, 2012

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>ASSETS</b>					
Current assets:					
Cash	\$ 12,720	\$ 407	\$ 6,437	\$—	\$ 19,564
Restricted cash	—	—	—	—	—
Short-term investments	37,000	—	—	—	37,000
Receivables, net	125,117	42,902	9,414	(1,846 )	175,587
Taxes receivable	12,078	3,043	(3,636 )	433	11,918
Inventories	162,567	55,035	6,833	—	224,435
Deferred tax assets	28,505	4,627	438	(8,713 )	24,857
Prepaid expenses	7,555	843	172	—	8,570
Total current assets	385,542	106,857	19,658	(10,126 )	501,931
Property, plant and equipment, net	586,344	207,179	47,458	—	840,981
Goodwill	229,533	—	—	—	229,533
Intangible assets, net	—	38,635	6,219	—	44,854
Intercompany receivable (payable)	39,164	(106,958 )	45,265	22,529	—
Investment in subsidiary	257,563	94,285	—	(351,848 )	—
Other assets, net	9,225	378	—	—	9,603
<b>TOTAL ASSETS</b>	<b>\$ 1,507,371</b>	<b>\$ 340,376</b>	<b>\$ 118,600</b>	<b>\$ (339,445 )</b>	<b>\$ 1,626,902</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>					
Current liabilities:					
Accounts payable and accrued liabilities	\$ 132,911	\$ 32,741	\$ 7,389	\$ (1,846 )	\$ 171,195
Current liability for pensions and other postretirement employee benefits	9,861	—	—	—	9,861
Total current liabilities	142,772	32,741	7,389	(1,846 )	181,056
Long-term debt	523,872	—	—	—	523,872
Liability for pensions and other postretirement employee benefits	197,222	—	—	—	197,222
Other long-term obligations	48,199	361	—	—	48,560
Accrued taxes	78,225	59	341	—	78,625
Deferred tax liabilities (assets)	(9,514 )	49,652	16,585	14,249	70,972
Accumulated other comprehensive loss, net of tax	(110,702 )	—	—	—	(110,702 )
Stockholders' equity excluding accumulated other comprehensive loss	637,297	257,563	94,285	(351,848 )	637,297
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,507,371</b>	<b>\$ 340,376</b>	<b>\$ 118,600</b>	<b>\$ (339,445 )</b>	<b>\$ 1,626,902</b>



Table of Contents

Clearwater Paper Corporation  
Condensed Consolidating Balance Sheet  
At December 31, 2011

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>ASSETS</b>					
Current assets:					
Cash	\$2,146	\$901	\$ 5,392	\$—	\$8,439
Restricted cash	769	—	—	—	769
Short-term investments	55,001	—	—	—	55,001
Receivables, net	100,600	66,580	9,009	—	176,189
Taxes receivable	8,957	709	334	—	10,000
Inventories	175,446	62,234	6,391	—	244,071
Deferred tax assets	27,801	2,950	194	8,521	39,466
Prepaid expenses	9,756	1,437	203	—	11,396
Total current assets	380,476	134,811	21,523	8,521	545,331
Property, plant and equipment, net	468,372	217,235	49,959	—	735,566
Goodwill	229,533	—	—	—	229,533
Intangible assets, net	—	42,873	6,875	—	49,748
Intercompany receivable (payable)	120,061	(155,395 )	35,334	—	—
Investment in subsidiary	249,142	89,718	—	(338,860 )	—
Other assets, net	10,815	325	—	—	11,140
<b>TOTAL ASSETS</b>	<b>\$1,458,399</b>	<b>\$329,567</b>	<b>\$ 113,691</b>	<b>\$(330,339 )</b>	<b>\$1,571,318</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>					
Current liabilities:					
Accounts payable and accrued liabilities	\$109,549	\$28,838	\$ 6,244	\$—	\$144,631
Current liability for pensions and other postretirement employee benefits	9,861	—	—	—	9,861
Total current liabilities	119,410	28,838	6,244	—	154,492
Long-term debt	523,694	—	—	—	523,694
Liability for pensions and other postretirement employee benefits	215,932	—	—	—	215,932
Other long-term obligations	48,009	465	—	—	48,474
Accrued taxes	73,594	—	870	—	74,464
Deferred tax liabilities (assets)	(7,144 )	51,122	16,859	8,521	69,358
Accumulated other comprehensive loss, net of tax	(115,265 )	—	—	—	(115,265 )
Stockholders' equity excluding accumulated other comprehensive loss	600,169	249,142	89,718	(338,860 )	600,169
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$1,458,399</b>	<b>\$329,567</b>	<b>\$ 113,691</b>	<b>\$(330,339 )</b>	<b>\$1,571,318</b>



Table of Contents

Clearwater Paper Corporation  
Condensed Consolidating Statement of Cash Flows  
Nine Months Ended September 30, 2012

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Net earnings (loss)	\$44,063	\$3,854	\$ 4,567	\$(8,205 )	\$44,279
Adjustments to reconcile net earnings to net cash provided by operating activities:					
Depreciation and amortization	35,244	19,076	4,157	—	58,477
Deferred tax expense (benefit)	(6,040 )	(3,147 )	(518 )	22,962	13,257
Equity-based compensation expense	7,681	—	—	—	7,681
Employee benefit plans	6,697	—	—	—	6,697
Changes in working capital, net	16,641	34,698	95	—	51,434
Change in taxes receivable, net	(3,121 )	(2,334 )	3,970	(433 )	(1,918 )
Excess tax benefits from equity-based payment arrangements	(9,193 )	—	—	—	(9,193 )
Change in non-current accrued taxes	4,631	59	(529 )	—	4,161
Funding of qualified pension plans	(17,625 )	—	—	—	(17,625 )
Change in restricted cash, net	769	—	—	—	769
Other, net	1,757	807	—	—	2,564
Net cash provided by operating activities	81,504	53,013	11,742	14,324	160,583
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Change in short-term investments, net	18,001	—	—	—	18,001
Additions to plant and equipment	(146,256 )	(8,344 )	(765 )	—	(155,365 )
Proceeds from the sale of assets	—	1,035	—	—	1,035
Net cash used for investing activities	(128,255 )	(7,309 )	(765 )	—	(136,329 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Purchase of treasury stock	(9,355 )	—	—	—	(9,355 )
Investment from (to) parent	70,454	(46,198 )	(9,932 )	(14,324 )	—
Excess tax benefits from equity-based payment arrangements	9,193	—	—	—	9,193
Payment of tax withholdings on equity- based payment arrangements	(12,965 )	—	—	—	(12,965 )
Other, net	(2 )	—	—	—	(2 )
Net cash provided by (used for) financing activities	57,325	(46,198 )	(9,932 )	(14,324 )	(13,129 )
Increase (decrease) in cash	10,574	(494 )	1,045	—	11,125
Cash at beginning of period	2,146	901	5,392	—	8,439
Cash at end of period	\$12,720	\$407	\$ 6,437	\$—	\$19,564



Table of Contents

Clearwater Paper Corporation  
Condensed Consolidating Statement of Cash Flows  
Nine Months Ended September 30, 2011

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Net earnings (loss)	\$26,024	\$793	\$ (933 )	\$2,288	\$28,172
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:					
Depreciation and amortization	34,074	18,882	4,152	—	57,108
Deferred tax expense (benefit)	20,595	(5,694 )	(2,590 )	—	12,311
Equity-based compensation expense	5,117	—	—	—	5,117
Employee benefit plans	6,252	—	—	—	6,252
Changes in working capital, net	4,049	(40,225 )	3,555	—	(32,621 )
Change in taxes receivable, net	6,722	(8,168 )	1,239	(1,821 )	(2,028 )
Change in non-current accrued taxes	1,873	—	—	—	1,873
Funding of qualified pension plans	(9,800 )	—	—	—	(9,800 )
Change in restricted cash, net	(500 )	3,637	1,292	—	4,429
Other, net	518	672	300	—	1,490
Net cash provided by (used in) operating activities	94,924	(30,103 )	7,015	467	72,303
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Change in short-term investments, net	41,094	—	—	—	41,094
Additions to plant and equipment	(74,958 )	(11,639 )	(654 )	—	(87,251 )
Net cash used for investing activities	(33,864 )	(11,639 )	(654 )	—	(46,157 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Purchase of treasury stock	(10,003 )	—	—	—	(10,003 )
Repayment of Cellu Tissue debt	—	—	(15,595 )	—	(15,595 )
Investment (to) from parent	(56,769 )	38,551	18,685	(467 )	—
Payment of tax withholdings on equity-based payment arrangements	(1,498 )	—	—	—	(1,498 )
Other, net	2,940	—	—	—	2,940
Net cash (used for) provided by financing activities	(65,330 )	38,551	3,090	(467 )	(24,156 )
Effect of exchange rate changes	—	—	153	—	153
Increase (decrease) in cash	(4,270 )	(3,191 )	9,604	—	2,143
Cash at beginning of period	15,719	1,728	1,481	—	18,928
Cash at end of period	\$11,449	\$(1,463 )	\$ 11,085	\$—	\$21,071

## Table of Contents

### ITEM 2.

#### Management's Discussion and Analysis of Financial Condition and Results of Operations

#### FORWARD-LOOKING STATEMENTS

Our disclosure and analysis in this report contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding our construction of additional converting and paper making capacity and the cost and timing to complete new facilities, including our facilities in Shelby, North Carolina, the cost and timing to upgrade existing paper making facilities, including those in Las Vegas, Nevada, the integration of and expected benefits from the former Cellu Tissue operations, including expected cost savings from synergies, future growth opportunities, the stock repurchase program, future revenues, cash flows, capital expenditures, tax rates, operating costs, manufacturing capability, liquidity, benefit plan funding levels, total selling, general and administrative costs, interest expenses, the tax treatment of the alternative fuels and cellulosic biofuels tax credits and the conversion of additional gallons of fuel from the Alternative Fuel Mixture Tax Credit to the Cellulosic Biofuel Producer Credit. Words such as "anticipate," "expect," "intend," "plan," "target," "project," "believe," "schedule," "estimate," "may," and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are based on management's current expectations, estimates, assumptions and projections that are subject to change. Our actual results of operations may differ materially from those expressed or implied by the forward-looking statements contained in this report. Important factors that could cause or contribute to such differences include those risks discussed in the section entitled "Risk Factors" in our 2011 Form 10-K, as well as the following:

- difficulties with the integration process or the realization of the benefits expected from the acquisition of Cellu Tissue; difficulties with completion, or significant delays in the construction or upgrade of, our new and existing tissue manufacturing and converting facilities, including the completion of our new through-air-dried, or TAD, paper machine;
- changes in the cost and availability of wood fiber used in the production of our products;
- changes in transportation costs and disruptions in transportation services;
- changes in raw material and energy costs and availability;
- the loss of business from any large customer;
  - changes in customer product preferences and competitors' product offerings;
- our qualification to retain, or ability to utilize, tax credits associated with alternative fuels or cellulosic biofuels and the tax treatment associated with receipt of such credits;
- labor disruptions;
- changes in the U.S. and international economies and in general economic conditions in the regions and industries in which we operate;
- changes in expenses and required contributions associated with our pension plans;
- cyclical industry conditions;
- competitive pricing pressures for our products, including as a result of increased capacity as additional manufacturing sites for consumer tissue products are constructed by our competitors;
- changes in exchange rates between the U.S. dollar and other currencies;
- reliance on a limited number of third-party suppliers for raw materials;
- unforeseen environmental liabilities or expenditures;
- unanticipated manufacturing or operating disruptions, including equipment malfunction and damage to our manufacturing facilities caused by fire or weather-related events and IT system failures;
- an inability to fund our debt obligations;
- restrictions on our business from debt covenants and terms; and
- changes in laws, regulations or industry standards affecting our business.

Forward-looking statements contained in this report present management's views only as of the date of this report. Except as required under applicable law, we do not intend to issue updates concerning any future revisions of management's views to reflect events or circumstances occurring after the date of this report.





Table of Contents

OVERVIEW

Background

We manufacture and sell pulp-based products. We currently manufacture quality consumer tissue, away-from-home tissue, parent roll tissue, machine-glazed tissue, bleached paperboard, and pulp at 15 manufacturing locations in the U.S. and Canada. Our private label tissue products, such as facial and bath tissue, paper towels and napkins, are used primarily at home and are principally sold to major retailers and wholesale distributors, which include grocery, drug, mass merchant and discount stores. Our paperboard is sold primarily in the high-end segment of the packaging industry and is ultimately used by our customers to make packaging for products ranging from liquids to pharmaceuticals to consumer goods packaging, all of which demand high quality construction and print surfaces for graphics. Our products primarily utilize pulp made from wood fiber. In addition to wood fiber, other major cost categories include chemicals, transportation, energy, packaging, and costs associated with our manufacturing facilities.

Recent Developments

Consumer Products Expansion

In 2010, as part of our TAD tissue expansion project, or TAD project, we began construction of new tissue manufacturing and converting facilities in Shelby, North Carolina to expand our Consumer Products segment in the Eastern United States. This site will include a TAD paper machine capable of producing ultra grades of private label tissue products and is currently expected to have five converting lines. The first two converting lines became operational during the second quarter of 2011. Two additional converting lines are expected to become operational in the fourth quarter of 2012 and the fifth line in 2013. The new TAD paper machine is scheduled to start-up in the fourth quarter of 2012. Also as part of our TAD project, during the third quarter of 2012, we began improvements to our TAD tissue manufacturing capabilities in Las Vegas that we completed in October 2012.

The TAD project will allow us to supply a full range of TAD products, including paper towels and bath tissue, to customers across the U.S., while minimizing transportation costs. We believe this project, along with our existing manufacturing capabilities, will establish us as the only private label tissue products company to offer a full line of tissue products to our customers.

We estimate the TAD project will cost approximately \$275 million, excluding capitalized interest. As of September 30, 2012, we have incurred a total of \$231.2 million in TAD project costs, of which \$39.3 million and \$121.9 million were incurred in the three and nine months ended September 30, 2012, respectively. We expect approximately \$23 million will be spent during the fourth quarter of 2012, with the remaining balance of approximately \$21 million to be spent in 2013. We have capitalized \$13.2 million of interest related to the TAD project to date, of which \$4.1 million and \$9.0 million were incurred in the three and nine months ended September 30, 2012, respectively, and we estimate total capitalized interest for the project will be approximately \$18 million.

Integration of Cellu Tissue Holdings, Inc.

On December 27, 2010, we acquired Cellu Tissue Holdings, Inc., or Cellu Tissue, which includes nine tissue manufacturing facilities located in the Southern, Midwestern and Eastern United States and one facility in Eastern Canada. These facilities allow us to better serve existing private label grocery customers by creating a national manufacturing footprint and provide us with the capability to expand into new private label channels. We recognized \$8.6 million of net cost savings from synergies relating to the acquisition in the third quarter of 2012, and \$20.6 million for the first three quarters of 2012. We expect to achieve total net cost savings from synergies of approximately \$29.0 million in 2012, and by the end of 2012 to be on track to achieve \$35 to \$40 million annually in net cost savings from synergies in 2013.

Table of Contents

## Components and Trends in our Business

## Net sales

Net sales consist of sales of consumer tissue, paperboard products and pulp, net of discounts, returns and allowances and any sales taxes collected. Prices for our consumer tissue products primarily tend to be driven by the value of our products to our customers, and are generally priced relative to the prices of branded tissue products. Demand and pricing for our pulp and paperboard products are largely determined by general global market conditions and the demand for high quality paperboard.

## Operating costs

(Dollars in thousands)	Three Months Ended September 30,			
	2012		2011	
	Cost	Percentage of Cost of Sales	Cost	Percentage of Cost of Sales
Purchased pulp	\$61,785	15.1 %	\$80,351	17.9 %
Chemicals	45,546	11.1	43,931	9.8
Transportation <sup>1</sup>	43,348	10.6	49,510	11.0
Chips, sawdust and logs	40,856	10.0	47,606	10.6
Energy	27,658	6.7	33,412	7.4
Packaging supplies	20,644	5.0	23,775	5.3
Maintenance and repairs <sup>2</sup>	20,597	5.0	23,767	5.3
	\$260,434	63.5 %	\$302,352	67.3 %

(Dollars in thousands)	Nine Months Ended September 30,			
	2012		2011	
	Cost	Percentage of Cost of Sales	Cost	Percentage of Cost of Sales
Purchased pulp	\$184,181	15.2 %	\$229,772	17.7 %
Chemicals	138,410	11.4	126,817	9.8
Transportation <sup>1</sup>	126,859	10.5	141,762	10.9
Chips, sawdust and logs	124,777	10.3	150,477	11.6
Energy	81,013	6.7	98,872	7.6
Maintenance and repairs <sup>2</sup>	77,706	6.4	74,974	5.8
Packaging supplies	63,981	5.3	70,688	5.5
	\$796,927	65.8 %	\$893,362	68.9 %

<sup>1</sup> Includes internal and external transportation costs.

<sup>2</sup> Excluding related labor costs.

**Purchased pulp.** We purchase a significant amount of the pulp needed to supply our consumer products, and to a lesser extent our pulp and paperboard, manufacturing facilities from external suppliers. For the three and nine months ended September 30, 2012, total purchased pulp costs were 15.1% and 15.2%, respectively, of our cost of sales, representing decreases of 2.8 percentage points and 2.5 percentage points, respectively, compared to the same periods in 2011. Our costs for purchased pulp, which were at record highs in 2011, decreased through the first three quarters of 2012 due to lower average external pulp prices and our continued focus on using our internally produced pulp.

**Chemicals.** We consume a substantial amount of chemicals in the production of pulp and paperboard. The chemicals we generally use include polyethylene, caustic, starch, sodium chlorate, latex and specialty paper process chemicals. A large portion of the chemicals used in our manufacturing processes, particularly in the pulp-making process, are petroleum-based and are impacted by petroleum prices. Our chemical costs increased \$1.6 million, or 1.3 percentage points, for the three months ended September 30, 2012, compared to the comparable period ended September 30,

2011. Chemical costs for the nine months ended September 30, 2012, increased \$11.6 million, or 1.6 percentage points, over the 2011 comparable period. Costs increased during both the three and nine month periods primarily as a result of increased production volumes and year to date increased caustic and other chemical costs.

## Table of Contents

Transportation. Fuel prices largely impact transportation costs related to delivery of raw materials to our manufacturing facilities, internal inventory transfers and delivery of our finished products to customers. Changing fuel prices particularly affect our margins for consumer products because we supply customers throughout the U.S., and we transport unconverted parent rolls from our tissue mills to our tissue converting facilities. Our transportation costs for the three and nine months ended September 30, 2012, compared to the prior year periods, decreased as less fuel was used due to an overall decline in miles shipped as a result of synergies from the Cellu Tissue acquisition, as well as improvement in negotiated rates. In addition, as a result of the sale of our Lewiston, Idaho sawmill in November 2011, overall transportation costs were lower for the nine months ended September 30, 2012, compared to the same period ending 2011.

Chips, sawdust and logs. We purchase chips, sawdust and logs used to manufacture pulp. We source these residual wood fibers under both long-term and short-term supply agreements, as well as in the spot market. Overall costs for chips, sawdust and logs for the three and nine months ended September 30, 2012, decreased compared to the same 2011 periods, both in dollars and as a percentage of cost of sales, primarily due to the sale of our Lewiston, Idaho sawmill in November 2011. Excluding the effects of our former sawmill, the cost of chips, sawdust and logs decreased slightly when compared to the prior year periods primarily due to lower pricing at our Idaho pulp and paperboard mill. Energy. We use energy in the form of electricity, hog fuel, steam, natural gas and, to a much lesser extent, coal to operate our mills. Energy prices have fluctuated widely over the past decade. We have taken steps to reduce our exposure to volatile energy prices through conservation. In addition, cogeneration facilities that produce steam and electricity at our East Hartford, Connecticut, Lewiston, Idaho and Menominee, Michigan manufacturing sites help to lower our energy costs. To help mitigate our exposure to changes in natural gas prices, from time to time we have used firm-price contracts to supply a portion of our natural gas requirements. As of September 30, 2012, these contracts covered approximately 18% of our expected average monthly natural gas requirements for our manufacturing facilities for the remainder of 2012, plus lesser amounts for 2013. Energy costs for the three and nine months ended September 30, 2012 were lower than the prior year period due to lower natural gas and electricity costs. Our energy costs in future periods will depend principally on our ability to produce a substantial portion of our electricity needs internally, on changes in market prices for natural gas and on our ability to reduce our energy usage. Maintenance and repairs. We regularly incur significant costs to maintain our manufacturing equipment. We perform routine maintenance on our machines and periodically replace a variety of parts such as motors, pumps, pipes and electrical parts.

Major equipment maintenance and repairs in our Pulp and Paperboard segment also require maintenance shutdowns annually at our Idaho facility and approximately every 18 months at our Arkansas facility, which increases costs and may reduce net sales in the quarters in which the major maintenance shutdowns occur. In the first quarter of 2012, we had 17 combined days of scheduled machine downtime for the two paperboard machines at our Idaho pulp and paperboard mill and incurred approximately \$15.5 million in major maintenance costs, excluding labor, compared to major maintenance costs of \$11.4 million and \$3.1 million, respectively, at the same mill in the first and third quarters of 2011. There was no major maintenance in the second and third quarters of 2012. A portion of our major maintenance originally planned for the fourth quarter of 2012 at our Arkansas facility has been deferred to the first quarter of 2013. Of the \$4.3 million of costs we expect to incur for this major maintenance, \$2.0 million is expected to be incurred in the fourth quarter of 2012, and the remainder is expected to be spent in the first quarter of 2013. In addition to ongoing maintenance and repair costs, we make capital expenditures to increase our operating capacity and efficiency, to improve our safety and to comply with environmental laws. Excluding \$39.3 million and \$121.9 million, respectively, of expenditures for our TAD project during the three and nine months ended September 30, 2012, we spent \$16.1 million and \$36.7 million, respectively, on capital expenditures during the three and nine months ended September 30, 2012, compared to \$8.6 million and \$32.7 million in the same periods in 2011. Capital expenditures for 2012 are expected to be between approximately \$205 million and \$210 million, which include an estimated \$145 million associated with our TAD project.

Packaging supplies. As a significant producer of private label consumer tissue products, we package to order for retail chains, wholesalers and cooperative buying organizations. Under these agreements, we incur expenses related to the unique packaging of our products for direct retail sale to consumers. For the three and nine months ended

September 30, 2012, packaging costs were lower than the same period in 2011 primarily due to procurement synergies resulting from the Cellu Tissue acquisition.

Other. Other costs not mentioned in the above table primarily consist of wage and benefit expenses and miscellaneous operating costs. Although period cut-offs and inventory levels can impact other cost of sales amounts, we would expect this amount to stay relatively steady as a percentage of costs.

## Table of Contents

### Selling, general and administrative expenses

Selling, general and administrative expenses primarily consist of compensation and associated expenses for sales and administrative personnel, as well as commission expenses related to sales of our products. Our selling, general and administrative expenses for the three months ended September 30, 2012, and 2011, were \$30.6 million and \$26.8 million, respectively. The \$3.8 million increase was primarily a result of higher wage and benefit, incentive based compensation and director equity-based compensation expenses.

### Interest expense

Interest expense is mostly comprised of interest on our \$375.0 million aggregate principal amount 7.125% senior notes due 2018 issued in October 2010, which we refer to as the 2010 Notes, and our \$150.0 million aggregate principal amount of 10.625% senior notes due 2016 issued in June 2009, which we refer to as the 2009 Notes. Interest expense also includes amortization of deferred finance costs associated with the 2009 Notes, 2010 Notes, and our revolving credit facility. Interest expense will be partially offset by our continued capitalization of interest for our TAD project, which we estimate will be \$13.8 million in 2012 and approximately \$18 million in total over the construction phase of the project. Interest expense before reductions for capitalized interest in 2012 is expected to continue decreasing slightly compared to 2011 as a result of the 2011 third quarter redemption of our industrial revenue bonds.

### Income taxes

Income taxes are based on reported earnings and tax rates in the jurisdictions in which our operations occur and offices are located, adjusted for available credits, changes in valuation allowances and differences between reported earnings and taxable income using current tax laws and rates. We generally expect our effective income tax rate, excluding discrete items, to remain fairly constant, but it could fluctuate due to changes in tax law.

We are registered with the Internal Revenue Service, or IRS, as both an alternative fuel mixer and a producer of cellulosic biofuel. During 2009 we received refundable tax credit payments in connection with our use of an alternative fuel mixture to produce energy at our pulp mills. The amount of the refundable tax credit is equal to \$0.50 per gallon of alternative fuel mixture used. The Alternative Fuel Mixture Tax Credit, or AFMTC, expired on December 31, 2009.

The Cellulosic Biofuel Producer Credit, or CBPC, enables us to claim \$1.01 per gallon in regards to black liquor produced and used as a fuel by us at our pulp mills in 2009. During 2010, the IRS issued guidance clarifying the treatment of the CBPC and the AFMTC in regards to the production or use of black liquor at the same facility, in the same tax year. Under the guidance provided, both credits may be claimed in the same year as long as the credits are not claimed for the same gallons of fuel. Furthermore, the IRS guidance clarified the ability to convert previously claimed gallons from the AFMTC to the CBPC.

In the first quarter of 2012 Congress identified the elimination or modification of the CBPC in connection with black liquor as a possible revenue source. Such proposed legislative action, if enacted, could limit or eliminate our ability to convert AFMTC gallons to CBPC gallons and/or CBPC gallons to AFMTC gallons and, accordingly, limit or eliminate our ability to claim carry forward credits. Although provisions relating to CBPC and AFMTC were removed from the proposed Highway Investment, Job Creation and Economic Growth Act of 2012, the ultimate outcome of these provisions or future provisions could be adverse. As a result, we made the determination to convert all gallons relating to CBPC carryforwards back to AFMTC and as of September 30, 2012 we have no remaining CBPC carryforwards. As a result of this determination, we recorded net discrete expense of \$6.5 million through the nine months ended September 30, 2012 comprised of \$3.4 million relating to the conversion back to the AFMTC and a resulting additional \$3.1 million increase in our liabilities for uncertain tax positions. Although under current federal tax law we have the ability to convert gallons of AFMTC to CBPC until 2013, we do not currently intend to do so. See Note 5 "Income Taxes" of our Condensed Consolidated Financial Statements for further discussion.

There is relatively little guidance regarding the AFMTC and the law governing the issue is complex. Accordingly, there remains uncertainty as to our qualification to receive the tax credit in 2009, as well as to whether we will be entitled to retain the amounts we received upon further review by the IRS. In addition, while it is our position that payments received or credits taken in relation to the AFMTC should not be subject to corporate income tax, there can be no assurance as to whether or not the amounts we have received will be subject to taxation.

Subsequent to September 30, 2012, the IRS has undertaken an audit of the company for the 2009 through 2011 tax years. Other audits opened during the third quarter of 2012 include a Canada Revenue Agency audit of our Canadian subsidiary, which we acquired in the Cellu Tissue acquisition, for the fiscal year ended February 2010 and calendar years 2010 and 2011.



Table of Contents

## RESULTS OF OPERATIONS

Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011

The following table sets forth data included in our Condensed Consolidated Statements of Operations as a percentage of net sales.

(Dollars in thousands)	Three Months Ended September 30,					
	2012			2011		
Net sales	\$480,233	100.0	%	\$501,125	100.0	%
Costs and expenses:						
Cost of sales	(409,822	) 85.3		(448,927	) 89.6	
Selling, general and administrative expenses	(30,649	) 6.4		(26,815	) 5.4	
Total operating costs and expenses	(440,471	) 91.7		(475,742	) 94.9	
Income from operations	39,762	8.3		25,383	5.1	
Interest expense, net	(7,900	) 1.6		(12,100	) 2.4	
Other, net	—	—		1,290	0.3	
Earnings before income taxes	31,862	6.6		14,573	2.9	
Income tax provision	(12,798	) 2.7		(5,928	) 1.2	
Net earnings	\$19,064	4.0		\$8,645	1.7	

Net sales—Third quarter 2012 net sales decreased by \$20.9 million, or 4.2%, compared to the third quarter of 2011, due to the sale of our Lewiston, Idaho sawmill in November 2011. Excluding net sales of \$22.0 million from the sawmill in the third quarter of 2011, net sales for the third quarter of 2012 were slightly higher as a result of record quarterly shipments of approximately 139,000 tons from our Consumer Products segment as well as higher paperboard shipments. The increase in net sales was partially offset by lower external pulp sales due to increased internal usage of the pulp we produce, a 2.4% decline in paperboard net selling prices, and slightly lower overall tissue net selling prices due to increased non-retail tissue sales, which had lower net sales prices. These items are discussed further below under “Business Segment Discussion.”

Cost of sales—Cost of sales was 85.3% of net sales for the three months ended September 30, 2012 and 89.6% of net sales for the same period in 2011. The decrease was due primarily to lower costs for purchased pulp, chips, sawdust, logs, transportation and energy, partially offset by higher chemical costs.

Selling, general and administrative expenses—Selling, general and administrative expenses increased \$3.8 million over the prior year period primarily as a result of higher wage and benefit, incentive compensation and director equity-based compensation expenses.

Interest expense—Interest expense decreased \$4.2 million during the three months ended September 30, 2012, compared to the same period of 2011. The decrease was largely attributable to capitalized interest of \$4.1 million associated with our TAD project, compared to \$0.8 million of capitalized interest in 2011. The increase in capitalized interest was due to a higher level of cumulative capital expenditures associated with the TAD project in the 2012 period.

Income tax expense—We recorded income tax expense of \$12.8 million in the three months ended September 30, 2012, compared to \$5.9 million in the three months ended September 30, 2011. The effective rate for the three months ended September 30, 2012, was 40.2%, compared to an effective rate of 40.7% for the same period of 2011. Income tax expense for both quarters included interest accrued on uncertain tax positions.

Table of ContentsBusiness Segment Discussion  
Consumer Products

	Three Months Ended September 30,			
(Dollars in thousands)	2012		2011	
Net sales	\$292,959		\$285,237	
Operating income	18,453		7,075	
Percent of net sales	6.3	%	2.5	%

Our Consumer Products segment reported an increase of \$7.7 million, or 2.7%, in net sales for the three months ended September 30, 2012, compared to the three months ended September 30, 2011. The higher net sales were driven by record shipments of approximately 139,000 tons, which was a 3.5% increase over shipments in the third quarter of 2011. The higher shipments in 2012 were largely a result of increased non-retail sales, which consist of parent rolls, machine-glazed tissue, away-from-home tissue and contract manufacturing, as well as increased shipments from our converting facility in North Carolina. Shipments of retail tissue for the third quarter of 2012 were similar in volume to those for the third quarter of 2011. Overall net selling prices for tissue were slightly lower for the third quarter of 2012 compared to the same period in 2011, as higher sales prices for retail tissue in the 2012 period were more than offset by a higher proportion of lower priced non-retail sales. The increased retail tissue sales prices were largely due to a price increase that was implemented in the fourth quarter of 2011 and first quarter of 2012.

Consumer Product's operating income for the three months ended September 30, 2012, increased by \$11.4 million compared to the same period in 2011. The higher operating income for the segment was primarily due to increased net sales and lower purchased pulp costs, as well as lower costs for transportation and packaging supplies associated with net cost saving synergies from the Cellu Tissue acquisition. These favorable changes were partially offset by increased staffing, training and startup costs associated with our North Carolina paper making and converting facilities and higher incentive compensation expense.

## Pulp and Paperboard

	Three Months Ended September 30,			
(Dollars in thousands)	2012		2011	
Net sales	\$187,274		\$215,888	
Operating income	34,449		26,266	
Percent of net sales	18.4	%	12.2	%

Net sales for the Pulp and Paperboard segment decreased by \$28.6 million, or 13.3%, in the three months ended September 30, 2012, compared to the three months ended September 30, 2011. The decrease was primarily due to the sale of our Lewiston, Idaho sawmill in November 2011, which accounted for \$22.0 million of the segment's net sales in the third quarter of 2011. Paperboard net sales increased 3.0% to \$184.9 million for the three months ended September 30, 2012, due to a 5.5% increase in shipments, partially offset by a 2.4% decrease in net selling prices. Net sales of our externally sold pulp were \$2.4 million, down \$11.9 million compared to the third quarter of 2011, due primarily to our increased internal usage of the pulp we produce.

Operating income for the segment increased \$8.2 million during the three months ended September 30, 2012, compared to the three months ended September 30, 2011. The higher operating income was primarily due to lower operating costs, as a result of no major maintenance costs during the current quarter compared to major maintenance costs of \$3.1 million in the third quarter of 2011, and lower chips, sawdust, logs, chemical and energy costs. In addition, segment operating income was favorably affected by the benefits from the sale of our Lewiston, Idaho sawmill.



Table of Contents

## Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011

The following table sets forth data included in our Condensed Consolidated Statements of Operations as a percentage of net sales.

(Dollars in thousands)	Nine Months Ended September 30,					
	2012			2011		
Net sales	\$1,411,603	100.0	%	\$1,461,582	100.0	%
Costs and expenses:						
Cost of sales	(1,211,444 )	85.8		(1,297,205 )	88.8	
Selling, general and administrative expenses	(90,252 )	6.4		(81,655 )	5.6	
Total operating costs and expenses	(1,301,696 )	92.2		(1,378,860 )	94.3	
Income from operations	109,907	7.8		82,722	5.7	
Interest expense, net	(26,775 )	1.9		(34,425 )	2.4	
Other, net	—	—		585	—	
Earnings before income taxes	83,132	5.9		48,882	3.3	
Income tax provision	(38,853 )	2.8		(20,710 )	1.4	
Net earnings	\$44,279	3.1		\$28,172	1.9	

Net sales—Net sales for the nine months ended September 30, 2012, decreased by \$50.0 million, or 3.4%, compared to the same period in 2011, due to the sale of our Lewiston, Idaho sawmill in November 2011, which accounted for \$64.1 million of net sales for the first nine months of 2011. Excluding net sales from the sawmill in the first nine months of 2011, overall net sales were higher in the nine months ended September 30, 2012, due to increased shipments and higher net selling prices for our Consumer Products segment as well as increased paperboard shipments. These favorable comparisons were partially offset by lower external pulp shipments, due to increased internal usage of pulp we produce, and lower pulp and paperboard net selling prices. These items are discussed further below under “Business Segment Discussion.”

Cost of sales—Cost of sales was 85.8% of net sales for the nine months ended September 30, 2012, and 88.8% of net sales for the same period in 2011. The favorable change in cost of sales was due primarily to lower costs for purchased pulp, energy, packaging supplies and transportation, partially offset by higher chemical and maintenance costs.

Selling, general and administrative expenses—Selling, general and administrative expenses increased 0.8 percentage points as a percentage of sales for the nine months ended September 30, 2012, compared to the same period in 2011. The increase was primarily a result of higher wage and benefits expense, increased incentive compensation expense, higher director equity-based compensation expense, \$1.9 million of expense related to the First Quality/Metso Paper litigation incurred in the first half of 2012 and additional expenses associated with the integration of Cellu Tissue information systems.

Interest expense—Interest expense decreased \$7.7 million during the nine months ended September 30, 2012, compared to the same period ended 2011. The decrease was largely attributable to capitalized interest of \$9.0 million associated with our TAD project in the first nine months of 2012, compared to \$2.3 million for the same period in 2011. The increase in capitalized interest was due to a higher level of cumulative capital expenditures associated with the TAD project in the 2012 period.

Income tax expense—Our effective tax rates were 46.7% and 42.4% for the nine months ended September 30, 2012, and 2011, respectively. The net increase to our tax expense and effective tax rate in the nine months ended September 30, 2012, was primarily the result of \$6.5 million in tax expense related to our decision to convert certain gallons of alternative fuel originally claimed in 2009 under the AFMTC, which had been converted by us in 2010 to the CBPC, back to gallons under the AFMTC. The tax expense attributable to the AFMTC was comprised of \$3.4 million relating to the conversion back to the AFMTC and a resulting additional \$3.1 million increase in our liabilities for uncertain tax positions. The net increase to our tax expense and effective tax rate in the nine months ended September 30, 2011, was primarily the result of recording three main discrete items. The first was an increase in tax expense based on evaluating our state tax structure as Cellu Tissue is integrated with our operations. The second discrete item was a

decrease in tax expense associated with certain transaction costs relating to the Cellu Tissue Acquisition that were determined to be deductible under the Internal Revenue Code. The final discrete item was an increase to tax expense related to interest accrued on uncertain tax positions.

Table of Contents

## Business Segment Discussion

## Consumer Products

(Dollars in thousands)	Nine Months Ended September 30,			
	2012		2011	
Net sales	\$853,911		\$823,607	
Operating income	70,420		27,758	
Percent of net sales	8.2	%	3.4	%

Net sales for our Consumer Products segment increased \$30.3 million, or 3.7%, for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011. The increase in net sales was primarily due to a 1.6% increase in net selling prices, which was attributable to a price increase for our retail tissue products that was implemented in the fourth quarter of 2011 and the first quarter of 2012. In addition, shipments for the 2012 nine month period were higher as a result of increased case sales of retail tissue products, due in part to more shipments from our North Carolina converting facility in 2012, and higher non-retail shipments.

Operating income, which increased \$42.7 million, outpaced the growth of net sales due to favorable purchased pulp and energy costs, as well as decreased overall transportation and packaging costs due largely to net cost saving synergies from the acquisition of Cellu Tissue. These improvements were partially offset by increased staffing, training and startup costs associated with our North Carolina paper making and converting facilities, higher incentive compensation, increased commission expense and a \$1.0 million loss on the sale of legacy Cellu Tissue foam manufacturing assets.

## Pulp and Paperboard

(Dollars in thousands)	Nine Months Ended September 30,			
	2012		2011	
Net sales	\$557,692		\$637,975	
Operating income	78,108		76,370	
Percent of net sales	14.0	%	12.0	%

Net sales for the Pulp and Paperboard segment were \$80.3 million lower, or 12.6%, for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. The decrease was primarily attributable to the sale of our Lewiston, Idaho sawmill in November 2011, which accounted for \$64.1 million of the segment's net sales for the first nine months of 2011. Paperboard net sales increased slightly to \$549.5 million for the first nine months of 2012 due to a 2.2% increase in shipments, which were partially offset by a 1.5% decrease in net selling prices resulting primarily from the sale of a lower proportion of higher priced extruded product in the 2012 period. The higher overall paperboard net sales were more than offset by a \$22.7 million decrease in net sales of external pulp, which were largely attributable to increased internal usage of pulp we produce.

Operating income increased \$1.7 million for the nine months ended September 30, 2012 when compared to the same period in 2011. The higher income was primarily due to lower energy costs and administrative expenses, as well as benefits from the sale of our Lewiston, Idaho sawmill.

**EARNINGS BEFORE INTEREST, TAX, DEPRECIATION AND AMORTIZATION (EBITDA) AND ADJUSTED EBITDA**

We use earnings before interest, tax, depreciation and amortization, or EBITDA, and EBITDA adjusted for certain items, or Adjusted EBITDA, as supplemental performance measures that are not required by, or presented in accordance with generally accepted accounting principles, or GAAP. EBITDA and Adjusted EBITDA should not be considered as alternatives to net earnings, operating income or any other performance measure derived in accordance with GAAP, or as alternatives to cash flows from operating activities or a measure of our liquidity or profitability. In addition, our calculation of EBITDA and Adjusted EBITDA may or may not be comparable to similarly titled measures of other companies.



Table of Contents

We present EBITDA and Adjusted EBITDA because we believe they assist investors and analysts in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance. In addition, we use EBITDA and Adjusted EBITDA: (i) as factors in evaluating management's performance when determining incentive compensation, (ii) to evaluate the effectiveness of our business strategies and (iii) because our credit agreement and the indentures governing the 2009 Notes and 2010 Notes use measures similar to EBITDA to measure our compliance with certain covenants.

The following table provides our EBITDA and Adjusted EBITDA for the periods presented, as well as a reconciliation to net earnings.

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net earnings	\$ 19,064	\$ 8,645	\$ 44,279	\$ 28,172
Interest expense, net	7,900	12,100	26,775	34,425
Income tax provision	12,798	5,928	38,853	20,710
Depreciation and amortization expense	19,199	19,569	58,477	57,108
EBITDA	\$ 58,961	\$ 46,242	\$ 168,384	\$ 140,415
Loss on sale of foam assets	—	—	1,014	—
Expenses associated with Metso litigation	—	—	1,948	—
Adjusted EBITDA	\$ 58,961	\$ 46,242	\$ 171,346	\$ 140,415

**LIQUIDITY AND CAPITAL RESOURCES**

The following table presents information regarding our cash flows for the nine months ended September 30, 2012 and 2011:

(In thousands)	2012	2011
Net cash provided by operating activities	160,583	72,303
Net cash used for investing activities	(136,329 )	(46,157 )
Net cash used for financing activities	(13,129 )	(24,156 )
Cash Flows Summary		

Net cash provided by operating activities for the nine months ended September 30, 2012 more than doubled compared to the same period in 2011. The increase in cash provided by operating activities for the 2012 period was due primarily to cash generated from working capital, compared to cash used for working capital in the first nine months of 2011, as well as higher earnings, after adjusting for noncash items. These increases were partially offset by a \$9.2 million excess tax benefit from equity-based compensation arrangements in 2012, and a \$7.8 million increase in contributions to our qualified pension plans for the nine months ended September 30, 2012 when compared to the same period in 2011.

Cash flows used in investing activities increased \$90.2 million during the nine months ended September 30, 2012, compared to the same period in 2011. The increase was largely due to increased capital spending for plant and equipment during the first nine months of 2012, primarily associated with our TAD project. Overall cash expenditures for capital spending during the nine months ended September 30, 2012, increased by \$68.1 million over the same period in 2011.

Net cash used for financing activities was \$13.1 million for the nine months ended September 30, 2012, compared with \$24.2 million for the same period in 2011. Cash used for financing activities in the first nine months of 2012 consisted of a \$13.0 million payment of minimum tax withholdings associated with equity-based payment arrangements and \$9.4 million in treasury stock purchases, partially offset by an excess tax benefit from equity-based payments of \$9.2 million recognized in the same period.

**Capital Resources**

Due to the competitive and cyclical nature of the markets in which we operate, as well as an uncertain economic environment, there is uncertainty regarding the amount of cash flows we will generate during the next twelve months.



However, we believe that our cash flows from operations, our cash on hand and short-term investments, as well as available borrowing capacity under our revolving credit facility will be adequate to fund debt service requirements and provide cash required to support our ongoing operations, capital expenditures, and working capital needs for the next twelve months.

## Table of Contents

We may choose to refinance all or a portion of our indebtedness on or before maturity. We cannot be certain that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all. As of September 30, 2012, our short-term investments were not restricted and were largely invested in demand deposits.

### Debt Arrangements

Our debt service obligation, consisting of cash payments for interest related to our 2009 Notes and 2010 Notes, is estimated to be \$42.6 million annually for 2012 and 2013.

The terms of each of our 2010 Notes and 2009 Notes limit our ability and the ability of any restricted subsidiaries to borrow money; pay dividends; redeem or repurchase capital stock; make investments; sell assets; create restrictions on the payment of dividends or other amounts to us from any restricted subsidiaries; enter into transactions with affiliates; enter into sale and lease back transactions; create liens; and consolidate, merge or sell all or substantially all of our assets.

### Credit Arrangements

As of September 30, 2012, there were no borrowings outstanding under the credit facility, but approximately \$5.9 million of the credit facility was being used to support outstanding standby letters of credit. Loans under the credit facility bear interest at LIBOR plus between 1.75% and 2.25% for LIBOR loans, and a base rate effectively equal to the agent bank's prime rate plus between 0.25% and 0.75% for other loans. The percentage margin on all loans is based on our fixed charge coverage ratio for the last twelve months, which is recalculated on a quarterly basis. As of September 30, 2012, we would have been permitted to draw approximately \$119.1 million under the credit facility at LIBOR plus 1.75%.

### CONTRACTUAL OBLIGATIONS

As of September 30, 2012, there have been no significant changes to the contractual obligations table as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

### OFF- BALANCE SHEET ARRANGEMENTS

We currently are not a party to off-balance sheet arrangements that would require disclosure under this section.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires our management to select and apply accounting policies that best provide the framework to report the results of operations and financial position. The selection and application of those policies requires management to make difficult, subjective and complex judgments concerning reported amounts of revenue and expenses during the reporting period and the reported amounts of assets and liabilities at the date of the financial statements. As a result, it is possible that materially different amounts would be reported under different conditions or using different assumptions.

As of September 30, 2012, there have been no significant changes with regard to the critical accounting policies disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

## ITEM 3.

### Quantitative and Qualitative Disclosures About Market Risk

#### Interest Rate Risk

Our exposure to market risks on financial instruments includes interest rate risk on our secured revolving credit facility. As of September 30, 2012, there were no borrowings outstanding under the credit facility. The interest rates applied to borrowings under the credit facility are adjusted often and therefore react quickly to any movement in the general trend of market interest rates. For example, a one percentage point increase or decrease in interest rates, based on assumed outstanding credit facility borrowings of \$10.0 million, would have a \$0.1 million annual effect on interest expense. We currently do not attempt to mitigate the effects of short-term interest rate fluctuations on our credit facility borrowings through the use of derivative financial instruments.

## Table of Contents

### Commodity Risk

We are exposed to market risk for changes in natural gas commodity pricing, which we have, from time-to-time, partially mitigated through the use of firm price contracts for a portion of our natural gas requirements for our manufacturing facilities. As of September 30, 2012, we had firm-price contracts for natural gas covering approximately 18% of the expected average monthly requirements for the remainder of 2012, plus lesser amounts in 2013.

We also have agreements with suppliers to purchase pulp and chemicals at market-based prices covering approximately 33% and 42%, respectively, of our current expected remaining 2012 pulp and chemical needs. These contracts for natural gas, pulp and chemicals qualify for treatment as “normal purchases or normal sales” under authoritative guidance and thus require no mark-to-market adjustment.

### Foreign Currency Risk

We have minimal foreign currency exchange risk. Virtually all of our international sales are denominated in U.S. dollars.

## ITEM 4.

### Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Subject to the limitations noted above, our management, with the participation of our CEO and CFO, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the third quarter of 2012. Based on that evaluation, the CEO and CFO have concluded that, as of September 30, 2012, our disclosure controls and procedures were effective to meet the objective for which they were designed and operated at the reasonable assurance level.

### Changes in Internal Controls

There was no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## Part II

## ITEM 1.

### Legal Proceedings

In 2010, we contracted with Metso Paper USA to construct the TAD paper machine for our North Carolina facilities. On August 2, 2011, First Quality Tissue SE, LLC, or First Quality, filed a complaint against Metso Paper in the Court of Common Pleas of South Carolina, Anderson County alleging breach of contract and requesting a permanent injunction. First Quality contended that Metso Paper’s sale of a TAD paper machine to Clearwater Paper violated the restrictive covenant in First Quality’s agreement with Metso Paper. On September 13, 2011, Metso Paper removed the case to the United States District Court for the District of South Carolina. We filed a motion to intervene in the litigation to protect our interests, which was granted by the court on November 29, 2011. On December 9, 2011, the court denied First Quality’s motion for a preliminary injunction. On June 20, 2012 following a six day trial before a federal magistrate judge that began on May 7, 2012, and post-trial briefing, the court denied First Quality’s request for

a permanent injunction and dismissed its amended complaint with prejudice. The court entered judgment in favor of Clearwater Paper and Metso Paper on June 21, 2012. The period for an appeal as of right by First Quality expired on July 23, 2012.

Table of Contents

On August 13, 2012, Clearwater Paper was notified that the U.S. Environmental Protection Agency (“EPA”) submitted a civil referral to the U.S. Department of Justice (“DOJ”) alleging violations of the Clean Air Act stemming from an EPA investigation that included an inspection of our Lewiston, Idaho pulp facility in July 2009 and a subsequent information request dated February 24, 2011. Prior to the filing of any formal action, we and the DOJ agreed to discuss the resolution of the allegations. On September 14, 2012, the parties entered into an agreement to toll the statute of limitations. The tolling agreement expires on March 29, 2013, unless further extended by the parties. Discussions with the DOJ and EPA are ongoing.

In addition to the matters discussed above, we may from time to time be involved in claims, proceedings and litigation arising from our business and property ownership. We believe, based on currently available information, that the results of such proceedings, in the aggregate, will not have a material adverse effect on our financial condition.

## ITEM 1A.

## Risk Factors

Other than the favorable ruling in the lawsuit between First Quality and Metso Paper, as discussed above in Part II, Item 1, there are no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011. See Part I, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2011, entitled “Risk Factors.”

## ITEM 2.

## Unregistered Sales of Equity Securities and Uses of Proceeds

## Issuer Purchases of Equity Securities

On July 28, 2011, we announced a stock repurchase program approved by our Board of Directors authorizing the company to purchase up to \$30 million in shares of our common stock. Under our stock repurchase program, which does not have an expiration date, we may repurchase shares in the open market or as otherwise may be determined by management, subject to market conditions, business opportunities and other factors. During the three months ended September 30, 2012, we repurchased 50,300 shares of our outstanding common stock at an average price of \$37.48 per share under this share repurchase program. As of September 30, 2012, approximately \$9.3 million of the authorization remains.

The following table provides information about share repurchases that we made during the three months ended September 30, 2012 (in thousands, except share and per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
July 1, 2012 to July 31, 2012	—	\$—	—	\$11,181
August 1, 2012 to August 31, 2012	16,900	\$36.87	16,900	\$10,558
September 1, 2012 to September 31, 2012	33,400	\$37.75	33,400	\$9,296
Total	50,300	\$37.48	50,300	

## ITEM 6. Exhibits

The exhibit index is located on page 35 of this Form 10-Q.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CLEARWATER PAPER CORPORATION  
(Registrant)

Date: November 2, 2012

By

/s/ JOHN D. HERTZ  
John D. Hertz  
Senior Vice President, Finance and  
Chief Financial Officer  
(Duly Authorized Officer; Principal  
Financial Officer)

Date: November 2, 2012

By

/s/ JOHNATHAN D. HUNTER  
Johnathan D. Hunter  
Vice President, Corporate Controller  
(Duly Authorized Officer; Principal  
Accounting Officer)

Table of Contents

CLEARWATER PAPER CORPORATION  
EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION
10.5(i) <sup>1</sup>	Amendment to Employment Agreement between Gordon L. Jones and the Company, dated effective October 4, 2012.
10.10(vii) <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan-Form of Restricted Stock Unit Award, to be used for special restricted stock unit awards.
10.10(viii) <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan-Form of RSU Deferral Agreement for Annual LTIP RSUs.
(31)	Rule 13a-14(a)/15d-14(a) Certifications.
(32)*	Furnished statements of the Chief Executive Officer and Chief Financial Officer under 18 U.S.C Section 1350.
101.INS**	XBRL Instance Document.
101.SCH**	XBRL Taxonomy Extension Schema.
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF**	XBRL Taxonomy Extension Definition Linkbase.
101.LAB**	XBRL Taxonomy Extension Label Linkbase.
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase.

- <sup>1</sup> Management contract or compensatory plan, contract or arrangement.  
In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 34-47986, the certifications furnished in Exhibit 32 hereto are deemed to accompany this Form 10-Q and will not be deemed “filed” for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act.
- \* In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed “filed” for purposes of Section 18 of the Exchange Act. Such exhibits will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act.
- \*\*