KAPSTONE PAPER & PACKAGING CORP
Form 10-K
March 31, 2009

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

FORM 10-K

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

For the fiscal year ended December 31, 2008

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

For the transition period from to
Commission File No.: 001-33494

KapStone Paper and Packaging Corporation
(Exact Name of Registrant as Specified in its Charter)

Delaware	**20-2699372**
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

KapStone Paper and Packaging Corporation
1101 Skokie Blvd. Suite 300
Northbrook, IL 60062
(Address of Principal Executive Offices) (ZIP Code)

Registrant's telephone number, including area code: **(847) 239-8800**

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

Title of Each Class	**Name of Exchange On Which Registered**
Common Stock (Par Value $.0001)	Nasdaq Stock Market, LLC
Warrants to purchase Common Stock	Nasdaq Stock Market, LLC

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: **NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been

subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of the above in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o	Accelerated Filer ý	Non-Accelerated Filer o	Smaller Reporting Company o

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

The aggregate market value of the 18,172,973 shares of Common Stock held by non-affiliates of the registrant on June 30, 2008 was $121,213,730. This calculation was made using a price per share of Common Stock of $6.67, the closing price of the Common Stock on the NASDAQ on June 30, 2008, the last day of the registrant's most recently completed second fiscal quarter of 2008. Solely for purposes of this calculation, all shares held by directors and executive officers of the registrant have been excluded. This exclusion should not be deemed an admission that these individuals are affiliates of the registrant.

On February 28, 2009, the number of shares of Common Stock outstanding, excluding 40,000 treasury shares, was 28,370,248.

DOCUMENTS INCORPORATED BY REFERENCE:

The registrant's Definitive Proxy Statement for its 2009 Annual Meeting of Stockholders will be filed with the Securities and Exchange Commission no later than 120 days after the end of the fiscal year covered by this Form 10-K pursuant to General Instruction G(3) of the Form 10-K. Information from such Definitive Proxy Statement will be incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 hereof.

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Forward Looking Statements.

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about us, including the risks set forth in Item 1A. Risk Factors below, that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may," "should," "could," "would," "expect," "plan," "anticipate," "believe," "estimate," "continue," or the negative of such terms or other similar expressions. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those described in our other Securities and Exchange Commission filings. All subsequent written and oral forward-looking statements attributable to KapStone or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph. KapStone disclaims any intention or obligation to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

PART I

Item 1. Business

Overview

KapStone Paper and Packaging Corporation, formerly Stone Arcade Acquisition Corporation, ("KapStone" or the "Company") was formed in Delaware as a special purpose acquisition corporation on April 15, 2005 for the purpose of effecting a merger, capital stock exchange, asset acquisition or other similar business combination with an unidentified operating business in the paper, packaging, forest products and related industries.

On August 19, 2005, we consummated our initial public offering of 20,000,000 units with each unit consisting of one share of our common stock and two warrants. Each warrant entitles the holder to purchase one share of our common stock at an exercise price of $5.00 per share. The units sold in our initial public offering were sold at an offering price of $6.00 per unit, generating gross proceeds of $120.0 million.

On January 2, 2007, we consummated the purchase from International Paper Company ("IP") of substantially all of the assets, and the assumption of certain liabilities, of the Kraft Papers Business ("KPB") for $155 million subject to certain adjustments. The assets consisted of an unbleached kraft paper manufacturing facility in Roanoke Rapids, North Carolina, and Ride Rite® Converting, an inflatable dunnage bag manufacturer located in Fordyce, Arkansas, trade accounts receivable and inventories. The liabilities assumed consisted of trade accounts payable, accrued expenses and certain long-term liabilities. The purchase price included two contingent earn-out payments of up to $60 million if certain EBITDA targets are achieved. We obtained a $95 million senior secured credit facility from LaSalle Bank National Association, which was used to fund a portion of the KPB purchase price.

On July 1, 2008, we consummated the purchase from MeadWestvaco Corporation ("MWV") of substantially all of the assets and the assumption of certain liabilities of the Charleston Kraft Division ("CKD"), for $485 million, subject to certain adjustments. The assets consisted of an unbleached kraft paper manufacturing facility in North Charleston, South Carolina, including a cogeneration facility, chip mills located in Elgin, Hampton, Andrews and Kinards, South Carolina and a lumber mill located in Summerville, South Carolina, trade accounts receivables and inventories. The liabilities assumed consisted of trade accounts payable, accrued expenses and certain long-term liabilities.

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The CKD acquisition was financed by cash on hand and by a new senior secured credit facility of $515 million consisting of a five-year term loan of $390 million, a seven-year term loan of $25 million and a $100 million revolving credit facility. In addition, $40 million of seven-year 8.30% senior notes were issued. As part of the transaction the Company paid off the remaining amount due under its prior credit facility.

The CKD business was deemed an attractive acquisition candidate based upon meeting the Company's objectives of being a North American-based, profitable company in the paper and packaging industry and for its synergies with the Company's existing operations.

Acquisitions

We intend to pursue other acquisition opportunities in an effort to diversify and/or grow our business. We have been and continue to be engaged in evaluating a number of potential acquisition opportunities and have had preliminary discussions with several potential targets. No assurance can be given that we will consummate additional transactions. The structuring and financing of any future acquisitions may be dependent on the terms and availability of additional financing to us that either replaces or does not conflict with the Company's existing senior secured credit facility.

General

We produce and sell a variety of unbleached kraft paper, linerboard, folding carton board, saturating kraft, inflatable dunnage bags and dimensional lumber. We review our business based on the following operating segments: unbleached kraft, dunnage bags and lumber.

In 2008, following completion of the CKD acquisition, the Company determined, in accordance with Statement of Financial Accounting No. 131, *Disclosures about* Segments *of an Enterprise and Related Information*, to make changes to its reportable segments. All segment disclosures in this Report are presented in conformance with the new presentation. For additional information regarding the change in segments, and the results of our segments, please see Note 16 of the Notes to Consolidated Financial Statements.

Industry Overview

Unbleached kraft paper market

We view the unbleached kraft paper market as including unbleached kraft paper, linerboard, saturating kraft and unbleached folding carton stock.

American Forest and Paper Association ("AF&PA") estimates that the size of the U.S. unbleached kraft paper market was approximately 1.56 million tons in 2008 up slightly from 1.55 million tons in 2007. The U.S. produced 1.49 million tons in 2008 compared to 1.36 million tons in 2007. In 2008, 0.25 million tons were imported and 0.18 million tons were exported. In 2007, 0.36 million tons were imported and 0.17 million tons were exported. U.S. operating rates for 2008 and 2007 were approximately 93% and 94%, respectively, based on the AF&PA's 48th Annual Capacity Survey. The kraft paper market is comprised of three general product types: (1) Multiwall; (2) Specialty converting (including rollwrap); and (3) Grocery bag and sack.

Both the multiwall packaging markets and the grocery bag and sack markets contracted between 2001 and 2008. The multiwall market contracted due to conversion to plastics in certain end-use markets (primarily in the insulation and lawn and garden markets) as well as the transition to 2-ply extensible sack packaging in certain markets (primarily in the cement market) where the package was considered a large percentage in the overall cost of the total product.

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In 2007, the Department of Commerce announced antidumping duties to be imposed on imports of laminated woven sacks from China. The duties will be an important first step for Paper Shipping Sack Manufacturers' Association, Inc. ("PSSMA") members in regaining market share.

Linerboard is primarily used to manufacture corrugated containers for packaging products. U.S. demand for corrugated boxes and linerboard tends to be driven by industrial production of processed foods, nondurable goods as well as certain durable goods. AF&PA reported that 2008 linerboard production of approximately 24.2 million tons was down from 25.2 million tons in 2007 resulting in a reduction in capacity utilization of 6.2% to 91%. We target our linerboard for specialty independent corrugated and laminated products customers who focus on specialty niche packaging.

Saturating kraft is a worldwide market of approximately 850,000 tons in 2008. It is a specialty product where the three major manufacturers (KapStone, International Paper, and Stora Enso) produce approximately 75% of the world's requirement. The remainder is supplied by local producers of lower quality material in various regions of the world. There are no published statistics for this grade. KapStone, through internal research believes that growth rates for the grade are greater than 3% per year for China, India, Southeast Asia, Latin America and portions of Europe. The overall market from 2007 through 2008 is flat due to declines in North America and the majority of Western Europe. Demand is affected by construction, remodeling activity, electronics manufacturing, and furniture manufacturing in the various regions of the world. Barriers to entry for producing high quality saturating kraft are high as it is a technically difficult grade to produce.

Unbleached, uncoated folding carton stock is a North American market of approximately 350,000 tons of production in 2008. The Company's Kraftpak® product is a unique low density, virgin fiber grade competing in this market with uncoated recycled board ("URB"). Major URB producers include Newark, Rock Tenn and Caraustar. KapStone believes that total unbleached folding carton production in North America was approximately flat in 2008 compared to 2007. Kraftpak® has also successfully found applications for consumer brands that are changing their image to promote environmental friendliness and sustainability. KapStone believes that these are the best growth opportunities for Kraftpak® in that they take share from Coated Recycled Board, Coated Natural Kraft Board, and Solid Bleached Sulfate Board, which are much larger markets.

Dunnage bags market

The demand for dunnage bags, which are used to protect products during transportation, is correlated to the general freight transportation industry. The American Trucking Association ("ATA") estimates that nearly 70% of U.S. freight volume, which includes general and bulk freight, is transported by trucks.

Lumber market

Lumber is a commodity business tied closely to housing starts and remodeling activity. Weak activity in the housing market in 2007 and 2008 has negatively impacted both volume and pricing. The Company's lumber mill in Summerville is an efficient, high quality producer with a focus on excellent service to local lumber retailers and treating companies in order to maximize profitability.

Customers

Unbleached kraft

The unbleached kraft segment has over 400 customers, many of which are leading world class converters of kraft paper. In 2007 the unbleached kraft segment had approximately 100 customers. Upon acquiring CKD in July of 2008, the unbleached kraft segment had approximately 400 customers of which approximately 100 were based in foreign countries. The segment's top three customers

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accounted for approximately $118.0 million, $92.9 million and $100.4 million of consolidated net sales in 2008, 2007 and 2006, or approximately 24.3%, 40.8% and 46.9% of all unbleached kraft revenues generated in 2008, 2007 and 2006, respectively. Graphic Packaging accounted for 10.7% of consolidated net sales in 2008. Altivity Packaging Corporation and Exopack, LLC, accounted for 17.1% and 10.4% of consolidated net sales in 2007, respectively, and 20.3% and 11.1% of consolidated net sales in 2006, respectively. In 2008, Graphic Packaging acquired Altivity Packaging Corporation. Kapstone continues to build long-term relationships, most of which were established by KPB as a division of IP and CKD as a division of MWV. We believe that the risk of losing customers or business with customers is reduced due to the long-term relationships that have been established.

Linerboard is sold to converters in the corrugated box industry and to other converters for a variety of end uses including laminated tier sheets for the bottling industry and wrapping material, among others. The focus is on independent producers who do not have their own mill systems or producers who commonly purchase liner on the open market.

Our Saturating Kraft customer base is evenly split between three geographic regions, the Americas, Europe and Asia. Approximately 70% of our sales are exports to customers in Europe, Latin America and Asia where growth opportunities are favorable. KapStone or its Predecessor have done business with many of these customers for well over 30 years. Some customers have consolidated to form a greater presence in their markets. Customer consolidation is particularly evident for North America and just in the beginning phase in Europe. In Asia, there are numerous players and it is a highly fragmented market making it difficult entry for some companies that do not have a presence in the region.

Our major customers' end-use markets are in the thin high pressure laminates (HPL) creating decorative surfaces such as kitchen and bath countertops, home and office furniture and flooring. In Europe, there is a growing and distinct HPL segment that involves a much thicker product called Compact laminates, which create surfacing products such as exterior cladding, partitions and doors. In Asia, there is significant use of our products for the manufacturing of Printed Circuit Boards (PCB) and Copper Clad Laminates (CCL) and there is also a growing use for thin HPL in Decorative surfaces. KapStone has acquired a leadership position through knowledge of our markets and understanding the technical needs of our customers' manufacturing process and the demanding requirements of their products.

Dunnage bags

The dunnage bags segment sold under the Ride Rite® Converting brand has a customer base consisting of leading distributors of shipping and packing materials, manufacturers, less-than-truckload carriers and retail regional distribution centers. No customer in the dunnage bag segment accounted for more than 10% of consolidated net sales for the years 2008, 2007 and 2006. The segment's top ten customers accounted for $20.9 million of net sales in 2008, $20.3 million of net sales in 2007 and $23.2 million of net sales in 2006, representing 63%, 62% and 65% of Ride Rite® Converting's net sales in 2008, 2007 and 2006, respectively. In connection with the KPB acquisition, IP entered into an agreement to continue purchasing dunnage bags from Ride Rite® Converting for a period of five years.

In February 2008, Sunrise Arkansas, a large customer in our dunnage bag segment, was purchased by Illinois Tool Works ("ITW"). ITW also owns Shippers Products Inc., which manufactures dunnage bags and competes directly with Ride Rite® Converting.

Lumber

Our lumber business sells approximately 58% of its lumber to third parties who apply preservatives to the product and resell it for exterior applications. Approximately 18% is sold for industrial applications, 14% to wholesalers, 7% to retail stores and 3% for engineered wood applications. The

lumber business has approximately 95 customers. Approximately 47% of revenues is under contracts which are generally a year in length. No customer in the lumber segment accounted for more than 10% of consolidated net sales for the year ended December 31, 2008.

Sales and Marketing

The sales and marketing team works directly with our technical, manufacturing and product development teams to offer solutions and meet new customer demands and product requirements. We market and sell our products through a national sales force for our domestic unbleached kraft business. Our international unbleached kraft business is supported by sales teams based in Europe and Asia. We sell export linerboard to unaffiliated resellers. Our dunnage bag and lumber businesses are supported by their own dedicated sales force.

Manufacturing and Distribution

Unbleached kraft

Our unbleached kraft paper and board manufacturing facilities are based in Roanoke Rapids, North Carolina and North Charleston, South Carolina and includes production facilities consisting of integrated pulp and paper mills that produce unbleached kraft paper, linerboard, saturating kraft products sold under the DuraSorb® brand and folding carton board sold under the Kraftpak® brand. Our Roanoke Rapids paper mill began operations in 1907 and North Charleston paper mill began operations in 1937.

The Company's paper mills' annual production capacity is approximately 1.3 million tons. The Company offers a portfolio of product grades, which are sold to customers who convert them into a wide range of products. The kraft paper is primarily used to produce multiwall bags for agricultural products, pet food, cement and chemicals, grocery bags and specialty conversion products such as wrapping paper products, dunnage bags and rollwrap. The linerboard grades are primarily used to produce manufacturing corrugated containers for packaging products. DuraSorb® saturating kraft is primarily used to manufacture decorative laminates used in home and office furniture products and industrial laminates and overlays used in electronics and construction applications. Kraftpak® folding carton board is an unbleached board used in the manufacture of folding cartons.

The Company's facilities are in good operating condition and are suited for the purpose for which they are presently being used. Machinery and equipment is regularly inspected to maintain good working order through annual planned maintenance outages.

Softwood pulp used to make unbleached kraft paper, folding carton board and linerboard is produced from a combination of locally sourced roundwood and pine woodchips. After the wood is debarked and chipped, the chips are loaded into digesters for cooking. Woodchips, chemicals and steam are mixed in the digester to produce softwood pulp. Hardwood pulp is produced in North Charleston in a similar fashion for the production of DuraSorb® saturating kraft. The pulp is screened and washed through a series of washers, and then stored prior to the paper making process. The Company processes softwood pulp using up to five unbleached kraft paper machines. Management monitors productivity on a real-time basis with on-line reporting tools that track production values versus targets. Overall equipment efficiency is also monitored daily through production reporting systems.

The majority of our domestic sales are distributed directly to customers who convert the paper into end-market finished products. Export linerboard paper is sold primarily to third party resellers.

Dunnage bags

Our dunnage bag business, based in Fordyce, Arkansas, produces and sells inflatable paper dunnage bags under the Ride Rite® Converting trademark. The bags are constructed of an internal

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poly liner encased by multiple layers of high strength unbleached kraft paper and/or linerboard and are used to secure freight to minimize movement and potential damage of goods and products during transport. Ride Rite® Converting uses unbleached kraft paper produced by the unbleached kraft segment for approximately two-thirds of its requirements. Additionally, the bags have an optional reusable valve design, which allows for the inflation and deflation of the bags for multiple uses. Ride Rite® Converting produces over 230 varieties of its inflatable dunnage bags. Ride Rite® Converting products are sold to manufacturers, less-than-trailer-load distributors, and retail regional distribution centers.

Lumber

Our Summerville lumber mill produces approximately 95 million board feet per year of kiln dried, southern pine lumber in many dimensions. Significant amounts of its products in decking, timbers and dimension lumber of various grades are sold to customers who apply preservatives to the lumber and resell it for exterior applications. Other customers purchase lumber for the manufacture of engineered wood trusses and resale through local or national brand building supply stores or for various industrial uses in the packaging and pallet industries. The lumber mill produces residual softwood chips from sawmilling as well as chips from a pulpwood chipping operation to supply the North Charleston paper mill.

Transitional Support

We have entered into two transitional services agreements to provide for certain services, including information technology and centralized transaction processing, until we could convert acquisitions to our own ERP systems. The term of each of the services ranges from six months to approximately 18 months, but our goal is to terminate all of the services promptly in order to reduce costs. Our transitional support services from IP ended in April 2008. Our transitional service agreement with MWV, which began on July 1, 2008, is projected to continue throughout 2009. The total cost of transferring services from IP to us was approximately $6.0 million, consisting primarily of the cost of installing a new enterprise resource planning system which included general ledger, order entry and receivables management, purchasing and payment plus additional modules. The system supports operations in North Carolina and Arkansas as well as the corporate headquarters. The transitional services being provided by MWV is estimated at approximately $9.0 million in total from July 1, 2008 through the third quarter of 2009. We expect to incur approximately $8.0 million to migrate and upgrade the Charleston operations to our Enterprise Resource Planning System ("ERP").

Suppliers

Unbleached kraft

The raw materials needed to process unbleached kraft paper and related products consists primarily of roundwood, woodchips and chemicals. In addition, we purchase coal, fuel oil and natural gas to run boilers and our cogeneration facility in South Carolina. We believe that these raw materials are readily available and that there are a number of suppliers from whom the materials can be bought in the open market.

In 2008 approximately 20% of our combined paper mills' fiber supply (roundwood and woodchips) was delivered under long-term supply agreements. Upon acquisition of the CDK business from MWV, we entered into a 15 year fiber supply agreement whereby MWV provides us with up to 25% of our South Carolina fiber requirements with prices tied to a market index. The balance of fiber is purchased from third parties in North Carolina, Virginia, Georgia and South Carolina.

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The primary chemical used in our pulp making process is caustic soda and is purchased at market prices. We have fixed-pricing contracts with two long-term suppliers for coal. Fuel oil is purchased from third parties at market prices.

Typical contracts for raw materials range from one to three years in length and are at fixed pricing or tied to a documented moving index for each material. As costs for raw materials, supplies and services increase, we implement price increases to recover these rising material costs from our customers, when possible. We currently do not use futures contracts or enter into hedging arrangements to manage the risk of fluctuations in coal or fuel prices. Thus, if we cannot pass on the rise in energy or other costs to our customers, such rise in costs will have an adverse effect on our gross profit margins.

Dunnage bags

Ride Rite® Converting purchases approximately two-thirds of its kraft paper requirements from KapStone's unbleached kraft operating segment. Other key materials such as resin and valves are purchased from a combination of domestic and foreign suppliers.

Lumber

Approximately 60% of the saw timber used in lumber production is supplied by MWV under the terms of a 15 year fiber supply agreement. The remaining saw timber is sourced from other third parties.

Competition

Unbleached kraft

We are one of the leading manufacturers of unbleached kraft paper in North America. Other key U.S. market suppliers are Georgia-Pacific Corporation, Longview Fibre, Delta Natural, and Smurfit Stone. A number of other competitors comprise the remainder of North American unbleached kraft paper production.

We believe the key parameters on which North American unbleached kraft suppliers compete are supply reliability, delivered price and product quality. KPB and now Kapstone have longstanding relationships with many of their customers and historically have entered into contracts with initial terms of at least two years. We believe our longstanding relationships are based on our ability to provide the best value proposition to our customers through quality products, consistent and reliable service and technical innovation.

The overall U.S. linerboard capacity is in excess of 25 million tons. As such the market share between our two mills is just over two percent. International Paper is the largest producer, followed by Smurfit-Stone Container, Georgia-Pacific and Temple-Inland Packaging Corporation. Our emphasis is on the independent producers of corrugated packaging and other users of linerboard. The products we produce are included in the grouping known as Kraft liner which is considered a premium product of the linerboard market.

Dunnage bags

We believe that two companies that account for over 50% of the North American paper inflatable dunnage bag market: Ride Rite® Converting and Shippers Products Inc., a division of ITW.

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Lumber

Competition for our lumber business includes large multisite companies such as New South, West Fraser, International Paper and Georgia Pacific, as well as smaller local sawmills.

Environmental Regulation

Our operations are subject to environmental regulation by federal, state, and local authorities in the United States, including requirements that regulate discharge into the environment, waste management, and remediation of environmental contamination. Environmental permits are required for the operation of our businesses and are subject to revocation, modification and renewal. Governmental authorities have the power to enforce compliance with environmental requirements and violators are subject to injunctions, civil penalties and criminal fines. Third parties may also have the right to sue to enforce compliance with such regulations.

KapStone is committed to maintaining high environmental quality standards which meet or exceed those established by all relevant environmental laws, regulations and other applicable requirements including Sustainable Forestry Initiatives. KapStone's goal is 100% compliance with all environmental laws and regulations wherever we do business. This is achieved by identifying, understanding and giving priority consideration to the environmental aspects and impacts of KapStone's activities, products and services while integrating continual environmental improvement, pollution prevention and employee diligence into daily operations.

On September 13, 2004, EPA published the Boiler MACT regulations affecting industrial boilers and process heaters burning all fuel types with the exception of small gas-fired units. On July 30, 2007, the U.S. Court of Appeals for the D.C. Circuit remanded and vacated the Boiler MACT. We continue to monitor the process the EPA is undertaking to develop new standards for industrial boilers and process heaters so that we can determine our liability regarding any future related regulations.

On July 30, 2004, EPA published the Plywood and Composite Wood Panel (or PCWP) MACT standards. Our Summerville lumber mill is in compliance with PCWP MACT which required compliance by October 1, 2008.

The EPA is continuing the development of new programs and standards such as additional wastewater discharge allocations, water intake structure requirements and national ambient air quality standards. We believe that our operations are in compliance in all material respects with all current environmental regulations and are not aware of any pending regulatory agency compliance actions.

The U.S. Congress is actively considering legislation to reduce emissions of greenhouse gases. In addition, several states have already taken legal measures to require the reduction of emissions of greenhouse gases by companies and public utilities, primarily through the planned development of greenhouse gas emission inventories and/or regional greenhouse gas cap and trade programs. Passage of climate control legislation by Congress or various states of the U.S., or the adoption of regulations by the Environmental Protection Agency or analogous state agencies that restrict emissions of greenhouse gases in areas in which we conduct business, may have a material effect on our operations in the United States. We expect that we will not be disproportionately impacted by these measures as compared to typical owners of comparable properties in the United States.

Employees

At December 31, 2008, KapStone had approximately 1,750 employees. Of these employees, approximately 1,100 employees were covered by collective bargaining agreements with the United Steel Workers. Currently, there are collective bargaining agreements in place with union employees in Roanoke Rapids, North Carolina, through August 31, 2010, in North Charleston, South Carolina

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through June 30, 2009 and with Ride Rite® Converting through June 30, 2011. We believe that we have a good relationship with our employees and union leadership.

In January 2007, upon consummation of the acquisition of KPB, we began hiring a corporate staff to manage our operations. This included a vice president and chief financial officer, a vice president and general manager to manage KPB and other corporate staff employees. Additional hiring at the corporate headquarters occurred throughout 2007 and 2008.

As part of the CKD acquisition, we acquired 11 employees who are located in Europe and Asia. These employees perform sales and order entry activities in support of the Company's export shipments to customers based in Europe and Asia.

International Sales

For the years ended December 31, 2008 and 2007 the Company had export shipments from the United States to customers in foreign countries of $165 million and $44 million, respectively. No foreign country accounted for more than 10% of consolidated net sales for either year.

Executive Officers of Registrant

Our executive officers are as follows:

Name	Age	Position
Roger W. Stone	74	Chairman of the Board and Chief Executive Officer
Matthew Kaplan	52	President and Secretary
Andrea K. Tarbox	58	Vice President and Chief Financial Officer
Timothy P. Keneally	61	Vice President and General Manager

Roger W. Stone has been Chairman of the Board and Chief Executive Officer since our inception. Mr. Stone was Manager of Stone-Kaplan Investments, LLC, a private investment company, from July 2004 through December 2007. He was Chairman and Chief Executive Officer of Box USA Holdings, Inc., a corrugated box manufacturer, from July 2000 until the sale of that company in July 2004. Mr. Stone was Chairman, President and Chief Executive Officer of Stone Container Corporation, a multinational paper company primarily producing and selling pulp, paper and packaging products, from March 1987 to November 1998 when Stone Container Corporation merged with Jefferson Smurfit Corporation, at which time he became President and Chief Executive Officer of Smurfit-Stone Container Corporation until March 1999. Mr. Stone has served on the board of directors of McDonald's Corporation since 1989. Mr. Stone received a B.S. in Economics from the Wharton School at the University of Pennsylvania. Mr. Stone is the father-in-law of Matthew Kaplan.

Matthew Kaplan has been our President and Secretary since our inception. Mr. Kaplan was Manager of Stone-Kaplan Investments, LLC, a private investment company, from July 2004 through December 2007. He was President, Chief Operating Officer and a director of Box USA Holdings, Inc., a corrugated box manufacturer, from July 2000 until the sale of the company in July 2004. Mr. Kaplan began his career at Stone Container Corporation in 1979 and was serving as its Senior Vice President and General Manager of North American Operations when Stone Container Corporation merged with Jefferson Smurfit Corporation in November 1998. He was Vice President/General Manager, Container Division with Smurfit-Stone Container Corporation until March 1999. Mr. Kaplan has served on the board of advisors of Victory Packaging since January 2007. In addition, Mr. Kaplan has also served on the board of trustees of Magnetar Spectrum Fund since November 2007. Mr. Kaplan received a B.A. from the Wharton School in Economics from the University of Pennsylvania and an M.B.A. from the University of Chicago. Mr. Kaplan is the son-in-law of Roger W. Stone.

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Andrea K. Tarbox was appointed Vice President and Chief Financial Officer in January 2007. Ms. Tarbox served as a financial consultant to the Company from April 2006 until her appointment as Vice President and Chief Financial Officer. Ms. Tarbox played a key financial role in the acquisition by the Company of the Kraft Papers Business from International Paper Company. From March 2003 through March 2006, Ms. Tarbox served as Chief Financial and Administrative Officer for Uniscribe Professional Services, Inc. From July 1994 until February 2003, Ms. Tarbox was employed by Gartner Inc., last serving as Group Vice President-Finance and Treasurer. Prior to that, Ms. Tarbox had assumed financial positions of increasing responsibility in several global companies including British Petroleum, p.l.c. and Fortune Brands, Inc. Ms. Tarbox began her career with Ernst & Young LLP and is a Certified Public Accountant. Ms. Tarbox earned a B.A. degree in Psychology from Connecticut College and an M.B.A. from the University of Rhode Island.

Timothy P. Keneally has been our Vice President and General Manager of the kraft paper business since its acquisition from International Paper in January 2007. Previously, Mr. Keneally led the International Paper team that assessed the review of strategic alternatives relating to the kraft paper business. He was the lead person in presenting the historical performance of the business and assisted in defining the future strategy for the business. Mr. Keneally has 35 years of experience in the paper and packaging industry. Mr. Keneally earned a B.A. degree in History from Marist College in Poughkeepsie, NY.

Website Access to Company Reports

The Company's annual reports on Form 10-K, including this Form 10-K, as well as the quarterly reports on Form 10-Q and current reports on Form 8-K, and all amendments to those reports are filed electronically with the Securities and Exchange Commission ("SEC") and are also available free of charge through our website, *www.kapstonepaper.com* as soon as reasonably practicable after such material is filed electronically with, or furnished to, the SEC. Also, copies of our annual report will be made available, free of charge, upon written request.

Item 1A Risk Factors

You should carefully consider the following risk factors, together with the other information contained in this annual report on Form 10-K, in evaluating us and our business before making an investment decision regarding our securities. If any of the events or circumstances described in the following risk factors were to actually occur, our business, financial condition or results of operations could be materially and adversely affected. The risks listed below are not the only risks that we face.

Risks associated with our business

Recent changes in U.S. and global economic conditions could have a continuing adverse effect on the profitability of some or all of our businesses.

Recent concerns over declining consumer and business confidence, the availability and cost of credit, reduced consumer spending and business investment, the volatility and strength of the capital and credit markets, and inflation all affect the business and economic environment and, ultimately, the profitability of our business. In an economic downturn characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment and lower consumer spending, the demand for our products is adversely affected. Adverse changes in the economy could negatively affect earnings and could have a material adverse effect on our business, results of operations, cash flows and financial position. We cannot predict whether or when such circumstances may occur, or what impact, if any such circumstances could have on our business, results of operations, cash flows and financial position.

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Conditions in the global capital and credit markets and the economy generally may materially adversely affect our business, results of operations and financial position and we do not expect these conditions to improve in the near future.

Our results of operations and financial position could be materially affected by adverse changes in the global capital and credit markets and the economy generally, including recent declines in consumer and business confidence and spending, both in the U.S. and elsewhere around the world. The capital and credit markets have been experiencing extreme volatility and disruption in recent months. In some cases, these markets have exerted downward pressure on availability of liquidity and credit and increased the costs of credit when such credit is available. Conditions in the capital and credit markets and the effects of the declines in consumer and business confidence and spending may adversely impact the ability of our lenders, suppliers and customers to conduct their business activities. The consequences of such adverse effects could include the interruption of production at the facilities of our customers, the reduction, delay or cancellation of customer orders, delays in or the inability of customers to obtain financing to purchase our products, and bankruptcy of customers or other creditors. Moreover, the current worldwide financial crisis has reduced the availability of liquidity and credit to fund or support the continuation and expansion of business operations worldwide as many lenders and institutional investors have reduced and, in some cases, ceased to provide funding to borrowers.

While we have procedures to monitor and limit exposure to credit risk, there can be no assurance such procedures will effectively limit our credit risk and avoid losses, which could have a material adverse effect on our financial condition and operating results.

We rely on key customers.

During the year ended December 31, 2008, our largest customer, Graphic Packaging, accounted for approximately 10.7% of consolidated net sales. This customer is in the unbleached kraft operating segment. A loss of this customer or other key customers could significantly impact our financial results.

We are dependent upon key management executives whose loss may adversely impact our business.

Our success depends significantly on the efforts and abilities of Roger W. Stone, Chairman of the Board and Chief Executive Officer, and Matthew Kaplan, President. The loss of services of one or both of these individuals could have a material adverse effect on our business.

In addition, we depend on the expertise, experience and continued services of KPB's and CKD's management. The loss of such management, or an inability to attract or retain other key individuals, could materially adversely affect us. We seek to compensate management, as well as other employees, through competitive salaries, bonuses and other incentive plans, but there can be no assurance that these programs will allow us to retain key management executives or hire new key employees.

KapStone's substantial indebtedness may adversely affect its financial health.

As of December 31, 2008, KapStone had an aggregate principal amount of approximately $440 million of outstanding debt. As a result of the indebtedness, KapStone's ability to obtain additional financing for working capital, capital expenditures, acquisitions or other general corporate purposes may be impaired in the future. The substantial debt could make us vulnerable to economic downturns and may hinder our ability to adjust to rapidly changing market conditions.

A substantial portion of our cash flow from operations will be needed to meet the payment of principal and interest on our indebtedness. The business may not generate sufficient cash flow from operations to enable it to repay KapStone's indebtedness and to fund other liquidity needs, including capital expenditure requirements. The indebtedness incurred by KapStone under its senior secured

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credit facility bears interest at variable rates, and therefore if interest rates increase, KapStone's debt service requirements will increase. In such case, KapStone may need to refinance or restructure all or a portion of its indebtedness on or before maturity. KapStone may not be able to refinance any of its indebtedness, including the senior secured credit facility, on commercially reasonable terms, or at all. If KapStone cannot service or refinance its indebtedness, it may have to take actions such as selling assets, seeking additional equity or reducing or delaying capital expenditures, any of which could have a material adverse effect on our operations and financial condition.

KapStone's senior secured credit facility contains restrictive covenants that limit its liquidity and corporate activities. KapStone's credit facility imposes operating and financial restrictions that limit KapStone's ability to:

- incur additional indebtedness;
- create additional liens on its assets;
- make investments;
- engage in mergers or acquisitions;
- pay dividends; and
- sell all or any substantial part of assets

In addition, the credit facility also imposes other restrictions on KapStone. Therefore, we will need to seek permission from the lenders in order to engage in certain corporate actions. The lender's interests may be different from ours, and no assurance can be given that we will be able to obtain the lender's permission when needed. This may prevent us from taking actions that are in our best interest.

The credit facility requires KapStone to maintain certain financial ratios. The failure to maintain the specified ratios could result in an event of default if not cured or waived.

In the event of a default under KapStone's senior credit facility, the lenders generally would be able to declare all of such indebtedness, together with accrued interest, to be due and payable. In addition, borrowings under the credit facility are secured by a first priority lien on all assets of the Company and, in the event of a default under that facility the lenders generally would be entitled to seize the collateral. A default under any debt instrument, unless cured or waived, would likely have a material adverse effect on our business and financial condition.

If we fail to extend or renegotiate the collective bargaining agreements with the United Steelworkers Union as they expire from time to time, or if our unionized employees were to engage in a strike or other work stoppage, our business and operating results could be materially harmed.

Most of our hourly paid employees are represented by trade unions. The Company is a party to collective bargaining contracts which represent approximately 615 employees at the North Charleston locations, 381 employees at Roanoke Rapids and 136 employees at Ride Rite® Converting. No assurance can be given that we will be able to successfully extend or renegotiate the collective bargaining agreements as they expire from time to time. Currently, there are collective bargaining agreements in effect with respect to North Charleston through June 30, 2009, Roanoke Rapids through August 31, 2010, and with respect to Ride Rite® Converting through June 30, 2011. If we are unable to extend or negotiate new agreements without work stoppages, it could negatively impact our ability to manufacture our products and adversely affect results of operations.

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As a result of the CKD acquisition, our operations have become increasingly global in nature. Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business, by fluctuations in exchange rates and other factors related to our international operations.

Approximately 32% of our annual revenues in 2008 were derived from export sales. As our international operations and activities expand, we face increasing exposure to the risks of selling to customers in foreign countries. These factors include:

- Changes in foreign currency exchange rates which could adversely affect our competitive position, selling prices, and therefore the demand for our products in a particular market.

- Trade protection measures in favor of local producers of competing products, including government subsidies, tax benefits, trade actions (such as anti-dumping proceedings) and other measures giving local producers a competitive advantage over the company.

- Changes generally in political, regulatory or economic conditions in the countries in which we conduct business.

These risks could affect the cost of selling our products, our pricing, sales volume, and ultimately our financial performance. The likelihood of such occurrences and their potential effect on the company vary from country to country and are unpredictable.

If we fail to maintain effective systems for disclosure controls and internal control over financial reporting, we may be unable to comply with the requirements of Section 404 of the Sarbanes Oxley Act of 2002 in a timely manner.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to document and test the effectiveness of its internal controls over financial reporting in accordance with an established internal control framework and to report on its conclusion as to the effectiveness of its internal controls. It also requires an independent registered public accounting firm to test our internal controls over financial reporting and report on the effectiveness of such controls for our fiscal year ending December 31, 2008 and subsequent years. It may cost us more than we expect to comply with these controls and procedure related requirements. If we discover areas of our internal controls that need improvement, we cannot be certain that any remedial measures taken will ensure that we implement and maintain adequate internal controls over financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could harm our operating results or cause us to fail to meet our reporting obligations.

The Company may be required to record a charge to our earnings if our goodwill becomes impaired.

The Company tests for impairment of goodwill annually at the beginning of the fourth quarter in accordance with generally accepted accounting standards. When events or changes in circumstances indicate that the carrying value for such assets may not be recoverable, however, the Company reviews its goodwill for impairment on an interim basis. Factors that may be considered a change in circumstances requiring our interim testing include a decline in stock price as compared to the Company's book value per share, future cash flows and slower growth rates. As a result of the dramatic change in the economic and market conditions in the fourth quarter of 2008, including the change in the Company's stock price as compared to its book value per share and the significant disruptions in the global credit markets, the Company performed an interim impairment test for goodwill as of the fiscal year end 2008. The Company did not record any impairment charge as a result of that interim test. However, in connection with future annual or interim tests, the Company may be required to record a non-cash charge to earnings in its financial statements during the period in which any impairment of goodwill is determined, resulting in an impact on the Company's results of operations.

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See *Note 2. "Summary of Significant Accounting Policies Goodwill and Intangible Assets"* in the Notes to the Consolidated Financial Statements for additional information related to impairment of goodwill.

Our business depends on effective information management systems.

We rely on our enterprise resource planning (ERP) systems to support such critical business operations as processing sales orders and invoicing, inventory control, purchasing and supply chain management, payroll and human resources, and financial reporting. We periodically implement upgrades to such systems or migrate one or more of our affiliates, facilities or operations from one system to another. If we are unable to adequately maintain such systems to support our developing business requirements or effectively manage any upgrade or migration, we could encounter difficulties that could have a material adverse impact on our business, internal controls over financial reporting, financial results, or our ability to timely and accurately report such results.

Risks Associated with KapStone's Common Stock and Warrants

The market price for our common stock may be highly volatile.

The market price of our common stock may be volatile due to certain factors, including, but not limited to; quarterly fluctuations in our financial and operating results; general conditions in the paper and packaging industries; or changes in earnings estimates.

Shares available for future issuance, conversion and exercise could have an adverse effect on the earnings per share and the market price of our common stock.

Any future issuance of equity securities, including upon exercise of outstanding warrants and stock options, could dilute the interests of our existing stockholders and could substantially decrease the trading price of our common stock. As of February 28, 2009, we have outstanding warrants to purchase approximately 37 million shares of our common stock. In addition, in connection with our initial public offering, we issued to the representative of the underwriter an option to purchase 1,000,000 units which, if exercised, would result in the issuance of an additional 1,000,000 shares of common stock and 2,000,000 warrants.

We may choose to redeem our outstanding warrants at a time that is disadvantageous to our warrant holders.

Subject to there being a current prospectus under the Securities Act of 1933 with respect to the shares of common stock issuable upon exercise of the warrants issued as a part of the units in our initial public offering, during the entire period between any notice of redemption and the actual redemption date, we may redeem the warrants at any time after the warrants become exercisable, in whole and not in part, at a price of $.01 per warrant, upon a minimum of 30 days prior written notice of redemption, if and only if, the last sales price of our common stock equals or exceeds $8.50 per share for any 20 trading days within a 30 trading day period ending three business days before the notice of redemption is sent. Redemption of the warrants could force the warrant holders (i) to exercise the warrants and pay the exercise price therefore at a time when it may be disadvantageous for the holders to do so, (ii) to sell the warrants at the then current market price when they might otherwise wish to hold the warrants, or (iii) to accept the nominal redemption price which, at the time the warrants are called for redemption, is likely to be substantially less than the market value of the warrants.

Although we currently have an effective registration statement covering the issuance of the shares underlying the warrants issued in our initial public offering at the time that the warrant holders exercise their warrants, we cannot guarantee that a registration statement will continue to be effective, in which case the warrant holders may not be able to exercise their warrants.

Holders of the warrants issued in our initial public offering will be able to receive shares upon exercise of the warrants only if (i) a current registration statement under the Securities Act of 1933 relating to the shares of common stock underlying the warrants is then effective and (ii) such shares are qualified for sale or exempt from qualification under the applicable securities laws of the states in which the various holders of warrants reside. Although we currently have a current registration statement covering the shares underlying the warrants to the extent required by federal securities laws, we cannot give assurance that we will be able to maintain the effectiveness of such registration statement. In addition, some states may not permit us to register the shares issuable upon exercise of our warrants for sale. Since we have no obligation to net cash settle the warrants in the absence of an effective registration statement, the value of the warrants will be greatly reduced if a registration statement covering the shares issuable upon the exercise of the warrants is not kept current or if the securities are not qualified, or exempt from qualification, in the states in which the holders of warrants reside. Holders of warrants who reside in jurisdictions in which the shares underlying the warrants are not qualified and in which there is no exemption will be unable to exercise their warrants and would either have to sell their warrants in the open market or allow them to expire unexercised. If and when the warrants become redeemable by us, we may exercise our redemption right even if we are unable to qualify the underlying securities for sale under all applicable state securities laws. In light of the foregoing, the warrants may expire worthless and a purchaser of units may have paid the full unit purchase price solely for the share component of the units.

Our executive officers and directors control a substantial percentage of our common stock and warrants and thus may influence certain actions requiring a stockholder vote.

At December 31, 2008, our executive officers and directors own 7.7 million shares of our common stock, or approximately 27% of our total issued and outstanding common stock and held warrants to purchase an additional 4.8 million shares of our common stock. The warrants expire August 15, 2009. Accordingly, our executive officers and directors may have considerable influence over the outcome of all matters requiring approval by our stockholders, including future acquisitions and the election of directors. In addition, our board of directors is divided into three classes, each of which will generally serve for a term of two years with only one class of directors being elected in each year. At the annual meeting, as a consequence of our "staggered" board of directors, only a minority of the board of directors will be considered for election and our officers and directors, because of their ownership position, will have considerable influence regarding the outcome.

Some of our executive officers and directors may in the future become affiliated with entities engaged in business activities similar to those intended to be conducted by us and, accordingly, may have conflicts of interest in determining to which entity a particular business opportunity should be presented.

Some of our executive officers and directors may in the future become affiliated with entities, including "blank check" companies, engaged in business activities similar to those conducted by us. Additionally, our executive officers and directors may become aware of business opportunities which may be appropriate for presentation to us as well as the other entities to which they have an affiliation. Accordingly, they may have conflicts as to questions pertaining to which entity a particular business opportunity should be presented.

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Risks associated with the paper, packaging, forest products and related industries.

The paper, packaging, forest products and related industries are highly cyclical. Fluctuations in the prices of and the demand for products could result in smaller profit margins and lower sales volumes.

Historically, economic and market shifts, fluctuations in capacity and changes in foreign currency exchange rates have created cyclical changes in prices, sales volume and margins for products in the paper, packaging, forest products and related industries. The length and magnitude of industry cycles have varied over time and by product, but generally reflect changes in macroeconomic conditions and levels of industry capacity. Most paper products and many wood products used in the packaging industry are commodities that are widely available from many producers. Because commodity products have few distinguishing qualities from producer to producer, competition for these products is based primarily on price, which is determined by supply relative to demand. The overall levels of demand for these commodity products reflect fluctuations in levels of end-user demand, which depend in large part on general macroeconomic conditions in North America and regional economic conditions in our markets, as well as foreign currency exchange rates. The foregoing factors could materially and adversely impact sales and profitability of our company.

Difficulty obtaining wood fiber at favorable prices, or at all, may negatively impact companies in the packaging industry.

Wood fiber is the principal raw material in many parts of the packaging industry. Wood fiber is a commodity, and prices historically have been cyclical. Environmental litigation and regulatory developments have caused, and may cause in the future, significant reductions in the amount of timber available for commercial harvest in the United States. These reductions have caused the closure of plywood and lumber operations in some of the geographic areas in which a target company might operate. In addition, future domestic or foreign legislation and litigation concerning the use of timberlands, the protection of endangered species, the promotion of forest health and the response to and prevention of catastrophic wildfires could also affect timber supplies. Availability of harvested timber may further be limited by fire, insect infestation, disease, ice storms, wind storms, flooding and other natural and man made causes, thereby reducing supply and increasing prices.

Industry supply of commodity paper and wood products is also subject to fluctuation, as changing industry conditions can influence producers to idle or permanently close individual machines or entire mills. In addition, to avoid substantial cash costs in connection with idling or closing a mill, some producers will choose to continue to operate at a loss, sometimes even a cash loss, which could prolong weak pricing environments due to oversupply. Oversupply in these markets can also result from producers introducing new capacity in response to favorable short-term pricing trends. Industry supply of commodity papers and wood products is also influenced by overseas production capacity, which has grown in recent years and is expected to continue to grow. Wood fiber pricing is subject to regional market influences, and the cost of wood fiber may increase in particular regions due to market shifts in those regions. In addition, the ability to obtain wood fiber from foreign countries may be impacted by legal and political conditions in those countries as well as transportation difficulties.

An increase in the cost of purchased energy and raw materials would lead to higher manufacturing costs, thereby reducing margins.

Energy is a significant raw material in the paper, packaging, forest products and related industries. Energy prices, particularly for electricity, coal and fuel oil, have been volatile in recent years and currently coal and electricity exceed historical averages. These fluctuations have historically impacted manufacturing costs of companies in these industries, often contributing to earnings volatility. Recent significant increases in energy prices can be expected to adversely impact businesses in these industries.

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In addition, we could be materially adversely impacted by supply disruptions or the inability to pass on cost increases to our customers.

Paper, packaging and forest products companies face strong competition.

The paper, packaging, forest products and related industries are highly fragmented, and we face competition from numerous competitors, domestic as well as foreign. Some of our competitors will be large, vertically integrated companies that have greater financial and other resources, greater manufacturing economies of scale, greater energy self-sufficiency and/or lower operating costs.

Certain paper and wood products are vulnerable to long-term declines in demand due to competing technologies or materials.

Companies in the paper, packaging, forest products and related industries are subject to possible declines in demand for their products as the use of alternative materials and technologies grows and the prices of such alternatives become more competitive. Any substantial shift in demand from wood and paper products to competing technologies or materials could result in a material decrease in sales of our products. While we would seek to adapt our product offerings to changes in market demand, we cannot assure you that any efforts will be successful or sufficient.

Packaging companies are subject to significant environmental regulation and environmental compliance expenditures, as well as other potential environmental liabilities.

Companies in the packaging industry are subject to a wide range of general and industry-specific environmental laws and regulations, particularly with respect to air emissions, wastewater discharges, solid and hazardous waste management, site remediation, forestry operations and endangered species habitats. We may incur substantial expenditures to maintain compliance with applicable environmental laws and regulations. Failure to comply with applicable environmental laws and regulations could expose us to civil or criminal fines or penalties or enforcement actions, including orders limiting operations or requiring corrective measures, installation of pollution control equipment or other remedial actions.

Risks Associated with Acquisitions

Future acquisitions of businesses by us would subject us to additional business, operating and industry risks, the impact of which cannot presently be evaluated, and could adversely impact our capital structure.

We intend to pursue other acquisition opportunities in an effort to diversify our investments and/or grow our business. Any business acquired by us may cause us to be affected by numerous risks inherent in the acquired business' operations. If we acquire a business in an industry characterized by a high level of risk, we may be affected by the currently unascertainable risks of that industry. Although our management will endeavor to evaluate the risks inherent in a particular industry or target business, we cannot assure you that we will be able to properly ascertain or assess all of the significant risk factors.

In addition, the financing of any acquisition completed by us could adversely impact our capital structure as any such financing would likely include the issuance of additional equity securities and/or the borrowing of additional funds. The issuance of additional equity securities may significantly reduce the equity interest of our stockholders and/or adversely affect prevailing market prices for our common stock. Increasing our indebtedness could increase the risk of a default that would entitle the holder to declare all of such indebtedness due and payable and/or to seize any collateral securing the indebtedness. In addition, default under one debt instrument could in turn permit lenders under other debt instruments to declare borrowings outstanding under those other instruments to be due and payable pursuant to cross default clauses. Accordingly, the financing of future acquisitions could adversely impact our capital structure and your equity interest in us.

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Except as required by law or the rules of any securities exchange on which our securities might be listed at the time it seeks to consummate a subsequent acquisition, stockholders will not be asked to vote on any such proposed acquisition and no redemption rights in connection with any such acquisition will exist.

If the benefits of our KPB and CKD acquisitions do not meet the expectations of the marketplace, or financial or industry analysts, the market price of our common stock may decline.

We acquired KPB on January 2, 2007 and CKD on July 1, 2008. The market price of our common stock may decline if these acquisitions do not perform as expected, or we do not otherwise achieve the perceived benefits of the acquisitions as rapidly as, or to the extent anticipated by, the marketplace, or financial or industry analysts. Accordingly, investors may experience a loss as a result of a decreasing stock price and we may not be able to raise future capital, if necessary, in the equity markets.

Our operations are dependent upon certain operating agreements with IP and MWV.

We are dependent upon MWV to provide us transitional support services for a period of up to 18 months from July 1, 2008. In addition, we rely on MWV and IP for certain supply arrangements to provide us roundwood and woodchips.

Although IP has agreed to indemnify us with respect to environmental liabilities that were assumed, we may incur significant remediation and other costs if such losses exceed the cap on indemnification or occur after the expiration of the indemnification period.

The Roanoke Rapids facility operated as an industrial facility for many years prior to the enactment of environmental legislation that would have required certain pollution prevention concepts to be addressed at the facility. Due to its long history of industrial operations, the possibility of onsite and offsite environmental impact to the soil and groundwater may present a heightened risk of liability for contamination. The overall indemnification by IP for certain losses includes assumed environmental liabilities, subject to a $1.0 million threshold and a cap of $15.0 million. IP's indemnification for assumed environmental liabilities will survive for three years. However, with respect to environmental claims, the cap described above will be reduced by $1.8 million every six months during the three year survival period. Because we are unable to presently make a determination as to whether the environmental impact, if any, would be widespread or significant, the negotiated cap and survival period may not be sufficient to cover future losses. Further, if we are required to make significant expenditures for remediation and other costs that exceed the cap, the cost of such efforts may have a significant negative impact on our results of operations and financial condition.

Although MWV has agreed to indemnify us with respect to environmental liabilities pertaining to the North Charleston facility, we may incur significant remediation and other costs if such losses are below the basket or exceed the cap on indemnification or occur after the expiration of the indemnification period.

Due to its past history of industrial operations at the North Charleston mill, the possibility of onsite and offsite environmental impact on soil and groundwater may present a heightened risk of liability for contamination. We did not assume responsibility for certain offsite environmental liabilities resulting from conditions existing prior to the closing. The overall indemnification by MWV for certain losses includes assumed environmental liabilities, subject to an $8.5 million threshold and a cap equal to 15% of the purchase price of $485 million. MWV's obligation to indemnify us for any historical onsite liability or breach of certain environmental representations and warranties terminates on December 31, 2013. MWV's indemnification for certain offsite historical liabilities survive indefinitely. Because we are unable to presently make a determination as to whether the environmental impact, if any, would be widespread or significant, the negotiated cap and survival period may not be sufficient to cover future losses. Further if we are required to make significant expenditures for remediation and

other costs that exceed the cap, the costs of such efforts may have a significant negative impact on our results of operations and financial conditions.

The anticipated benefits of the CKD acquisition may not be realized.

We consummated the acquisition of CKD with the expectation that it would result in various benefits including, among other things, benefits relating to enhanced revenues, a broader array of product offerings, the expansion of our production capabilities, operational improvements and a diversification of our customer base. The acquisition presents challenges to management, including the integration of operations, properties and personnel of CKD and our existing operations. Achieving the anticipated benefits of the transaction is subject to a number of uncertainties, including, but not limited to, whether we can integrate our business and the CKD business in an efficient and effective manner. Failure to achieve these anticipated benefits could result in increased costs, decreases in the amount of expected revenues and diversion of management's time that could materially impact our business, financial condition and operating results.

We may fail to realize the anticipated synergies and cost savings expected from the CKD acquisition.

Our success after the CKD acquisition will depend, in part, on our ability to realize the anticipated growth opportunities and cost savings from integrating our business with CKD. To realize these anticipated benefits, we must successfully integrate our business with CKD in a manner that permits these synergies to be realized. If we are not able to successfully achieve these objectives, such anticipated benefits may not be realized fully, or at all, or may take longer to realize than expected.

We may have difficulty integrating our business with the CKD business and may incur substantial costs in connection with the integration.

Achieving the anticipated benefits of the acquisition will depend on the successful integration of our products, operations, personnel, and facilities with those of CKD in a timely and efficient manner.

Although we do not anticipate material difficulties in connection with such integration, the possibility exists that such difficulties could be experienced in connection with the transaction, especially given the relatively large size of the acquisition. The time and expense associated with integrating our businesses and CKD may exceed our expectations and limit or delay the intended benefits of the transaction. Similarly, the process of integrating sales and marketing forces and administrative functions and coordinating product offerings can take longer, cost more, and provide fewer benefits than initially projected. To the extent any of these events occurs, the benefits of the acquisition may be reduced.

Integrating our business with CKD will be a complex, time-consuming and expensive process. Before the acquisition, KapStone and CKD operated independently, each with its own business, products, customers, employees, culture and systems. We may face substantial difficulties, costs and delays in integrating the two businesses. These difficulties, costs and delays may include:

- Costs and delays in migrating CKD to our ERP system;
- Charges to earnings resulting from start up costs;
- Difficulty comparing financial reports due to differing financial and/or internal reporting systems;
- Diversion of management resources from the business;
- Challenges in retaining and integrating management and other key employees of KapStone and CKD;
- Difficulties in coordinating infrastructure operations in an effective and efficient manner; and

The inability to achieve the synergies anticipated to be realized from the acquisition.

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We may seek to combine certain operations and functions using common information and communication systems, operating procedures, financial controls and human resource practices, including training, professional development and benefit programs. We may be unsuccessful in implementing the integration of these systems and processes in a timely and efficient manner. Any one or all of these factors may cause increased operating costs, worse than anticipated financial performance and/or the loss of customers and employees. Many of these factors are also outside of our control.

We may have difficulty integrating our system of internal control over financial reporting with that of CKD.

The failure to integrate our system of internal control over financial reporting with that of CKD following the acquisition could affect adversely our ability to exercise effective internal control over financial reporting. A failure to exercise effective internal control over financial reporting could result in a material misstatement in our annual or interim consolidated financial statements.

Item 1B Unresolved Staff Comments

None.

Item 2. Properties

We believe that our property is well-maintained, in good operating condition and adequate for our present needs. The following table sets forth our principal properties, as of December 31, 2008:

Location	Use	Owned/Leased
North Charleston, South Carolina	Kraft paper manufacturing	Owned
Roanoke Rapids, North Carolina	Kraft paper manufacturing	Owned
Summerville, South Carolina	Lumber manufacturing	Owned
Fordyce, Arkansas	Dunnage bag manufacturing	Leased
Northbrook, Illinois	Corporate Headquarters	Leased

The lease for the Fordyce, Arkansas facility expires in 2017 with two extension options of 5 and 4 years, respectively. The lease for the corporate headquarters expires in 2015.

Item 3. Legal Proceedings

To the knowledge of management, there is no litigation currently pending or contemplated against us or any of our officers or directors in their capacity as such that would likely have a material adverse effect on our consolidated financial results.

Disclosure of Certain Tax Penalties

The Company has no tax penalties owing to the Internal Revenue Service.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders of KapStone, through the solicitation of proxies or otherwise, during the fourth quarter of 2008.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock and warrants have been traded on the NASDAQ Global Market since May 29, 2007 under the symbols "KPPC" and "KPPCW," respectively. Previously, KapStone's common stock and warrants were traded on the Over-the-Counter Bulletin Board under the symbols "SCDE" and "SCDEW," respectively, since September 14, 2005. KapStone's units are traded on the Over-the-Counter Bulletin Board under the symbol "KPPCU.OB." The following table sets forth the high and low bid information for the Company's securities from January 1, 2007 through December 31, 2008, as reported by the various exchanges where its securities are traded. The quotations reflect inter-dealer prices, are without retail markup, markdowns or commissions, and may not represent actual transactions.

		2008		2007	
	Quarter	Low	High	Low	High
Common Stock	1st	$ 6.31	$ 6.98	$ 6.10	$ 6.95
	2nd	$ 6.41	$ 7.18	$ 6.42	$ 7.79
	3rd	$ 6.10	$ 7.97	$ 6.16	$ 7.75
	4th	$ 2.06	$ 6.07	$ 6.68	$ 7.40
Warrants	1st	$ 1.45	$ 2.00	$ 1.50	$ 2.04
	2nd	$ 1.46	$ 2.17	$ 1.62	$ 2.90
	3rd	$ 1.31	$ 2.87	$ 1.66	$ 2.80
	4th	$ 0.05	$ 1.25	$ 1.80	$ 2.40
Units	1st	$ 9.33	$ 10.60	$ 9.19	$ 11.00
	2nd	$ 9.65	$ 11.79	$ 10.00	$ 13.55
	3rd	$ 9.00	$ 14.29	$ 9.85	$ 13.40
	4th	$ 2.30	$ 7.50	$ 10.60	$ 12.15

Number of Holders of Common Stock

The number of holders of record of our common stock on February 28, 2009 was 2,068.

Dividends

There were no cash dividends or other cash distributions made by us during the fiscal years 2008 or 2007. The Company's senior secured credit facility restricts the declaration or payment of cash dividends. The Company does not expect to pay dividends in the foreseeable future.

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Stock Performance Graph

The performance graph shall not be deemed to be "soliciting material" or to be "filed" with the commission or subject to Regulation 14A or 14C, or to the liabilities of Section 18 of the Securities Exchange Act of 1934 as amended.

The following graph compares a $100 investment in Company stock in August 31, 2005 with a $100 investment in each of the S&P 500 and the S&P Paper and Packaging Index (the Company's peer group) also made in August 31, 2005. The graph portrays total return, 2005-2008, assuming reinvestment of dividends.

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Item 6. Selected Financial Data

The following table sets forth KapStone's selected financial information derived from its audited consolidated financial statements as of, and for the years ended, December 31, 2008, 2007 and 2006 as well as KPB Predecessor's audited financial statements as of, and for the years ended December 31, 2006, 2005 and 2004.

The selected financial data presented below summarizes certain financial data which has been derived from and should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and KapStone's audited financial statements included in Item 8.

				Predecessor KPB		
	Years Ended December 31,			Years Ended December 31,		
In thousands, except per share amounts	**2008**	**2007**	**2006**	**2006**	**2005**	**2004**
Statement of Income Data:						
Net sales	$524,549	$256,795	$	$246,161	$221,972	$188,293
Operating income / (loss)	$ 50,656	$ 44,300	$ (1,976)	$ 33,951	$ 9,478	$ (4,681)
Net income / (loss)	$ 19,665	$ 26,963	$ 2,196	$ 19,967	$ 4,933	$ (3,756)
Basic net income per share	$ 0.74	$ 1.08	$ 0.09	$ n/a	$ n/a	$ n/a
Diluted net income per share	$ 0.57	$ 0.75	$ 0.07	$ n/a	$ n/a	$ n/a
Balance Sheet Data:						
Cash and cash equivalents	$ 4,165	$ 56,635	$	$ 1	$ 1	$ 2
Total assets	$727,190	$225,450	$119,257	$257,382	$269,328	$279,227
Long-term liabilities	$419,545	$ 37,668	$	$ 22,622	$ 24,064	$ 23,936
Total stockholders' equity	$180,767	$144,185	$116,045	$219,685	$228,557	$239,648

For the year ended December 31, 2006, net income allocable to holders of nonredeemable common stock was $1.5 million.

See Notes 4 and 5 to Notes to Consolidated Financial Statements for acquisition information.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive Summary

We were a special purpose acquisition corporation formed on April 15, 2005 for the purpose of effecting a merger, capital stock exchange, asset acquisition or other similar business combination with an unidentified operating business in the paper, packaging, forest products and related industries.

We have consummated two acquisitions since January 2007 as we drive towards our strategic objective of being a $2 billion revenue company.

KapStone's operating results in 2008 benefited from the July 1, 2008 acquisition of the CKD business from MeadWestvaco. We financed the acquisition with a new $515 million senior secured credit facility, which includes up to a $100 million revolving credit line to provide flexibility during these uncertain economic times, and the issuance of $40 million of seven year 8.3% senior notes and cash.

Our operating results for 2008 reflect six months of operations for CKD. The acquisition accounted for $254.1 million of net sales and $16.3 million of operating income. In addition, we successfully increased selling prices throughout 2008 to offset the tremendous amount of inflation experienced by our industry. We experienced double digit increases in fiber and certain key chemical costs, energy and transportation. Overall, our operations had a strong year producing approximately 830,000 tons of paper and related products with minimal unplanned outages.

Our transition from the IP hosted ERP system in April 2008 went smoothly upon migration to our new enterprise resource planning (ERP) system. We are working to upgrade and migrate the CKD operations to our ERP in various stages throughout 2009. This project is expected to cost approximately $8.0 million. MWV will provide transitional services until the migration has been completed.

In the fourth quarter of 2008, we initiated certain production curtailments in our unbleached kraft segment totaling approximately 25,000 tons to balance our inventory levels with our customers' demand. In January 2009, in light of the economic slowdown, we implemented additional production curtailments of approximately 25,000 tons, mainly with linerboard in the unbleached kraft segment. In February 2009, we continued curtailing linerboard production by approximately 25,000 tons a month which will remain in effect until market conditions improve. We will continue to monitor our production capacity closely to ensure that it remains in balance with market demand.

Due to weaker demand of linerboard paper and falling raw material and energy costs, published prices were reduced by $10/ton in December 2008 and an additional $10/ton in January 2009.

In January 2009, we announced compensation and benefit reductions to all salaried employees to reduce costs by approximately $1 million a month effective February 1, 2009. This savings includes temporary salary reductions, and suspending management and sales force incentives and 401k matching contributions.

Results of Operations for the Years Ended December 31, 2008, 2007 and 2006 (Predecessor KPB).

Presented below are results for the years ended December 31, 2008, 2007 and 2006, as reported in accordance with generally accepted accounting principles in the United States ("GAAP"). Results of operations for the years ended December 31, 2008 and 2007 represent KapStone's results while results of operations for the year ended December 31, 2006, represent the results of KPB, our "Predecessor." See Note 1 to Notes to Consolidated Financial Statements for additional information.

The results of operations and cash flows on a consolidated basis for the years ended December 31, 2007 and 2008 are not comparative to the Predecessor KPB results of operations and cash flows for the

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year ended December 31, 2006 as i) the basis of the acquired assets and liabilities from KPB have been adjusted to fair value pursuant to Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* and ii) KPB was a division of IP and not a stand alone business. The appraisal process for determining the fair value of the acquired KPB assets, in accordance with SFAS No. 141, *Business Combinations*, included using a combination of valuation approaches based on the type of asset being appraised. The valuation approaches included primarily the cost approach for machinery and equipment, the income approach for a property lease with favorable market terms and a combination of the cost and income approaches for land and buildings. Management reviewed the results of the appraisal and deemed them to be reasonable.

	Years Ended December 31,		Predecessor KPB Year Ended December 31,
Dollars In thousands	**2008**	**2007**	**2006**
Net sales	$524,549	$256,795	$ 246,161
Cost of sales, excluding depreciation and amortization	362,462	162,429	160,444
Freight and distribution	50,154	23,581	22,274
Selling, general and administrative expenses	30,411	16,482	11,282
Depreciation and amortization	31,683	11,327	18,210
Other operating income	817	1,324	
Operating income	50,656	44,300	33,951
Foreign exchange losses	987		
Interest income	927	2,096	
Interest expense	18,449	4,295	1,411
Income before provision for income taxes	32,147	42,101	32,540
Provision for income taxes	12,482	15,138	12,573
Net income	$ 19,665	$ 26,963	$ 19,967

All comments and variances in the following commentary for the year ended December 31, 2006 refer to the Predecessor, or KPB.

2008 compared to 2007

Net sales for the year ended December 31, 2008 were $524.5 million compared to $256.8 million for the year ended December 31, 2007, an increase of 104%. The increase in net sales was driven primarily by the acquisition of the CKD on July 1, 2008. The acquisition accounted for $254.1 million, or 95% of the increase. The balance of the increase in net sales was driven by higher prices of $18.8 million offset by lower volume of $5.2 million mainly in the unbleached kraft segment. The higher prices reflect increases implemented in 2007 and 2008 to offset the inflationary impact on raw material and freight costs. Refer to the segment results below for detailed sales information for each segment.

Cost of sales for the year ended December 31, 2008 was $362.5 million compared to $162.4 million for the year ended December 31, 2007 an increase of 123%. The increase in cost of sales was primarily driven by the acquisition of CKD on July 1, 2008. The acquisition accounted for $189.1 million, or 95% of the increase. The balance of the increase in cost of sales was mainly due to inflation on fiber, caustic soda, coal and other costs of $14.8 million and a $1.4 million increase in the cost of the annual planned maintenance outage due to higher inspection costs for a turbine generator, partially offset by lower sales volume. In addition, 2008 and 2007 results included $0.7 million and $1.5 million, respectively, of non-cash purchase accounting charges to adjust acquired finished goods inventory to fair value as part of the CKD and KPB acquisitions.

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Freight and distribution expenses for the year ended December 31, 2008 totaled $50.2 million compared to $23.6 million for the year ended December 31, 2007. The increase of $26.6 million mainly reflects the acquisition of CKD. The acquisition accounted for $23.7 million of the increase. The balance of the increase in freight and distribution reflects higher transportation rates due to fuel oil surcharges of $3.3 million and a higher percentage of shipments by truck compared to rail of $0.6 million, partially offset by lower sales volume of $1.0 million.

Selling, general and administrative expenses for the year ended December 31, 2008 totaled $30.4 million compared to $16.5 million for the same period in 2007. The increase of $13.9 million reflects CKD's direct selling and administrative expenses of $4.8 million, acquisition related start up expenses of $2.4 million, transitional services provided by MWV of $3.6 million, higher stock compensation costs of $1.1 million, higher bad debt provisions of $2.1 million and other cost increases of $1.5 million, offset by lower transitional support services from IP of $1.6 million as the Company terminated its transitional services agreement with IP upon converting to its new ERP system in April 2008. As a percentage of net sales, selling, general and administrative expenses dropped from 6.4% for the year ended December 31, 2007 to 5.8% for the year ended December 31, 2008.

Depreciation and amortization for the year ended December 31, 2008 totaled $31.7 million compared to $11.3 million for the same period in 2007. The increase of $20.4 million is primarily due to the CKD acquisition which resulted in an additional $14.0 million of depreciation and $6.2 million of amortization of intangible assets, which includes $4.3 million of amortization for the intangible asset related to an acquired coal contract with prices below market prices at July 1, 2008. The acquired coal contract expires on December 31, 2009.

Other operating income for the years ended December 31, 2008 and 2007 totaled $0.8 million and $1.3 million, respectively. Other operating income includes commissions the Company receives from marketing bleached paper produced and sold by IP to KapStone customers.

Foreign exchange losses of $1.0 million for the year ended December 31, 2008 reflect the impact of stronger U.S. dollar of approximately 11 percent from July 1, 2008 through December 31, 2008. As a result of the CKD acquisition on July 1, 2008 the Company acquired certain European customers which are invoiced in euros.

Interest income for the years ended December 31, 2008 and 2007 was $0.9 million and $2.1 million, respectively. Interest income represents earnings on the Company's cash and cash equivalents. The decrease in interest income reflects the Company's use of cash and cash equivalents to fund a portion of the CKD acquisition.

Interest expense for the years ended December 31, 2008 and 2007 was $18.4 million and $4.3 million, respectively. Interest expense reflects interest on the Company's long-term debt and amortization of debt issuance costs. Interest expense was $14.1 million higher in the year ended December 31, 2008, primarily due to the Company obtaining a new $515 million senior secured credit facility and issuing $40 million of senior notes to finance the CKD. Amortization of debt issuance costs for the years ended December 31, 2008 and 2007 was $2.0 million and $0.3 million, respectively. The increase of $1.7 million is due to amortization of the $12.6 million paid in 2008 for the new senior secured credit facility. Prior to the CKD acquisition, the Company had $37.4 million of outstanding debt.

Provision for income taxes for the year ended December 31, 2008 decreased by $2.7 million due to lower pre-tax income offset by a higher effective tax rate. The higher effective tax rate was driven by a lower benefit from the federal domestic manufacturing deduction. The effective tax rate of 38.8% for the year ended December 31, 2008, compared to 36.0% for the same period in 2007.

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The following table presents a reconciliation of consolidated net sales and operating income to amounts reported by operating segment:

Operating Segment ($ 000's):	Years Ended December 31, 2008	2007
Consolidated net sales:		
Unbleached kraft	$485,877	$227,921
All other	43,028	32,801
Elimination of intersegment sales	(4,356)	(3,927)
Total	$524,549	$256,795
Operating income / (loss):		
Unbleached kraft	$ 69,327	$ 51,901
All other	2,792	6,350
Corporate	(21,463)	(13,951)
Total	$ 50,656	$ 44,300

Unbleached Kraft

	Years Ended December 31, 2008	2007	Change	%
Net sales	$485,877	$227,921	$257,956	113.2%
Operating income	69,327	51,901	17,426	33.6%
Operating income % of net sales	14.3%	22.8%	(8.5)%	
Average revenue per ton	$ 603	$ 547	$ 56	10.2%
Tons of paper sold	805,605	416,501	389,104	93.4%

For the year ended December 31, 2008, unbleached kraft segment net sales increased by $258.0 million, or 113.2%, to $485.9 million compared to $227.9 million for the year ended December 31, 2007. The increase in net sales was driven primarily by the acquisition of CKD on July 1, 2008. The acquisition accounted for $244.1 million of the increase. Average revenue per ton increased $56 due to the full realization of price increases implemented in 2007 and the partial realization of multiple price increases implemented throughout 2008, accounting for approximately $17.9 million of the sales increase. Volume of paper sold increased by 389,104 tons, of which 396,262 was due to the CKD acquisition. Intersegment sales to other segments of $4.4 million increased by $0.4 million.

Unbleached kraft segment operating income increased by $17.4 million, or 33.6%, to $69.3 million for the year ended December 31, 2008 compared to $51.9 million for the year ended December 31, 2007. The increase in operating income was driven primarily by the acquisition of CKD on July 1, 2008. The acquisition accounted for $18.8 million of the increase. The balance of the change in operating income is due to higher average revenue per ton which contributed $17.9 million of additional operating income for the year ended December 31, 2008, but was offset by higher fiber and caustic soda costs of $10.2 million, inflation on freight and fuel oil surcharges of $3.0 million and inflation on utilities of $1.9 million and other cost increases of $3.0 million. In addition, the cost of the annual planned maintenance outage increased by $1.4 million due to higher inspection costs for a turbine generator and the segment incurred approximately $2.0 million of bad debt provisions in 2008. Operating income in the year ended December 31, 2007 was negatively impacted by $1.0 million due to a two day unplanned outage caused by an electrical fire and other smaller unplanned outages during the fourth quarter.

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Operating income for the years ended December 31, 2008 and 2007 was negatively impacted by non-cash purchase accounting charges of $1.0 million and $1.2 million, respectively, adjusting acquired finished goods inventories to fair value.

Operating income for the years ended December 31, 2008 and 2007 includes $6.0 million and $4.6 million, respectively, of expenses relating to the Company's annual planned maintenance outage. Operating income as a percentage of net sales declined to 14.3%.

All other

	Years ended December 31,			
	2008	2007	Change	%
Net sales	$43,028	$32,801	$10,227	31.2%
Operating income	2,792	6,350	(3,558)	(56.0)%
Operating income % of net sales	6.5%	19.4%	(12.9)%	

For the year ended December 31, 2008, net sales for the all other operating segment increased by $10.2 million, or 31.2%, to $43.0 million compared to $32.8 million for the year ended December 31, 2007. The increase in net sales is mainly due to the CKD acquisition which included a lumber mill in Summerville, South Carolina. The acquisition accounted for $10.0 million of the net sales increase. In addition, sales in the dunnage bag segment increased by $0.2 million mainly due to $0.9 million of price increases implemented to offset higher raw material and freight costs, partially offset by a 1.5% volume decline.

Operating income for the all other segment decreased by $3.6 million, or 56.0%, to $2.8 million for the year ended December 31, 2008 compared to $6.4 million for the year ended December 31, 2007. The lumber business incurred an operating loss of $2.5 million while inflation on raw material and freight costs reduced operating income in the dunnage bag segment. Operating income for the year ended December 31, 2007 was negatively impacted by a non-cash purchase accounting charge of $0.3 million adjusting acquired finished goods inventories to fair value. Operating income as a percentage of net sales declined to 6.5%.

Corporate

Corporate expenses for the year ended December 31, 2008 totaled $21.5 million compared to $14.0 million for the year ended December 31, 2007. The increase of $7.5 million is due to CKD related acquisition start up expenses of $2.4 million, transitional services provided by MWV of $3.6 million, higher stock compensation costs of $1.1 million, depreciation and amortization of $1.1 million and other cost increases of $0.9 million, partially offset by lower transitional support services from IP of $1.6 million as the Company terminated its transitional services agreement with IP upon converting to its new ERP system in April 2008.

2007 compared to 2006 (Predecessor KPB)

Net sales for the year ended December 31, 2007 were $256.8 million compared to $246.2 million for the similar period in 2006, an increase of 4.3%. The increase was driven by higher prices of 3.4% and volume of 2.8% in the unbleached kraft segment, partially offset by an 8.3% decrease in dunnage bag sales due to lower volume. Refer to the individual segment discussions below for detailed sales information for each segment.

Cost of sales for the year ended December 31, 2007 was $162.4 million compared to $160.4 million for the similar period of 2006, an increase of 1.2%. The increase in cost of sales for the year ended December 31, 2007, compared to the respective period in 2006 was due to a $1.5 million non-cash purchase accounting charge adjusting finished goods inventory to fair value, higher unbleached kraft

volume of $5.9 million, and inflation on utilities and other costs of $2.7 million, partially offset by lower dunnage bag volume of $1.8 million, cost reduction initiatives of $1.1 million, lower raw material costs of $3.2 million and lower facilities and other costs of $2.0 million.

Freight and distribution expenses for the year ended December 31, 2007 totaled $23.6 million compared to $22.3 million for the year ended December 31, 2006. The increase of $1.3 million was driven by higher unbleached kraft sales volume and inflation on truck and rail shipment rates. In addition a greater percentage of 2007 shipments were by truck which has a higher cost per ton compared to rail.

Selling, general and administrative expenses for the year ended December 31, 2007 totaled $16.5 million compared to $11.3 million for the 2006 period. The increase of $5.2 million is due to KapStone incurring its own corporate headquarters expenses. Expenses for the 2006 period reflect an allocation of corporate expenses from IP.

Depreciation and amortization for year ended December 31, 2007 totaled $11.3 million compared to $18.2 million for the year ended December 31, 2006. The decrease of $6.9 million reflects the results of a third party appraisal of depreciable plant and machinery and equipment assets to their respective fair values as of January 2, 2007. The fair value of assets acquired was approximately $100 million less than the basis being used for depreciation in the 2006 period.

Other operating income for the year ended December 31, 2007 totaled $1.3 million. Other operating income includes commissions the Company receives from marketing bleached paper produced by IP and sold to KapStone customers.

Interest income for the year ended December 31, 2007 was $2.1 million. Interest income represents earnings on the Company's short-term investments and cash equivalents. Interest income earned on cash and short-term investments for the year ended December 31, 2007 averaged 4.6%.

Interest expense for the year ended December 31, 2007 was $4.3 million compared to $1.4 million for the similar period in 2006. Interest expense for the year ended December 31, 2007 reflects interest on the Company's long-term debt and amortization of debt issuance costs while interest expense in the 2006 period reflects interest on Industrial Development Bonds and Environmental Development Bonds. These bonds were not assumed by KapStone as part of the KPB acquisition. Amortization of debt issuance costs for the year ended December 31, 2007 was $0.3 million and reflects amortization of the $0.9 million paid in 2007 for the KPB acquisition credit facility.

Provision for income taxes for the year ended December 31, 2007 reflects an effective tax rate of 36.0%. The effective tax rate for the 2006 period was 38.6%. The lower effective tax rate was due to a higher benefit from the domestic manufacturing deduction in 2007.

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The following table presents a reconciliation of consolidated net sales and operating income to amounts reported by operating segment:

Operating Segment ($ 000's):	Year Ended December 31, 2007	Predecessor KPB Year Ended December 31, 2006
Consolidated net sales:		
Unbleached kraft	$ 227,921	$ 214,175
All other	32,801	35,753
Elimination of intersegment sales	(3,927)	(3,767)
Total	$ 256,795	$ 246,161
Operating income / (loss):		
Unbleached kraft	$ 51,901	$ 34,280
All other	6,350	7,514
Corporate	(13,951)	(7,843)
Total	$ 44,300	$ 33,951

Unbleached Kraft

	Years Ended December 31,			
	2007	2006	Change	%
Net sales	$227,921	$214,175	$13,746	6.4%
Operating income	51,901	34,280	17,621	51.4%
Operating income % of net sales	22.8%	16.0%	6.8%	
Average revenue per ton	$ 547	$ 529	$ 18	3.4%
Tons of paper sold	416,501	405,143	11,358	2.8%

For the year ended December 31, 2007, unbleached kraft segment net sales increased by $13.7 million, or 6.4%, to $227.9 million compared to $214.2 million for the year ended December 31, 2006. Average revenue per ton increased $18 due to the favorable impact of higher kraft paper prices in 2007 and the full realization of price increases implemented in 2006 net of mix changes, or approximately $7.6 million of the sales increase. Volume of paper sold increased by 11,358 tons, or $6.1 million, driven by a 38,543 ton increase in linerboard partially offset by a 27,185 ton reduction in kraft paper. Intersegment sales to the dunnage bag segment of $3.9 million increased by $0.1 million.

Unbleached kraft segment operating income increased by $17.6 million, or 51.4%, to $51.9 million for the year ended December 31, 2007 compared to $34.3 million for the year ended December 31, 2006. Higher sales volume, mix changes and average revenue per ton contributed $8.0 million of the increased operating income. In addition, lower depreciation costs of $6.9 million due to revaluing plant, property and equipment to fair values, cost reduction initiatives and lower other costs of $5.1 million and lower raw material costs of $3.2 million also contributed to the improved results. These improvements were partially offset by a $1.2 million non-cash purchase accounting charge adjusting finished goods inventory to fair value, inflation on utilities and other costs of $3.4 million, a $1.0 million two day unplanned outage caused by an electrical fire in June 2007 and several unplanned outages in the fourth quarter of 2007 that negatively impacted operating income by $1.9 million. In addition, operating income for the years ended December 31, 2007 and 2006 includes $4.6 million of expenses relating to the Company's annual planned maintenance outage. Operating income as a percentage of net sales improved to 22.8%.

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All other

	Years ended December 31,			
	2007	2006	Change	%
Net sales	$32,801	$35,753	$(2,952)	(8.3)%
Operating income	6,350	7,514	(1,164)	(15.5)%
Operating income % of net sales	19.4%	21.0%	(1.6)%	

For the year ended December 31, 2007, net sales for the all other operating segment decreased by $3.0 million, or 8.3%, to $32.8 million compared to $35.8 million for the year ended December 31, 2006 mainly due to a 7.5% decrease in unit volume. Average revenue per dunnage bag of $3.78 decreased by $0.03 or 0.8%, for the year ended December 31, 2007 compared to the similar period in the prior year. Dunnage bag sales have decreased due to reduced customer shipping activity particularly in the less-than-truckload market, lower demand in the home construction industry and a distributor losing position with two key accounts.

All other segment operating income decreased by $1.2 million, or 15.5%, to $6.4 million for the year ended December 31, 2007 compared to $7.5 million for the year ended December 31, 2006. Lower sales volume and prices contributed approximately $1.0 million of the shortfall, offset by cost reduction initiatives of $0.3 million. In addition, 42% of the shortfall was contributed by a non-cash purchase accounting charge of $0.3 million adjusting finished goods inventories to fair value and higher amortization expense of intangible assets of $0.2 million. Operating income as a percentage of net sales declined to 19.4%.

Corporate

Corporate expenses for the year ended December 31, 2007 totaled $14.0 million compared to $7.8 million for the year ended December 31, 2006. The increase of $6.2 million is due to the KPB acquisition which was consummated on January 2, 2007. Results for the 2006 period include an allocation of corporate expenses from IP while the expenses for the 2007 period reflect corporate expenses associated with an operating company. Included in 2007 corporate expenses is approximately $2.4 million for transitional support provided by IP.

KapStone Paper and Packaging Corporation compared to Stone Arcade Acquisition Corporation

2007 compared to 2006

Operating Income

Operating income for the Company for the year ended December 31, 2007 was $44.3 million compared to an operating loss of $2.0 million for the similar period in 2006. The change in operating income is due to the KPB acquisition which was consummated on January 2, 2007. Results for the 2006 period reflect the Company as a development stage enterprise and as a result, the operating loss includes expenses incurred to identify and acquire a business. Operating income for the 2007 period reflects results associated with an operating company.

Interest expense and interest income

Interest expense and interest income for the year ended December 31, 2007, was $4.3 and $2.1 million, respectively, compared to interest income of $5.3 million for the year ended December 31, 2006. Interest expense for the year ended December 31, 2007 reflects interest on the Company's long-term debt while interest income reflects earnings on excess cash that was invested in a combination of a bank certificate of deposit (maturity of 120 days), commercial paper (seven day maturity) and overnight deposits. Interest income in 2006 reflects interest earned on restricted cash

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held in trust when the Company was a development stage enterprise. These investments consisted primarily of U.S. government securities.

Liquidity and Capital Resources

Acquisitions

The Company has consummated two acquisitions totaling $619.2 million in its first two years of operations. The assets acquired consist of unbleached kraft paper mills in Roanoke Rapids, North Carolina and North Charleston, South Carolina, Ride Rite® Converting, an inflatable dunnage bag manufacturer located in Fordyce, Arkansas and a lumber mill in Summerville, South Carolina. The KPB acquisition in 2007 also includes contingent earn-out payments of up to $60 million based on KPB's annual earnings before interest, income taxes, depreciation and amortization ("EBITDA") during the five year period immediately following the acquisition. The first contingent payment will be equal to 5.3 times KPB's average annual EBITDA for the five year period immediately following the acquisition, less $165 million and subject to a maximum of $35 million. The second contingent payment is an "all or nothing" payment and is payable if KPB's average annual EBITDA for the same five year period equals or exceeds $49.2 million. Both payments, if earned, will be due and paid at the end of the five year period. A portion of the contingent earn-out payment, as defined by the purchase agreement, can be accelerated upon the sale of either the Roanoke Rapids or Fordyce businesses.

If these contingent earn-out payments are made, they will be accounted for as additional purchase price consideration and recorded as goodwill.

The purchase agreement for the CKD acquisition has no provision for contingent earn-out payments.

Credit Facilities

Senior Credit Agreement

We entered into a Senior Credit Agreement, dated as of June 12, 2008, and effective with the consummation of the acquisition of CKD, (the "Senior Credit Agreement"), among us, KapStone Kraft Paper Corporation, as borrower ("KapStone Kraft"), our other subsidiaries named therein, as guarantors, the lenders named therein, and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer. The Senior Credit Agreement provides for an aggregate of up to $515 million in senior secured credit facilities (the "Senior Credit Facilities"), consisting of a $390 million term A loan facility, a $25 million term B loan facility and a $100 million revolving credit facility (including a letter of credit subfacility). The Senior Credit Facilities are guaranteed by KapStone Kraft and our other domestic subsidiaries and are secured by substantially all of our assets, including all of the capital stock of the borrower and guarantor subsidiaries and up to 66% of the capital stock of our foreign subsidiaries.

The term A loan facility is required to be repaid by us in consecutive quarterly installments of $7.1 million March 31, 2009 to June 30, 2009, $9.5 million from September 30, 2009 to June 30, 2010, $11.8 million from September 30, 2010 to March 31, 2013, with a final payment of all outstanding principal and interest on the maturity date. The term B loan is required to be repaid by KapStone in consecutive quarterly installments of $0.5 million from March 31, 2009 to June 30, 2009, $0.6 million from September 30, 2009 to June 30, 2010, $0.8 million from September 30, 2010 to March 31, 2015 and $5.6 million on the maturity date. Borrowings under the revolving credit facility may be used for working capital and other general corporate purposes and are required to be repaid in full on the maturity date. The maturity date is the earlier of: (a) June 12, 2013 with respect to the term A loan facility and the revolving credit facility, and June 12, 2015 with respect to the term B loan facility, and (b) the date which is 90 days prior to the date on which any earn-out obligations to International Paper will become (or are reasonably expected to become) due; provided that the maturity date will not be so

accelerated if, among other things, the total leverage ratio at the end of the then most recent fiscal quarter is less than 2.0 to 1.0.

Outstanding principal under the term B loan facility bears interest at a rate equal to, at our option, either (1) the base rate (which is the higher of the then current Federal Funds rate plus 0.5% or the prime rate most recently announced by Bank of America, N.A., the administrative agent under the Senior Credit Facilities) plus a margin of 2.00% or (2) the reserved adjusted one, two, three or six-month Eurodollar rate plus a margin of 3.50%.

Outstanding principal under the term A loan facility and the revolving credit facility initially bears interest at a rate equal to, at our option, either (1) the base rate plus a margin of 1.50%, or (2) the reserve adjusted one, two, three or six-month Eurodollar rate plus a margin of 3.00%. The undrawn portion of the revolving credit facility is subject to an unused line fee calculated initially at an annual rate of 0.50%. Commencing six months after the closing of the Senior Credit Facilities, pricing under the term A loan facility and the revolving credit facility and the unused line fee for the revolving credit facility will be determined by reference to a pricing grid based on our total leverage ratio. Under the pricing grid, the applicable margins for the term A loan facility and the revolving credit facility will range from 0.0% to 1.5% for base rate loans and from 1.50% to 3.00% for Eurodollar loans, and the unused line fee for the revolving credit facility will range from 0.375% to 0.50%. Outstanding letters of credit are subject to an annual fee equal to the applicable margin for Eurodollar loans under the revolving credit facility as in effect from time to time, plus a fronting fee on the undrawn amount thereof.

The term loan facilities and the revolving credit facility may be prepaid at any time without premium. The Senior Credit Facilities are subject to mandatory prepayment with specified percentages of the net cash proceeds of certain asset dispositions, casualty events, exercise of outstanding warrants, debt and equity issuances, and with excess cash flow, in each case subject to certain conditions.

In accordance with its debt agreements, the Company's availability under its Revolving Credit Facility has been reduced by the amount of standby letters of credit issued of $14.5 million as of December 31, 2008. These letters of credit are used as security for certain contractual commitments and workers' compensation obligations. These letters of credit expire at various dates through 2009 unless extended.

The Senior Credit Facilities contain covenants that restrict, among other things, our ability to create liens, incur indebtedness and guarantees, make certain investments or acquisitions, merge or consolidate, dispose of assets, pay dividends, repurchase or redeem capital stock and subordinated indebtedness, change the nature of our business, enter into certain transactions with affiliates, and make changes in accounting policies or practices except as required by generally accepted accounting principles. The Senior Credit Facilities also contain a total leverage ratio covenant and a fixed charge coverage ratio. The Senior Credit Facilities contain events of default including, but not limited to, nonpayment of principal or interest, violation of covenants, breaches of representations and warranties, cross-default to other indebtedness, bankruptcy and other insolvency events, material judgments, certain ERISA events, actual or asserted invalidity of loan documentation and certain changes of control.

Note Purchase Agreement

Pursuant to the Note Purchase Agreement dated July 1, 2008 (the "Note Purchase Agreement") by and among us, KapStone Kraft and the purchasers listed in the Purchaser Schedule attached to the Note Purchase Agreement (the "Purchasers"), the Purchasers purchased from KapStone Kraft senior secured promissory notes (the "Senior Notes") with an aggregate principal amount of $40 million. The Senior Notes are guaranteed by the Company and the Company's other domestic subsidiaries and are secured by substantially all of our assets, including all of the capital stock of KapStone Kraft and the other guarantor subsidiaries and up to 66% of the capital stock of the Company's foreign subsidiaries.

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The Senior Notes mature on July 1, 2015 and bear interest at the rate of 8.30% per annum, payable quarterly on the 1st day of October, January, April and July in each year. The Senior Notes are required to be repaid by KapStone Kraft in annual installments of $3 million on July 1, 2009; $4 million on July 1, 2010; $5 million on July 1, in each of the years 2011 to 2014, inclusive and $13 million on July 1, 2015. The Senior Notes may be prepaid at any time with the payment of an applicable yield- maintenance amount. In the event that a mandatory prepayment event occurs under the Senior Credit Agreement (certain asset dispositions, casualty events, exercises of outstanding warrants, debt and equity issuances and excess cash flow, in each case subject to certain conditions), then KapStone Kraft is required to offer to repay, without premium, a pro rata portion of the Senior Notes held by each holder who accepts the KapStone Kraft's prepayment offer (such portion based on the product of (a) the net cash proceeds from the mandatory prepayment event required to be prepaid pursuant to the Senior Credit Agreement multiplied by (b) a fraction, the numerator of which is the aggregate outstanding principal amount of the Senior Notes held by such holder and the denominator of which is the sum of (x) the aggregate outstanding principal amount under the Senior Credit Agreement and (y) the aggregate outstanding principal amount under all Senior Notes.)

The Senior Notes contain covenants substantially the same as the covenants contained in the Senior Credit Agreement.

Subject to the Intercreditor Agreement described below, if an event of default (other than an event of default resulting from certain events of bankruptcy, insolvency or reorganization) occurs and is continuing, the holders of more than 50% in principal amount of Senior Notes then outstanding may declare all of the Senior Notes immediately due and payable together with interest accrued thereon and any yield maintenance amount; provided that if such event of default arises from the failure to pay principal, any yield maintenance amount or interest on the Senior Notes, any holder of a Senior Note may declare all of the Senior Notes held by such holder to be immediately due and payable. If an event of default relating to the certain events of bankruptcy, insolvency or reorganization occurs and is continuing, the principal, interest and any yield maintenance amount on all of the Senior Notes shall automatically become immediately due and payable without notice or demand of any kind.

Intercreditor and Collateral Agency Agreement

The Company, KapStone Kraft and each of its guarantor subsidiaries entered into an Intercreditor and Collateral Agency Agreement dated July 1, 2008 (the "Intercreditor Agreement") with Bank of America, N.A., as administrative agent under the Senior Credit Agreement, and each of the holders of Senior Notes. The Intercreditor Agreement provides, among other things, that the borrowings under the Senior Credit Agreement and the Senior Notes shall be secured equally and ratably by the assets of the Company, KapStone Kraft and the Company's other domestic subsidiaries. Bank of America, N.A. is appointed as collateral agent to act on behalf of the holders of the Senior Notes and the lenders under the Senior Credit Agreement.

Alternative Fuel Credits

The U.S. Internal Revenue Code allows an excise tax credit for alternative fuel mixtures produced by a taxpayer for sale, or for use as a fuel in a taxpayer's trade or business. The credit, equal to $.50 per gallon of alternative fuel contained in the mixture, is refundable to the taxpayer. In January 2009 the Company filed to be registered as an alternative fuel mixer and is expected to receive notification that the registration was approved in April of 2009. The Company plans to use the tax credits to pay down debt.

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Subsequent Event

On March 31, 2008 the Company consummated the sale of its dunnage bag business to Illinois Tool Works, Inc. for $36.0 million. Total assets of the dunnage bag business at December 31, 2008 were approximately $17.1 million. Net cash proceeds from the transaction were used to pay down debt.

Debt Covenants

Under the financial covenants of the Senior Credit Agreement, KapStone must comply on a quarterly basis with a maximum permitted leverage ratio. The leverage ratio is calculated by dividing KapStone's debt by its rolling twelve month total earnings before interest expense, taxes, depreciation and amortization and allowable adjustments. The maximum permitted leverage ratio declines over the life of the Senior Credit Agreement. On December 31, 2008 the maximum permitted leverage ratio is 3.75 to 1.00. From March 31, 2009 through September 30, 2009 the ratio is 3.5 to 1.00. Thereafter the maximum permitted leverage ratio is 3.00 to 1.00. On December 31, 2008 KapStone was in compliance with the Senior Credit Agreement with a leverage ratio of 3.67 to 1.00.

The Senior Credit Agreement also includes a financial covenant requiring a minimum fixed charge coverage ratio. This ratio is calculated by dividing KapStone's twelve month total earnings before interest expense, taxes, depreciation and amortization and allowable adjustments less cash payments for income taxes and capital expenditures by the sum of our cash interest and principal payments during the twelve month period. From the closing date of the credit agreement through the quarter ending September 30, 2011 the fixed charge coverage ratio is required to be at least 1.10 to 1.00. Starting with the quarter ending December 31, 2011 through the end of the credit agreement, the fixed charge coverage ratio is required to be not less than 1.15 to 1.00. On December 31, 2008 KapStone was in compliance with the Senior Credit Agreement with a fixed charge coverage ratio of 1.39 to 1.00.

As of December 31, 2008 KapStone was in compliance with all applicable covenants in the Senior Credit Agreement.

Sources and Uses of Cash

Years ended December 31 (dollars in thousands)	2008	2007	2006
Operating activities	$ 47,352	$ 52,235	$ 2,431
Investing activities	(490,569)	(47,416)	(4,589)
Financing activities	390,747	51,816	

2008

Cash and cash equivalents of $4.2 million at December 31, 2008 decreased by $52.5 million during the year ended December 31, 2008, reflecting net cash inflow from operating activities of $47.4 million, net cash outflow from investing activities of $490.6 million and net cash inflow from financing activities of $390.7 million.

Net cash inflow from operating activities was $47.4 million due to net income for the period of $19.7 million, an increase in operating assets and liabilities of $24.7 million and non-cash charges of $52.4 million. Operating assets and liabilities increased mainly due to a $14.2 million increase in inventories driven by higher levels of finished goods at year end as production exceeded demand and $14.1 million for refundable and prepaid income taxes.

Net cash outflow from investing activities was $490.6 million and included payment for the CKD acquisition of $467.4 million and capital expenditures of $23.2 million. Capital expenditures of $20.3 million for the unbleached kraft segment include equipment upgrades and replacements at paper mills in Roanoke Rapids, North Carolina and North Charleston, South Carolina. In addition,

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$2.3 million of capital expenditures at corporate reflect final costs to complete the Company's new ERP system. Capital expenditures for other operating segments totaled $0.6 million.

Net cash inflow from financing activities totaled $390.7 million during the year ended December 31, 2008, and included $415.0 million of proceeds from two term loans as part of a new senior secured credit facility, $78.5 million of proceeds from borrowings under a revolving credit line, $40.0 million of proceeds from the issuance of senior notes and $15.5 million from the exercises of common stock warrants. In addition, during the year, the Company made $145.6 million of long-term debt principal payments and paid $12.6 million of debt issuance costs associated with its new senior secured credit facility.

2007

Cash flow from all activities during the year ended December 31, 2007 increased by $56.6 million from December 31, 2006, reflecting the receipt of funds held in trust at December 31, 2006 not used for the KPB acquisition of $28.3 million, and cash generated from operations of $52.2 million, partially offset by capital expenditures of $11.9 million, repayment of long-term debt of $7.5 million, acquisition costs paid of $1.2 million and an investment banking fee paid of $1.2 million.

Net cash inflow from operating activities was $52.2 million due to net income for the period of $27.0 million, changes in operating assets and liabilities of $12.8 million and non-cash charges of $12.4 million.

Net cash outflow from investing activities was $47.4 million and included payment for the KPB acquisition of $149.6 million and capital expenditures of $11.9 million. Capital expenditures of $6.1 million were for the unbleached kraft segment and include equipment upgrades and replacements at the paper mill in Roanoke Rapids, North Carolina. In addition, $5.4 million of capital expenditures at corporate included $3.9 million paid for development of a new ERP system. Capital expenditures for the all other segments totaled $0.4 million. These amounts were partially offset by receipt of funds held in trust for the KPB acquisition of $115.2 million.

Net cash inflow from financing activities totaled $51.8 million during the year ended December 31, 2007 and included proceeds form the long-term loan of $60.0 million and $1.6 million from the exercise of common stock warrants. In addition, during the year, the Company made long-term debt principal payments of $7.5 million, paid its investment banker a $1.2 million fee relating to services performed for the Company's Initial Public Offering and paid a $0.9 million fee for its credit facility.

Summary of Financial Position

At December 31 (dollars in thousands)	2008	2007	2006
Cash and cash equivalents	$ 4,165	$ 56,635	$
Working capital	63,931	65,090	112,377
Current portion of long-term debt and long-term debt and notes, net	429,929	52,500	

Cash and cash equivalents

The decrease in cash and cash equivalents in 2008 was primarily due to using approximately $56 million to fund a portion of the CKD acquisition on July 1, 2008.

The increase in cash and cash equivalents in 2007 was primarily from cash flow from operations of $52.2 million.

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Working Capital

The decrease in working capital of $1.2 million in 2008 was mainly due to a $52.5 million decrease in cash and cash equivalents, an increase in accounts payable and accrued expenses assumed from the CKD acquisition and $21.0 million of higher current portion of long-term debt relating to the new senior secured credit facility offset by higher trade accounts receivables and inventories acquired as part of the CKD acquisition and $14.1 million of refundable and prepaid income taxes.

The decrease in working capital in 2007 reflects the use of restricted cash held in trust to fund a portion of the KPB acquisition offset by trade accounts receivable, inventories, prepaid expenses, accounts payable and accrued expenses acquired and assumed as part of the KPB acquisition.

Current portion of long-term debt and long-term debt and notes

The $377.4 million increase in current portion of long-term debt and long-term debt in 2008 reflects $455.0 million of proceeds from the Company's new senior secured credit facility and senior notes to fund the CKD acquisition and $78.5 million of proceeds from the revolving credit facility, offset by principal repayments including the outstanding balance from the prior credit facility of $145.6 million. In addition, at December 31, 2008, the Company has $12.4 million of borrowings outstanding from the revolving credit facility.

The $52.5 million increase in current portion of long-term debt and long-term debt in 2007 reflects $60.0 million of proceeds from the Company's first credit facility used to fund a portion of the KPB acquisition, offset by $7.5 million of principal repayments.

Future Cash Needs

We expect that cash generated from operating activities and, if needed, the ability to draw from our revolving credit facility will be sufficient to meet anticipated 2009 cash needs primarily consisting of $40.6 million of debt service, approximately $30.0 million of capital expenditures and any additional working capital needs. At December 31, 2008 the Company utilized $12.4 million on the $100 million revolving credit facility.

Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet financing arrangements and have not established any special purpose entities. We have not guaranteed any debt or commitments of other non-related entities or entered into any options on non-financial assets.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates. KapStone believes its most critical accounting policies are those described below. For a detailed discussion of these and other accounting policies, see Note 2 to the consolidated financial statements.

Revenue Recognition Revenue is recognized when the customer takes title and assumes the risks and rewards of ownership. Sales with terms designated f.o.b. (free on board) shipping point are recognized at the time of shipment. For sales transactions designated f.o.b. destination, revenue is recorded when the product is delivered to the customer's site and when title and risk of loss are transferred. Sales on consignment are recognized in revenue at the earlier of the month that the goods are consumed or after a period of time subsequent to receipt by the customer as specified by contract

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terms. Incentive rebates are typically paid in cash and are netted against revenue on an accrual basis as qualifying purchases are made by the customer to earn and thereby retain the rebate.

The Company recognizes revenue from the sale of shaft horsepower, generated by its cogeneration facility, on a gross basis and within net sales. These sales are included in the unbleached kraft segment.

Freight charged to customers is recognized in net sales.

Goodwill and Intangible Assets Goodwill is the excess of cost over the fair value of the net assets of businesses acquired. On an annual basis and in accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standard ("SFAS") No. 142, *Goodwill and Other Intangible Assets* ("SFAS No. 142"), the Company tests for goodwill impairment annually using a two-step process, unless there is a triggering event, in which case a test would be performed at the time that such triggering event occurs. The first step is to identify a potential impairment by comparing the fair value of a reporting unit with its carrying amount. For all periods presented, the Company's reporting units are consistent with its operating segments. The estimates of fair value of a reporting unit are determined based on a discounted cash flow analysis. A discounted cash flow analysis requires the Company to make various judgmental assumptions, including assumptions about future cash flows, growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the forecast and long-term business plans of each operating segment. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting units. If necessary, the second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination.

The Company's goodwill impairment analysis is performed annually at the beginning of the fourth quarter. However, as a result of the dramatic change in the economic and market conditions in the fourth quarter of 2008, including the change in the Company's stock price as compared to its book value per share and the significant disruptions in the global credit markets, the Company performed an interim impairment test for goodwill as of the fiscal year end 2008. The Company's annual and interim impairment tests did not result in an impairment charge for goodwill in the years presented.

Pension and Postretirement Benefits KapStone provides pension and postretirement benefits to certain employees. For financial reporting purposes, long-term assumptions are developed through consultations with actuaries. Such assumptions include the expected long-term rate of return on plan assets, discount rates, health care trend rates and mortality rates. The discount rate for the current year is based on long-term high quality bond rates.

Income Taxes The Company accounts for income taxes under the liability method in accordance with Statement of Financial Accounting Standard ("SFAS") No. 109, *Accounting for Income Taxes*. Accordingly, deferred income taxes are provided for the future tax consequences attributable to differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets and liabilities are measured using tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized.

Stock Based Compensation Costs The Company accounts for stock compensation expense in accordance with SFAS No. 123(R), *Accounting for Stock Based Compensation*. The compensation expense for stock options is recorded on an accelerated basis over the awards' vesting periods. The compensation expense for restricted stock is recorded on a straight-line basis over the awards' vesting periods.

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Recent Accounting Pronouncements

See Note 2 in the Notes to Consolidated Financial Statements for a discussion of recent accounting pronouncements.

Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2008 ($000's):

	Payments Due by Period						
Contractual Obligations	**Total**	**1 Year**	**2 Years**	**3 Years**	**4 Years**	**5 Years**	**Thereafter**
Long-term debt and notes(1)	$440,389	$ 40,556	$ 49,056	$ 55,062	$ 55,062	$213,305	$ 27,348
Interest on long-term debt and notes(2)	70,766	17,817	16,162	14,094	11,944	6,518	4,231
Operating lease obligations(3)	18,010	3,991	3,701	3,422	2,429	1,457	3,010
Purchase obligations(4)	366,566	34,001	33,067	31,767	31,117	30,256	206,358
Minimum pension plan funding(5)	7,252	7,252					
Total	$902,983	$103,617	$101,986	$104,345	$100,552	$251,536	$ 240,947

(1) These obligations are reflected on our Consolidated Balance Sheets at December 31, 2008 in current portion of long-term debt and notes, and long-term debt and notes, as appropriate.

(2) Assumes debt is carried to full term and includes any mandatory prepayment for 2009. Debt bears interest at variable rates and the amounts above assume future interest will be incurred at in the rates in effect on December 31, 2008. These obligations are not reflected on our Consolidated Balance Sheet at December 31, 2008.

(3) These obligations are not reflected on our Consolidated Balance Sheet at December 31, 2008. The Company has no capital lease obligations.

(4) Purchase obligations are agreements to purchase goods that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased. These obligations are not reflected on our Consolidated Balance Sheet at December 31, 2008. See Note 4 of Notes to Consolidated Financial Statements regarding the Company's purchase obligation relating to the Long Term Fiber Supply with MWV.

(5) The Company's pension and post retirement liabilities were $8.4 million as of December 31, 2008. This minimum pension plan funding represents the Company's expected 2009 contributions and was determined in accordance with IRS guidelines.

The KPB acquisition includes contingent earn-out payments of up to $60 million based on KPB's EBITDA during the five year period immediately following the acquisition. The payments, if earned, will be due and payable in early 2012. The potential earn-out payments are not included in the contractual obligations table as all conditions for the payments have not been met.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the sensitivity of income to changes in interest rates, commodity prices and foreign currency changes. The Company is exposed to the following types of market risk: interest rates, commodity prices and foreign currency.

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Interest rates

Under KapStone's Senior Secured Credit Facility, at December 31, 2008 we have outstanding variable based interest rate term loans totaling $388.0 million and advances under the revolving credit facility of $12.4 million. The facility has various maturity dates from June 12, 2013 through June 12, 2015. Borrowings under the term loan accrue interest, at our option, at either: Eurodollar plus 1.5% to 3.5% depending on KapStone's total debt to EBITDA ratio (as defined in the agreement); or the Base Rate (prime rate) plus 0% to 2.0% depending on KapStone's total debt to EBITDA ratio.

Changes in market rates may impact the bank's Eurodollar rate. For instance, if the bank's Eurodollar rates were to increase or decrease by one percentage point (1.0%), our annual interest expense would change by approximately $3.8 million based upon our expected future monthly loan balances per our existing repayment schedule.

Commodity prices

We are exposed to price fluctuations of certain commodities used in production. Key raw materials and energy used in the production process include roundwood and woodchips, fuel oil, electricity and caustic soda. We purchase these raw materials and energy at market prices, and do not use forward contracts or other financial instruments to hedge our exposure to price risk related to these commodities. We have two contracts to purchase coal at fixed prices that expire on December 31, 2009.

We are exposed to price fluctuations in the price of our finished goods. The prices we charge for our products are primarily based on market conditions.

Foreign currency

We are exposed to currency fluctuations as we invoice certain European customers in euros. At times, the Company uses forward contracts to reduce the impact of currency fluctuations. No such contracts were outstanding at December 31, 2008.

Item 8. Financial Statements and Supplementary Data

Financial statements are attached hereto beginning on Page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures.

An evaluation of the effectiveness of our disclosure controls and procedures as of December 31, 2008 was made by our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Disclosure controls and procedures are designed to ensure that information required to be disclosed is accumulated and communicated to management, including our principal executive and principal financial officers to allow for timely decisions regarding financial disclosure.

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Internal Control over Financial Reporting.

Management Annual Report on Internal Control over Financial Reporting. Our management's report on internal control over financial reporting is set forth on page F-2 of this report.

Our management has excluded CKD from its assessment of internal control over financial reporting as of December 31, 2008 as it was acquired by us in a purchase business combination on July 1, 2008. CKD is a wholly-owned subsidiary whose total assets and total revenues represent 74% and 48%, respectively, of our consolidated financial statement amounts as of, and for the year ended December 31, 2008. Under guidelines established by the Securities and Exchange Commission, companies are allowed to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition.

Changes in Internal Control over Financial Reporting. No change was identified in connection with the evaluation required by Rule 13a-15(d) under the Securities Exchange Act of 1934 that occurred during the fourth quarter of fiscal 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information called for by this Item with respect to our Executive Officers is furnished in Part I of this Form 10-K under the caption "Executive Officers of the Registrant."

Additional information required by this Item (i) with respect to members of our Board of Directors will be contained in the Company's Proxy Statement under the caption "Election of Directors," (ii) with respect to our audit committee will be contained in the Company's Proxy Statement under the caption "Election of Directors What Committees has the Board of Directors Established?," (iii) with respect to compliance under Section 16(a) of the Securities Exchange Act of 1934 will be contained in Company's Proxy Statement under the caption "Section 16(a) Beneficial Ownership Reporting Compliance," and (iv) with respect to our code of ethics will be contained in the Company's Proxy Statement under the caption "Code of Ethics," and is incorporated herein by this reference.

Item 11. Executive Compensation

The information required by this Item is contained in the Company's Proxy Statement under the captions "Executive Compensation," "Compensation Discussion and Analysis," "Report of the Compensation Committee of the Board of Directors," "Compensation Committee Interlocks and Insider Participation," "Summary Compensation Information," "Grants of Plan-Based Awards Table," "Outstanding Equity Awards at December 31, 2008," "Potential Payments upon Termination or Change-in-Control," and "2008 Director Compensation" and is incorporated herein by this reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item will be contained in the Company's Proxy Statement under the captions "Securities Authorized for Issuance Under Equity Compensation Plan", "Stock Ownership of Directors and Executive Officers" and "Certain Beneficial Stockholders" and is incorporated herein by this reference.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by this Item will be contained in the Company's Proxy Statement under the captions "Certain Relationships and Related Person Transactions," "Nominating and Governance Committee" and "Election of Directors What Committees has the Board Established?" and is incorporated herein by this reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item will be contained in the Company's Proxy Statement under the caption "Independent Registered Public Accounting Firm" and is incorporated herein by this reference.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) **Financial Statements**

An index to Consolidated Financial Statements appears on page F-1.

(a)(2) **Financial Statement Schedule**

Certain financial statement schedules have been omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

(b) **Exhibits.**

The following Exhibits are filed as part of this report:

Exhibit No.	Description
2.1	Purchase Agreement, dated June 23, 2006, by and among International Paper Company, the Registrant, and KapStone Kraft Paper Corporation.(1)
2.2	Letter Amendment to Purchase Agreement, dated June 23, 2006, by and among International Paper Company, the Registrant, and KapStone Kraft Paper Corporation, dated December 15, 2006.(2)
2.3	Asset Purchase Agreement dated April 4, 2008 among MeadWestvaco South Carolina LLC, MeadWestvaco Corporation, KapStone Paper and Packaging Corporation and Oak Acquisition, LLC.(7)
3.1	Amended and Restated Certificate of Incorporation.(3)
3.2	Certificate of Amendment of the Amended and Restated Certificate of Incorporation(2)
3.3	Amended and Restated By-laws.(8)
4.1	Specimen Unit Certificate.(3)
4.2	Specimen Common Stock Certificate.(3)
4.3	Specimen Warrant Certificate.(3)
4.4	Form of Unit Purchase Option to be granted to Representative.(2)
4.5	Form of Warrant Agreement between Continental Stock Transfer & Trust Company and the Registrant.(3)
4.6	Amended and Restated Warrant Clarification Agreement.(4)
4.7	Amended and Restated Unit Purchase Clarification Agreement(5)
10.1	Form of Letter Agreement among the Registrant, Morgan Joseph & Co. Inc. and each of the Initial Stockholders.(3)
10.11	Lease Agreement between City of Fordyce, Arkansas and IP.(2)
10.13+	Amendment to the KapStone Paper and Packaging Corporation 2006 Incentive Plan.(8)

10.14+ Performance Incentive Plan of KapStone Paper and Packaging Corporation.(8)

10.15+ Form of Restricted Stock Unit Agreement.(8)

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Exhibit No.	Description
10.16	Long-Term Fiber Supply Agreement, dated July 1, 2008, by and among MeadWestvaco Forestry LLC and KapStone Charleston Kraft LLC (with certain confidential information deleted there from).(9)
10.17	Note Purchase Agreement, dated July 1