

Mossberg's Investor Digest

Best Idea Profile:

KapStone Paper and Packaging Corporation (NYSE:KS)

DESCRIPTION:

KapStone Paper and Packaging Corporation produces a wide spectrum of bleached and unbleached kraft paper and corrugated products for domestic and international markets. It has four paper mills with capacity of 2.7 million tons and 22 converting plants strategically spread throughout the U.S. to meet customer needs. Containerboard, primarily corrugated boxes of various grades and weights, represents 1.7 million tons per year of the company's production. KapStone generates 600,000 tons per year in kraft papers, including multiwall, various kraft grades and packaging for food, pet food, grocery and yard debris. Approximately 260,000 tons per year is used in various high pressure laminates, including furniture, shelving, countertops and flooring. In this market it is the market leader. The company was founded in 2005, is headquartered in Northbrook, Illinois, and employs approximately 4,500 people.

KEY INVESTMENT CONSIDERATIONS:

Impressive Growth – From its inception in 2005 KapStone shareholder funds have increased at a compound annual growth rate of 39%; it now has more than \$2 billion in market capitalization. Management's goal is to grow profitably by investing in brown paper and packaging assets where it can optimize the operation of acquired companies and focus on cash generation. It appears to have a good track record so far as it has paid off 95% of the first three acquisitions. The most recent quarter's results set all-time records in net sales and adjusted diluted earnings per share of \$0.48.

Favorable Industry Environment – The industry is undergoing consolidation. Although supply and demand appear to be in balance currently, the industry's inventories are low with a strong expectation that demand will continue to increase as worldwide economies improve. There will be only minimal growth in supply. Pricing is up in most grades with increases announced in spring 2013 that will begin to be fully realized in the third quarter results. Pricing was a significant contributor to the record results in the second quarter even before its full impact hits.

Recent Acquisition a Great Fit – In July 2013 KapStone acquired Longview Fibre and Packaging, Inc. for \$1 billion in a cash-free and debt-free transaction. It improves the geographic footprint and diversifies the product mix offered by KapStone. It also creates a

strong global position in the kraft paper segment as it has an established global customer base in 35 countries. Longview adds the ability to produce products that are 100% recycled. Possibly most significantly in the short term, the acquisition is immediately accretive to earnings. Further, the opportunities for growth and synergies are appealing when the companies are fully integrated.

Flexibility – Management expects a positive industry environment will continue but the company can quickly de-lever if needed because of its strong free cash flow. On the other hand the current asset base provides good growth opportunities, and increased utilization of the converting facilities can increase revenue and profits.

VALUATION:

The largest shareholders of KS, including immediate family, control 14% of the shares. The adjusted diluted earnings per share for KS (based on annualized second quarter combined results) is \$3.28. The appeal of this stock comes from the immediate impact of this combined company, the potential for growth, and the support from its shareholders.

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Investment Data (as of 10/25/13)

Recent Price	\$45.83
52-Week Range	\$19.24 - \$50.10
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	48 M
Average Trading Volume (3 mos)	338k
Market Capitalization	\$2.2 B
Cash	\$8.4 M
Long-term Debt	\$311.0 M
Enterprise Value (EV)	\$2.5 B
Book Value	\$11.81
TTM Revenue	\$1.3 B
P/ Revenue	1.8x
TTM EPS	\$1.42
P/ EPS	32.3 x
TTM EBITDA	\$187.3 M
EV/ EBITDA	13.4 x

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