

Stone Arcade Acquisition CORP  
Form PRER14A  
November 28, 2006

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

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934  
(Amendment No. 3)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**Stone Arcade Acquisition Corporation**

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:  
None

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(2) Aggregate number of securities to which transaction applies:  
None

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):  
Calculated based on the purchase price of \$155,000,000 in cash delivered at the closing of the transaction

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(4) Proposed maximum aggregate value of transaction:  
\$155,000,000

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(5) Total fee paid:  
\$16,585

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ý Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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**STONE ARCADE ACQUISITION CORPORATION**

c/o Stone-Kaplan Investments, LLC  
One Northfield Plaza, Suite 480  
Northfield, Illinois 60093

**To the Stockholders of Stone Arcade Acquisition Corporation:**

You are cordially invited to attend a special meeting of the stockholders of Stone Arcade Acquisition Corporation, or Stone, relating to the proposed acquisition of substantially all of the assets of the Kraft Papers Business, or KPB, a division of International Paper Company, or IP, which will be held at 10:00 a.m., Central time, on \_\_\_\_\_, 2006, at the offices of Stone, located at One Northfield Plaza, Suite 480, Northfield, IL 60093.

At this important meeting, you will be asked to consider and vote upon the following proposals:

the adoption and approval of the transactions contemplated by the Purchase Agreement, dated as of June 23, 2006, among Stone, KapStone Kraft Paper Corporation, a wholly-owned subsidiary of Stone, or KapStone Kraft, and IP we call this proposal the acquisition proposal;

the approval of an amendment to Stone's certificate of incorporation to change Stone's name to "KapStone Paper and Packaging Corporation" we call this proposal the name change amendment proposal;

the approval of an amendment to Stone's certificate of incorporation to remove the preamble and sections A through D, inclusive, of Article SIXTH from the certificate of incorporation after the closing of the acquisition, as these provisions will no longer be applicable to Stone, and to redesignate section E of Article SIXTH as Article SIXTH we call this proposal the Article SIXTH amendment proposal; and

the approval of Stone's 2006 Incentive Plan we call this proposal the incentive plan proposal.

The approval of the foregoing proposals requires the affirmative vote of:

a majority of those shares of Stone's common stock issued in its initial public offering, which we call IPO shares, that are voted at the meeting to adopt the acquisition proposal;

a majority of the issued and outstanding shares of Stone's common stock to adopt the name change amendment proposal;

a majority of the issued and outstanding shares of Stone's common stock to adopt the Article SIXTH amendment proposal; and

a majority of the shares of Stone's common stock represented in person or by proxy and entitled to vote at the meeting to adopt the incentive plan proposal.

Adoption by Stone stockholders of the acquisition proposal is not conditioned upon the adoption of the name change amendment proposal, the Article SIXTH amendment proposal or the incentive plan proposal. However, the adoption of the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal are conditioned upon the adoption of the acquisition proposal.

As provided in Stone's certificate of incorporation, each Stone stockholder (other than an officer or director of Stone) who holds shares of common stock issued in Stone's initial public offering, which we call IPO shares, has the right to vote against the acquisition proposal and at the same time demand that Stone redeem such stockholder's shares for cash equal to such stockholder's pro rata portion of the trust account which contains a substantial portion of the net proceeds of Stone's initial public offering. These IPO shares will be redeemed for cash only if the acquisition is completed. If holders of 4,000,000 or more IPO shares, which represents 20% or more of the total number of IPO shares, vote against the acquisition and demand redemption of their shares for their pro rata portion of the trust account, then, in accordance with Stone's

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certificate of incorporation and the terms governing the trust account, Stone will not consummate the acquisition. If Stone does not consummate a business combination by the later of February 19, 2007, or August 19, 2007 in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed but not consummated by February 19, 2007, then, pursuant to Article SIXTH of Stone's certificate of incorporation, and in accordance with Section 281(b) of the Delaware General Corporation Law, Stone will adopt a plan of dissolution and as soon as reasonably possible after dissolution make liquidating distributions from the trust account to its stockholders. Prior to exercising

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redemption rights, Stone stockholders should verify the market price of Stone's common stock as they may receive higher proceeds from the sale of their common stock in the public market than from exercising their redemption rights. Stone's shares of common stock are quoted on the Over-the-Counter Bulletin Board under the symbol "SCDE." On \_\_\_\_\_, 2006, the last sale price of Stone's common stock was \$ \_\_\_\_\_. As of the same date, the beneficial value per share of the amounts held in the trust account (which amount approximately equals the amount receivable upon exercise of redemption rights) was approximately \$ \_\_\_\_\_.

Stone's initial stockholders, who are Stone's current officers and directors, have agreed to vote their 5,000,000 shares of Stone common stock acquired prior to Stone's initial public offering, representing an aggregate of 20% of the outstanding shares of Stone common stock, in accordance with the vote of the majority of the IPO shares voted at the meeting with respect to the acquisition proposal. In addition, Stone's Chief Executive Officer intends to vote 500,000 shares of common stock acquired by him in Stone's initial public offering, representing 2% of the outstanding shares of Stone common stock, and 2.5% of the outstanding IPO shares, "FOR" the adoption of the acquisition proposal. Stone's officers and directors, including Stone's Chief Executive Officer, intend to vote all of their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" each of the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal. To date, only Mr. Stone owns IPO shares through his purchase of units, consisting of 500,000 IPO shares and 1,000,000 warrants, in the initial public offering. None of the other officers or directors of Stone acquired units, or IPO shares, in the initial public offering or in the aftermarket.

After careful consideration, Stone's board of directors has determined that the acquisition proposal is fair and in the best interest of Stone and its stockholders. As required by Stone's certificate of incorporation, Stone's board of directors has also determined that the KPB assets to be acquired have a fair market value equal to at least 80% of Stone's net assets, inclusive of the amount in the trust account. Stone's board of directors has determined that the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal are in the best interests of Stone's stockholders. Stone's board of directors unanimously recommends that you vote or give instruction to vote "FOR" the adoption of the acquisition proposal, the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal.

Enclosed is a notice of special meeting and proxy statement containing detailed information concerning the acquisition proposal and the transactions contemplated thereby as well as detailed information concerning the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal.

Your vote is important. Whether or not you plan to attend the special meeting, we urge you to read this material carefully, sign, date and return the enclosed proxy card as soon as possible in the envelope provided. If you sign and return the proxy card but do not give instructions on how to vote your shares, your shares will be voted as recommended by Stone's board "FOR" the adoption of the acquisition proposal, the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal.

I look forward to seeing you at the meeting.

Sincerely,

Roger Stone,  
Chairman of the Board and  
Chief Executive Officer

Neither the Securities and Exchange Commission nor any state securities commission has determined if this proxy statement is truthful or complete. Any representation to the contrary is a criminal offense.

**See "Risk Factors" beginning on page 23 for a discussion of various factors that you should consider in connection with the acquisition proposal.**

This proxy statement is dated \_\_\_\_\_, 2006 and is first being mailed to Stone stockholders on or about \_\_\_\_\_, 2006.

**STONE ARCADE ACQUISITION CORPORATION**

c/o Stone-Kaplan Investments, LLC  
One Northfield Plaza, Suite 480  
Northfield, Illinois 60093

**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS  
TO BE HELD ON \_\_\_\_\_, 2006**

**To the Stockholders of Stone Arcade Acquisition Corporation:**

NOTICE IS HEREBY GIVEN that a special meeting of stockholders, including any adjournments or postponements thereof, of Stone Arcade Acquisition Corporation, or Stone, a Delaware corporation, will be held at 10:00 a.m., Central time, on \_\_\_\_\_, 2006, at the offices of Stone, located at One Northfield Plaza, Suite 480, Northfield, IL 60093:

to consider and vote upon the adoption and approval of the transactions contemplated by the Purchase Agreement, dated as of June 23, 2006, among Stone, KapStone Kraft Paper Corporation, a wholly-owned subsidiary of Stone, or KapStone Kraft, and International Paper Company, or IP we call this proposal the acquisition proposal;

to consider and vote upon an amendment to Stone's certificate of incorporation to change Stone's name to "KapStone Paper and Packaging Corporation" we call this proposal the name change amendment proposal;

to approve an amendment to Stone's certificate of incorporation to remove the preamble and sections A through D, inclusive, of Article SIXTH from the certificate of incorporation after the closing of the acquisition, as these provisions will no longer be applicable to Stone, and to redesignate section E of Article SIXTH as Article SIXTH we call this proposal the Article SIXTH amendment proposal; and

to consider and vote upon Stone's 2006 Incentive Plan we call this proposal the incentive plan proposal.

These items of business are described in the attached proxy statement, which we encourage you to read in its entirety before voting. Only holders of record of Stone's common stock at the close of business on November 17, 2006 are entitled to receive notice of, and to vote at, the Stone special meeting and any and all adjournments thereof. Stone will not transact any other business at the special meeting except for business properly brought before the special meeting or any adjournment or postponement of it by Stone's board of directors.

Your vote is important. Please sign, date and return your proxy card as soon as possible to make sure that your shares are represented at the special meeting. If you are a stockholder of record of Stone common stock, you may also cast your vote in person at the special meeting. If your shares are held in an account at a brokerage firm or bank, you must instruct your broker or bank on how to vote your shares. If you abstain from voting or do not instruct your broker or bank how to vote your shares it will have no effect on the acquisition proposal, but will have the same effect as voting against the name change amendment proposal and the Article SIXTH amendment proposal. If you do not instruct your broker or bank how to vote on the incentive plan proposal, it will have no effect on the incentive plan proposal. However, if you abstain from voting on the incentive plan proposal it will have the same effect as a vote against the incentive plan proposal.

Stone's board of directors unanimously recommends that you vote "FOR" the adoption of each proposal listed above.

By Order of the Board of Directors,

Roger Stone, Chairman of the Board and  
Chief Executive Officer

\_\_\_\_\_, 2006

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**SUMMARY OF THE MATERIAL TERMS OF THE ACQUISITION**

The parties to the Purchase Agreement are Stone Arcade Acquisition Corporation, or Stone, KapStone Kraft Paper Corporation, or KapStone Kraft, and International Paper Company, or IP. See the section entitled "*The Acquisition Proposal.*"

Stone, through KapStone Kraft, will purchase the assets and assume certain liabilities of the Kraft Papers Business, or KPB, a division of IP, which consists of IP's Roanoke Rapids, North Carolina facility, which we refer to herein as Roanoke Rapids, and Ride Rite® Converting, located in Fordyce, Arkansas. See the section entitled "*The Acquisition Proposal.*"

Roanoke Rapids is a pulp and paper mill that produces unbleached kraft paper and lightweight linerboard. Ride Rite® Converting converts unbleached kraft paper into inflatable dunnage bags. See the section entitled "*Information about KPB.*"

KapStone Kraft will enter into certain ancillary agreements, including a transition services agreement whereby IP will provide certain operational support after the closing, and certain supply and purchase agreements with IP and other third parties. See the section entitled "*The KPB Purchase Agreement Ancillary Agreements.*"

As a condition to the closing of the acquisition KapStone Kraft must have obtained from LaSalle Bank, N.A. a senior secured credit facility in the amount of \$95,000,000 to be used to fund a portion of the purchase price of the acquisition. See the section entitled "*Acquisition Financing.*"

The consideration for the purchase of the assets of KPB is \$155,000,000 in cash, payable at closing (subject to a working capital adjustment described herein), plus two contingent earn-out payments, (A) of up to \$35,000,000 and (B) \$25,000,000, based on KPB's annual earnings before interest, income taxes, depreciation and amortization, or EBITDA, during the five year period immediately following the acquisition, and assumption of approximately \$4,800,000 in long-term liabilities. See the sections entitled "*The KPB Purchase Agreement Contingent Earn-Out Payments*" and "*The KPB Purchase Agreement Assumed Liabilities.*"

The contingent earn-out payment A is equal to 5.3 times the average annual EBITDA of KPB for the five years immediately following the acquisition, less \$165,000,000, with a provision that such payment may not exceed \$35,000,000 or be a negative amount. The contingent payment B will be earned, on an "all or none" basis, if the average annual EBITDA of KPB for the five year period immediately following the acquisition equals or exceeds \$49,200,000. See the section entitled "*The KPB Purchase Agreement Purchase Price Contingent Earn-Out Payments.*"

The \$155,000,000 cash payment at closing is 5.0 times KPB's EBITDA for the fiscal year ended December 31, 2005.

In the event Stone pays all of the contingent earn-out payment A of \$35,000,000 (but none of contingent earn-out payment B), the purchase price paid will be no more than 5.0 times the average EBITDA for the five year period immediately following the acquisition.

In the event Stone pays all of the contingent earn-out payment A of \$35,000,000 and contingent earn-out payment B of \$25,000,000, the purchase price paid will be no more than 4.4 times the average EBITDA for the five year period immediately following the acquisition.

The closing of the acquisition is subject to the satisfaction by each party of various conditions prior to closing. See the section entitled "*The KPB Purchase Agreement Conditions to the Completion of the Acquisition.*"

*Non-GAAP Financial Measures*

This proxy statement contains disclosure of EBITDA, which is a non-GAAP financial measure within the meaning of Regulation G promulgated by the Securities and Exchange Commission. Stone's management believes that EBITDA, or earnings before interest, income taxes, depreciation and amortization, is an appropriate measure for evaluating operating performance and liquidity, because it reflects the resources available for strategic opportunities including, among others, investments in the business and strategic acquisitions. The disclosure of EBITDA may not be comparable to similarly titled measures reported by other companies. EBITDA should be considered in addition to, and not as a substitute for, or superior to, operating income, cash flows, revenue, or other measures of financial performance prepared in accordance with generally accepted accounting principles. In addition, EBITDA will be used in determining the contingent earn-out payments payable in connection with acquisition of KPB.

**QUESTIONS AND ANSWERS ABOUT  
THE PROPOSALS**

**Q.**  
**What is being voted on?**

A. There are four proposals that you are being asked to vote on. The first proposal is to approve the transactions contemplated by the Purchase Agreement providing for the acquisition of the KPB assets. This first proposal is called the acquisition proposal. See page .

The second proposal is to adopt an amendment to Stone's certificate of incorporation to change Stone's name to "KapStone Paper and Packaging Corporation." This second proposal is called the name change amendment proposal. See page .

The third proposal is to adopt an amendment to Stone's certificate of incorporation to eliminate certain provisions of Article SIXTH that will no longer be applicable to Stone after the consummation of the acquisition. This third proposal is called the Article SIXTH amendment proposal. See page .

The fourth proposal is to adopt Stone's 2006 Incentive Plan. This fourth proposal is called the incentive plan proposal. See page .

**Q.**  
**Who is entitled to vote?**

A. Only holders of record of Stone's common stock at the close of business on November 17, 2006 are entitled to receive notice of, and to vote at, the Stone special meeting and any and all adjournments thereof. Warrant holders are not entitled to vote.

**Q.**  
**Why is Stone proposing the acquisition proposal?**

A. Stone was organized to effect a business combination with an operating business in the paper, packaging, forest products or related industries. Under the terms of its certificate of incorporation, prior to completing a business combination, Stone must submit the transaction to its stockholders for approval. Stone has negotiated the terms of a business combination with IP with respect to the acquisition of the KPB assets. Stone is now submitting the transaction to its stockholders for their approval.

**Q.**  
**What vote is required in order to adopt the acquisition proposal?**

A. Adoption of the acquisition proposal requires the affirmative vote of a majority of the IPO shares voted at the meeting. However, notwithstanding adoption of the acquisition proposal, the acquisition will only proceed if holders of no more than 20% of the IPO shares exercise their redemption rights. See page . No vote of the warrant holders is necessary to adopt the acquisition proposal, and, accordingly, Stone is not asking the warrant holders to vote on the acquisition proposal. Adoption of the acquisition proposal is not conditioned upon the adoption of the name change amendment proposal, the Article SIXTH amendment proposal or the incentive plan proposal. See page .

**Q.**  
**Why is Stone proposing the name change amendment proposal?**

A. Stone believes that the name "KapStone Paper and Packaging Corporation" better reflects the business it will conduct after the acquisition, and will enable industry and financial market participants to better associate Stone with its operating business.

**Q.**  
**What vote is required to adopt the name change amendment proposal?**

A. Adoption of the name change amendment proposal requires the affirmative vote of a majority of the issued and outstanding shares of Stone's common stock. No vote of the warrant holders is necessary to adopt the name change amendment proposal, and, accordingly,

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Stone is not asking the warrant holders to vote on the name

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change amendment proposal. Adoption of the name change amendment proposal is conditioned upon the adoption of the acquisition proposal, but is not conditioned on adoption of the Article SIXTH amendment proposal or the incentive plan proposal. See page .

Q.

**Why is Stone proposing the Article SIXTH amendment proposal?**

A.

The Article SIXTH amendment proposal allows the revision of Stone's certificate of incorporation to reflect the adoption of the acquisition proposal by removing language that would no longer apply after the acquisition.

Q.

**What vote is required to adopt the Article SIXTH amendment proposal?**

A.

Adoption of the Article SIXTH amendment proposal requires the affirmative vote of a majority of the issued and outstanding shares of Stone's common stock. No vote of the warrant holders is necessary to adopt the Article SIXTH amendment proposal, and, accordingly, Stone is not asking the warrant holders to vote on the Article SIXTH amendment proposal. Adoption of the Article SIXTH amendment proposal is conditioned upon the adoption of the acquisition proposal, but is not conditioned upon adoption of the name change amendment proposal or the incentive plan proposal. See page .

Q.

**Why is Stone proposing the 2006 Incentive Plan proposal?**

A.

Stone is proposing the incentive plan to enable it to attract, retain and reward its directors, officers, employees and consultants using equity-based incentives following the acquisition. The incentive plan has been approved by Stone's board of directors and will be effective upon consummation of the acquisition.

Q.

**What vote is required to adopt the 2006 Incentive Plan proposal?**

A.

Adoption of the incentive plan proposal requires the affirmative vote of a majority of the shares of Stone's common stock represented in person or by proxy and entitled to vote at the special meeting. No vote of the warrant holders is necessary to adopt the incentive plan proposal, and, accordingly, Stone is not asking the warrant holders to vote on the incentive plan proposal. Adoption of the incentive plan proposal is conditioned upon the adoption of the acquisition proposal, but is not conditioned upon the adoption of the name change amendment proposal or the Article SIXTH amendment proposal. See page .

Q.

**Does the Stone board recommend voting in favor of the acquisition proposal, the name change amendment, the amendment of Article SIXTH and the incentive plan proposal?**

A.

Yes. After careful consideration of the terms and conditions of the Purchase Agreement, the amendments to the certificate of incorporation and the incentive plan, the board of directors of Stone has determined that the acquisition and the transactions contemplated thereby, and the amendments to the certificate of incorporation and adoption of the incentive plan are fair and in the best interest of Stone and its stockholders. The Stone board of directors unanimously recommends that the Stone stockholders vote **FOR** each of (i) the acquisition proposal, (ii) the name change amendment, (iii) the Article SIXTH amendment, and (iv) the incentive plan proposal. The members of Stone's board of directors have interests in the acquisition that are different from, or in addition to, your interests as a stockholder. For a description of such interests, please see the section entitled "*Summary of the Proxy Statement Interests of Stone's Directors and Officers in the Acquisition.*"

For a description of the factors considered by Stone's board of directors in making its determination to approve the acquisition, see the section entitled "*The Acquisition Proposal Factors Considered by the Stone Board in Approving the Acquisition.*"

Q.

**Do I have the right to redeem my shares for cash?**

A.

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If you hold shares of common stock issued in Stone's initial public offering, which we call IPO shares, then you have the right to vote against the acquisition proposal and demand that Stone redeem your shares for your pro



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rata portion of the trust account in which a substantial portion of the net proceeds of Stone's initial public offering are held. We refer to the right to vote against the acquisition and demand redemption of your shares for your pro rata portion of the trust account as your redemption rights. However, if the holders of 4,000,000 or more IPO shares, representing 20% or more of the total number of IPO shares, exercise their redemption rights, then, in accordance with the terms of Stone's certificate of incorporation and the documents governing the trust account, Stone will not consummate the acquisition and your shares will not be redeemed. Warrant holders do not have redemption rights. See page .

**Q.**

### **How do I exercise my redemption rights?**

**A.**

If you wish to exercise your redemption rights, you must vote against the acquisition and at the same time affirmatively demand that Stone redeem your shares for cash. You will not have an opportunity to remedy an improper exercise of your redemption rights. If, notwithstanding your vote, the acquisition is completed, then you will be entitled to receive your pro rata share of the trust account in which a substantial portion of the net proceeds of Stone's initial public offering are held, including your pro rata share of any interest earned thereon through the date of the special meeting. Based on the amount of cash held in the trust account at November , 2006, you will be entitled to redeem each share that you hold for approximately \$ . If you exercise your redemption rights, then you will be exchanging your shares for cash and will no longer own these shares. You will only be entitled to receive cash for these shares if you continue to hold these shares through the closing date of the acquisition and then tender your stock certificate to Stone. If the acquisition is not completed, your shares will not be redeemed for cash. See page .

Prior to exercising redemption rights, Stone stockholders should verify the market price of Stone's common stock as they may receive higher proceeds from the sale of their common stock in the public market than from exercising their redemption rights. Stone's shares of common stock are listed on the Over-the-Counter Bulletin Board under the symbol "SCDE."

**Q.**

### **What is Stone acquiring in the acquisition?**

**A.**

Stone, through a wholly-owned subsidiary formed by it for the purpose of the acquisition, will acquire substantially all of the assets and assume certain limited liabilities of KPB, a division of IP. The assets being acquired consist principally of a facility in Roanoke Rapids, North Carolina, which is North America's leading manufacturer of unbleached kraft paper, the Ride Rite® Converting facility, based in Fordyce, Arkansas, a leading manufacturer of inflatable dunnage bags used to secure freight during transport, and the net working capital associated with the operation of these two facilities. The liabilities that are being assumed, include the current liabilities included in the calculation of the net working capital, union employee benefits related obligations and projected costs related to the future closing of that portion of a landfill being acquired in the transaction that was used by KPB prior to the acquisition. See page .

**Q.**

### **How much is Stone paying for KPB?**

**A.**

Stone is paying IP \$155,000,000 in cash (subject to a working capital adjustment), plus two contingent earn-out payments of up to \$35,000,000 and of \$25,000,000, based on KPB's annual earnings before interest, income taxes, depreciation and amortization, or EBITDA, during the five years immediately following the acquisition. See page .

**Q.**

### **How is Stone paying for the acquisition?**

**A.**

Stone intends to use the proceeds of its initial public offering, which includes approximately \$ as of November , 2006, including interest, held in the trust account, together with borrowings from a \$95,000,000 senior secured credit facility to be obtained in connection with the acquisition, to acquire the KPB assets, to pay transaction expenses and to pay holders of IPO shares who exercise their redemption rights.

Q.

**What will I receive in the acquisition?**

A.

You will not receive any cash or other property in the acquisition, but instead you will continue to hold your shares of Stone common stock. As a result of the acquisition and related transactions, Stone will own, through KapStone Kraft, the KPB assets.

Q.

**Is Stone issuing any shares of common stock in the acquisition?**

A.

No.

Q.

**What happens to the funds deposited in the trust account after consummation of the acquisition?**

A.

Upon consummation of the acquisition, any funds remaining in the trust account after payment of amounts to stockholders exercising their redemption rights, and after funding the acquisition, will be released for general corporate purposes and the trust account will cease to exist.

Q.

**What will the structure of the company be after the acquisition?**

A.

Immediately following the acquisition and related transactions, KapStone Kraft will own the KPB assets as a wholly-owned subsidiary of Stone.

Q.

**Who will manage the acquired business?**

A.

Following the acquisition, KPB will continue to be managed by its existing management under the supervision of Roger Stone and Matthew Kaplan, who are Stone's officers, as well as any other persons as may be hired by Stone from time to time. See page .

Q.

**What happens if the acquisition is not consummated?**

A.

If the acquisition is not consummated, Stone will continue to search for an operating company or assets to acquire. However, if Stone does not consummate a business combination by February 19, 2007, or by August 19, 2007 if a letter of intent, agreement in principle or definitive agreement is executed but a business combination is not consummated by February 19, 2007, Stone will, pursuant to Article SIXTH of its certificate of incorporation, and in accordance with Section 281(b) of the Delaware General Corporation Law, adopt a plan of dissolution. As soon as reasonably possible after dissolution, the net proceeds of Stone's initial public offering held in the trust account, plus any interest earned thereon, as well as the net proceeds from the disposition of any other assets, will be distributed pro rata to Stone's common stockholders holding IPO shares.

Q.

**When do you expect the acquisition to be completed?**

A.

It is currently anticipated that the acquisition will be completed, or closed, at the end of the month following the Stone special meeting on , 2006.

Q.

**If I am not going to attend the Stone special meeting in person, should I return my proxy card instead?**

A.

Yes. After carefully reading and considering the information contained in this document, please fill out and sign your proxy card. Then, return the enclosed proxy card in the return envelope as soon as possible, so that your shares may be represented at the Stone special meeting. See page .

Q.

**What will happen if I abstain from voting or fail to instruct my broker to vote?**

A.

An abstention or the failure to instruct your broker how to vote, also known as a broker non-vote, will not be considered a vote cast at the meeting with respect to the acquisition proposal and therefore, will have no effect on the acquisition proposal. An abstention or broker non-vote will not enable you to elect to have your shares

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redeemed for your pro rata portion of the trust account. To exercise your redemption rights, you must vote against the acquisition proposal and affirmatively elect redemption of your shares by checking the appropriate box, or directing your broker to check the appropriate box, on the proxy card and ensure that the proxy card is delivered prior to the Stone special meeting.

An abstention will have the same effect as a vote against the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal. A broker non-vote will have the same effect as a vote against the name change proposal and the Article SIXTH amendment proposal, but will have no effect on the incentive plan proposal. See page .

**Q. What do I do if I want to change my vote?**

A. Send a later-dated, signed proxy card to Stone's Chief Executive Officer prior to the date of the special meeting or attend the special meeting in person, revoke your proxy and vote. You may also revoke your proxy by sending a notice of revocation to Stone's Chief Executive Officer at the address of Stone's corporate headquarters. See page .

**Q. If my shares are held in "street name" by my broker, will my broker vote my shares for me?**

A. With respect to the acquisition proposal and the incentive plan proposal, your broker can only vote your shares if you provide instructions on how to vote. If you do not instruct your broker on how to vote on those matters, your broker may not vote for you, and this will be a broker non-vote. With respect to the name change amendment proposal and the Article SIXTH amendment proposal, if you do not instruct your broker how to vote on these matters, your broker may vote for you. You should instruct your broker to vote your shares, following the directions provided by your broker. To exercise your redemption rights, you must affirmatively elect redemption of your shares by directing your broker to check the appropriate box on the proxy card and ensure that the proxy card is delivered prior to the Stone special meeting. See page .

**Q. Who will pay for this proxy solicitation?**

A. Stone has retained Morrow & Co., Inc. to aid in the solicitation of proxies. Morrow & Co., Inc. will receive a fee of approximately \$5,500, as well as reimbursement for certain costs and out of pocket expenses incurred by them in connection with their services, all of which will be paid by Stone. In addition, officers and directors may solicit proxies by mail, telephone, telegraph and personal interview, for which no additional compensation will be paid, though they may be reimbursed for their out-of-pocket expenses. Stone will bear the cost of preparing, assembling and mailing the enclosed form of proxy, this Proxy Statement and other material which may be sent to stockholders in connection with this solicitation. Stone may reimburse brokerage firms and other nominee holders for their reasonable expenses in sending proxies and proxy material to the beneficial owners of our shares. See page .

**Q. Who can help answer my questions?**

A. If you have questions about the solicitation of proxies, you may write, e-mail or call Morrow & Co., Inc., 470 West Avenue 3rd Floor, Stamford, CT 06902, E-mail: Stone.info@morrowco.com. Banks and brokerage firms, please call (203) 658-9400. Stockholders, please call (800) 607-0088.

## SUMMARY OF THE PROXY STATEMENT

The following discusses in summary form selected information from this proxy statement, but does not contain all of the information that is important to you. The proposals are described in greater detail elsewhere in this document. You should carefully read this entire document, including the Purchase Agreement attached as *Annex A* to this proxy statement and the other documents to which this proxy statement refers you. The Purchase Agreement is the legal document that governs the acquisition. It is also described in detail elsewhere in this proxy statement.

### The Acquisition Proposal

On June 23, 2006, Stone, Stone's wholly-owned subsidiary, KapStone Kraft Paper Corporation, or KapStone Kraft, and International Paper Company, or IP, entered into a Purchase Agreement. The Purchase Agreement provides for the acquisition of substantially all of the assets of the Kraft Papers Business, or KPB, a division of IP, consisting 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, for a cash purchase price of \$155,000,000, plus two contingent earn-out payments of up to \$35,000,000 and of \$25,000,000, based on KPB's annual earnings before interest, income taxes, depreciation and amortization, or EBITDA, during the five years immediately following the acquisition, and the assumption of approximately \$4,800,000 in long-term liabilities. The purchase price payable on the closing date will be adjusted dollar-for-dollar to the extent KPB's estimated working capital as of such date is greater or less than \$42,637,709. Unless KPB's working capital is disputed in accordance with the dispute resolution provisions set forth in the Purchase Agreement, the final determination of KPB's working capital, as of the date of closing, will be made within 90 days of closing. The purchase price will be increased or decreased, as the case may be, dollar-for-dollar to the extent the final working capital is greater or less than the estimated closing date working capital amount. Such increase or decrease, together with interest at six percent per annum, will be paid within 10 days of the final determination.

Stone will use the proceeds of its initial public offering, including funds held in the trust account (\$ \_\_\_\_\_ as of November \_\_\_\_\_, 2006, including interest), and borrowings from a \$95,000,000 credit facility to be obtained in connection with the acquisition to fund the purchase price, redemption price, transaction expenses, investment banking and finance fees and working capital. See "*The KPB Purchase Agreement Purchase Price*" on page \_\_\_\_\_.

The approximately \$ \_\_\_\_\_ held in the trust account as of November \_\_\_\_\_, 2006 (net of taxes) together with any additional interest earned thereon as of the closing date will be used in the following manner and priority:

up to approximately \$22,676,166 will be paid to holders of IPO shares who elect to have their shares redeemed;

\$90,000,000 will be used to fund the acquisition of the KPB assets;

assuming the maximum redemption by the holders of IPO shares of approximately 19.99% of the IPO shares, the balance of approximately \$932,314 will remain as working capital; and

assuming no redemption by the holders of IPO shares, the balance of approximately \$23,608,480 will remain as working capital.

In addition to the trust account funds, KapStone Kraft will utilize its new credit facility in the following manner:

up to \$65,000,000 will be paid to IP for the balance of the KPB acquisition purchase price;

approximately \$3,000,000 will be used to pay transaction expenses and a finance fee;

\$1,200,000 will be paid to Morgan Joseph & Co., Inc., the managing underwriter of Stone's IPO, as an investment banking fee; and

the balance will remain available to be used for working capital.

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At the close of the transaction, in addition to liabilities incurred during the normal course of operations that will be reflected in the working capital that is being acquired as accounts payable and accrued liabilities, Stone will also assume long-term liabilities of \$3,015,000 for union employee benefits related obligations and \$1,797,000 related to

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the projected future cost of closing that portion of a landfill being acquired in the transaction that was used by KPB prior to the acquisition. None of the liabilities being assumed or any fees will be paid from the trust account funds.

Stone, KapStone Kraft and IP plan to complete the acquisition at the end of the month following the Stone special meeting or at such other time or place as the parties agree, provided that:

Stone's stockholders have approved the acquisition proposal;

holders of no more than 20% of the IPO shares, vote against the acquisition proposal AND properly elect to exercise their right to have their shares redeemed for cash;

KapStone Kraft has obtained the debt financing described in the commitment letter from LaSalle Bank, N.A.; and

the other conditions specified in the Purchase Agreement have been satisfied or waived.

The Purchase Agreement is included as *Annex A* to this document. We encourage you to read the Purchase Agreement in its entirety. It is the legal document that governs the acquisition.

### **The Parties**

#### *Stone and KapStone Kraft*

Stone is a blank check company organized as a corporation under the laws of the State of Delaware on April 15, 2005 that was formed to effect a business combination with a suitable operating business in the paper, packaging, forest products and related industries. On August 19, 2005, Stone successfully consummated an initial public offering of its equity securities from which it derived net proceeds of approximately \$113,236,000. \$110,854,000 of the net proceeds of the initial public offering were placed in a trust account and will be released to Stone in connection with the consummation of the acquisition. The balance of the net proceeds of \$2,382,000 is being used by Stone to pay the expenses incurred in its pursuit of a business combination. A portion of the interest earned on the trust account has been released to Stone for the payment of taxes on interest earned on the proceeds held in trust. Other than its initial public offering and the pursuit of a business combination, Stone has not engaged in any business to date. If Stone does not consummate a business combination by the later of February 19, 2007, or August 19, 2007, in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed but not consummated by February 19, 2007, then, pursuant to Article SIXTH of its certificate of incorporation, Stone's officers must take all actions necessary in accordance with the Delaware General Corporation Law to dissolve and liquidate Stone within 60 days.

KapStone Kraft is a Delaware corporation formed solely for purposes of this acquisition.

The mailing address of the principal executive office of Stone and KapStone Kraft is c/o Stone-Kaplan Investments, LLC, One Northfield Plaza, Suite 480, Northfield, Illinois 60093, and the companies' telephone number is (847) 441-0929.

#### *IP and KPB*

IP is the world's largest paper and forest products company with operations in 40 countries. IP is a market leader in the production of uncoated free sheets used in copiers, envelopes and forms, and is also a leading producer of linerboard and bleached paperboard widely used in various packaging applications. IP's forest products division sells lumber and structural panels. IP's common stock is listed on the New York Stock Exchange under the symbol "IP."

KPB is the Kraft Papers Business, which is a division of IP and is comprised of IP's operations at Roanoke Rapids, North Carolina and Ride Rite® Converting in Fordyce, Arkansas. KPB's Roanoke Rapids facility is the leading producer of unbleached kraft paper in North America and also produces lightweight linerboard. Ride Rite® Converting manufactures inflatable dunnage bags which are used to secure freight during transport thereby minimizing damage to goods and products.

The mailing address of IP's and KPB's principal executive offices is 6410 Poplar Avenue, Memphis, Tennessee 38197, and their telephone number is (901) 419-7000.

#### **Past Transactions between IP and Stone's Officers and Affiliates**

In July 2000, Messrs. Stone and Kaplan and certain of their affiliates purchased an approximately 33% indirect ownership interest in Box USA Holdings, Inc., a company engaged in the full service conversion of corrugated packaging materials. A fund affiliated with Messrs. Chapman, Furer and Rahman, Stone's other directors, was a co-investor in Box USA. In July 2004, Box USA was sold to IP at an enterprise valuation of \$405,000,000 which was paid in cash and a \$15,000,000 note payable by IP to the Box USA shareholders. In connection with such sale, Messrs. Stone and Kaplan entered into non-competition agreements with IP that expire in July 2007. Under the terms of these agreements, they are prohibited from participating or owning a significant equity interest in any company in the corrugated packaging and containerboard business. The consummation of the acquisition by Stone of KPB's assets will terminate these non-competition agreements. None of the assets of Box USA that were acquired by IP in that transaction are being purchased by Stone pursuant to this business combination. Messrs. Stone and Kaplan have not, at any time, held any management or advisory positions with IP, and no officer or director of Stone is, or within the past two years was, an affiliate of IP or any of IP's subsidiaries.

#### **The Certificate of Incorporation Amendments**

Stone is proposing an amendment to its certificate of incorporation to change its name to "KapStone Paper and Packaging Corporation" upon consummation of the acquisition and to eliminate certain provisions that are applicable to Stone only prior to its completion of a business combination. Stone believes that the name "KapStone Paper and Packaging Corporation" better reflects the business it will conduct after the acquisition, and will enable industry and financial market participants to more closely associate Stone with its operating business. Separately, as amended, Article SIXTH of Stone's certificate of incorporation will address only its classified board of directors, with existing provisions that relate to it as a blank check company being deleted.

#### **The 2006 Incentive Plan Proposal**

The 2006 Incentive Plan, which reserves 3,000,000 shares of Stone's common stock for issuance in accordance with the plan's terms, has been established to enable Stone to attract, retain, motivate and provide additional incentives to certain directors, officers, employees, consultants and advisors, whose contributions are essential to its growth and success by enabling them to participate in its long-term growth through the exercise of stock options and the ownership of its stock. The plan is attached as *Annex C* to this proxy statement. Stone encourages you to read the plan in its entirety.

#### **Stone Insider Stock Ownership**

At the close of business on the record date, Roger Stone, Matthew Kaplan, John Chapman, Jonathan Furer and Muhit Rahman, who together comprise all of Stone's directors and officers, together with their affiliates, beneficially owned 5,500,000 shares of Stone common stock, or 22% of the outstanding shares of Stone common stock. Of such shares, 5,000,000 were purchased by Stone's officers and directors prior to Stone's initial public offering for \$0.005 per share for an aggregate purchase price of \$25,000. The remaining 500,000 shares were purchased by Mr. Stone in the initial public offering for \$6.00 per unit, for an aggregate purchase price of \$3,000,000. These shares, without taking into account any discount that may be associated with certain restrictions on these shares, have a market value of approximately \$ based on Stone's common stock price of \$ per share as of November , 2006. Other than the IPO shares held by Mr. Stone, which will participate in any liquidating distributions made from the trust account, Stone's officers and directors will not receive any value associated with their share ownership in the event that a business combination is not consummated.

Stone's executive officers and directors also hold warrants to purchase 4,500,000 shares of common stock, of which 3,500,000 warrants were purchased in the aftermarket following the initial public offering during the 40-day



period between September 14, 2005 and November 7, 2005 pursuant to a limit order that was submitted to Morgan Joseph immediately following the initial public offering, and the remaining 1,000,000 warrants were purchased by Mr. Stone as part of his purchase of 500,000 units in the initial public offering. These warrants, without taking into account any discount that may be associated with certain restrictions on transfer, collectively have a market value of approximately \$ based on Stone's warrant price of \$ per warrant as of November , 2006. The 3,500,000 warrants purchased in the aftermarket were purchased at prices ranging from \$0.3991 per warrant to \$0.60 per warrant, for an aggregate purchase price of \$1,821,806. The remaining 1,000,000 warrants are owned by Mr. Stone as part of the 500,000 units he purchased in the initial public offering for \$6.00 per unit, for an aggregate purchase price of \$3,000,000. The warrants held by Stone's officers and directors and their affiliates and associates (as well as all other warrants) will expire and become worthless if the acquisition is not approved and Stone fails to consummate an alternative business combination by the later of February 19, 2007, or August 19, 2007, in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed but not consummated by February 19, 2007, pursuant to Stone's certificate of incorporation.

The following table sets forth information with respect to the aftermarket warrant purchases made by Stone's officers and directors during the 40-day period commencing September 14, 2005 and ending November 7, 2005:

Name	Aggregate Number of Warrants	Price Range		Aggregate Purchase Price
Roger Stone	962,500	\$	0.3991	\$ 500,997
Matthew Kaplan	962,500	\$	0.3991	\$ 500,997
John Chapman	525,000	\$	0.3991	\$ 273,271
Jonathan Furer	525,000	\$	0.3991	\$ 273,271
Muhit Rahman	525,000	\$	0.3991	\$ 273,271

Mr. Stone is currently Chairman of Stone's board of directors and Chief Executive Officer of Stone. Mr. Kaplan is currently President of Stone. Messrs. Chapman, Furer and Rahman are directors of Stone. For more information on beneficial ownership of Stone's common stock by executive officers, directors and 5% stockholders, see page .

#### Special Meeting of Stone's Stockholders

The special meeting of the stockholders of Stone will be held at 10:00 a.m., Central time, on , 2006, at the offices of Stone, located at One Northfield Plaza, Suite 480, Northfield, IL 60093.

#### Voting Power; Record Date

You will be entitled to vote or direct votes to be cast at the special meeting if you owned shares of Stone common stock at the close of business on November 17, 2006, which is the record date for the special meeting. You will have one vote for each share of Stone common stock you owned at the close of business on the record date. Stone warrants do not have voting rights.

At the close of business on November 17, 2006, there were 25,000,000 shares of Stone common stock outstanding, 20,000,000 of which were issued in Stone's initial public offering.

With respect to the acquisition proposal, Stone's initial stockholders, who are Stone's officers and directors, have agreed to vote their 5,000,000 shares of Stone common stock acquired prior to Stone's initial public offering, representing an aggregate of 20% of the outstanding shares of Stone common stock, in accordance with the vote of the majority of the IPO shares voted at the meeting, and intend to vote such shares "FOR" all other proposals that have been approved by Stone's board of directors. In addition, Stone's CEO intends to vote 500,000 shares of common stock that are part of the 500,000 units acquired by him in Stone's initial public offering, representing 2% of the outstanding shares of Stone common stock, and 2.5% of the shares issued in Stone's initial public offering, "FOR" the adoption of the acquisition proposal and all other proposals that have been approved by Stone's board of directors. To date, only Mr. Stone owns IPO shares through his purchase of units in the initial public offering. None

of the other officers and directors of Stone acquired units, or IPO shares, in the initial public offering or in the aftermarket.

#### **Quorum and Vote of Stone's Stockholders**

A quorum of Stone's stockholders is necessary to hold a valid meeting. A quorum will be present at the Stone special meeting if a majority of the issued and outstanding shares of Stone's common stock entitled to vote at the meeting are present in person or by proxy. Abstentions and broker non-votes will count as present for the purpose of establishing a quorum. No vote of the warrant holders is necessary to adopt any of the proposals.

The approval of the acquisition proposal requires the affirmative vote of a majority of the IPO shares voted at the meeting. Adoption of the acquisition proposal is not conditioned upon the adoption of the name change amendment, the Article SIXTH amendment or the incentive plan proposal. However, in accordance with the provisions of Stone's certificate of incorporation, if the holders of 4,000,000 or more IPO shares, representing 20% or more of the total number of IPO shares, vote against the acquisition and exercise their redemption rights, then Stone will not consummate the acquisition.

The approval of the name change amendment will require the affirmative vote of a majority of the issued and outstanding shares of Stone's common stock.

The approval of the Article SIXTH amendment will require the affirmative vote of a majority of the issued and outstanding shares of Stone's common stock.

The approval of the incentive plan proposal will require the affirmative vote of a majority of the shares of Stone's common stock represented in person or by proxy and entitled to vote at the special meeting.

#### **Consideration Offered to Stone's Stockholders**

The stockholders of Stone will not receive any cash or property in the acquisition, but instead will continue to hold their shares of Stone common stock. As a result of the acquisition, Stone will own, through KapStone Kraft, substantially all of the assets of KPB.

#### **Appraisal or Dissenters Rights**

No appraisal or dissenters rights are available under the Delaware General Corporation Law for the stockholders of Stone in connection with the acquisition proposal.

#### **Redemption Rights**

As provided in Stone's certificate of incorporation, holders of IPO shares may, if the stockholder votes against the acquisition proposal, demand that Stone redeem their shares for cash. This demand must be made on the proxy card at the same time that the stockholder votes against the acquisition proposal. If so demanded, and if the acquisition is completed, Stone will redeem each share of common stock for a pro rata portion of the trust account in which a substantial portion of the net proceeds of Stone's initial public offering are held, plus interest earned thereon. However, if the holders of 4,000,000 or more IPO shares, representing 20% or more of the total number of IPO shares, exercise their redemption rights, then, in accordance with the terms of Stone's certificate of incorporation and the documents governing the trust account, Stone will not consummate the acquisition and your shares will not be redeemed. Based on the amount of cash held in the trust account at November 1, 2006, you will be entitled to redeem each share of common stock that you hold for approximately \$ . If you exercise your redemption rights, then you will be exchanging your shares of Stone's common stock for cash and will no longer own these shares. You will only be entitled to receive cash for these shares if you continue to hold these shares through the closing date of the acquisition and then tender your stock certificate to Stone. If the acquisition is not completed, then these shares will not be redeemed for cash. A stockholder who exercises redemption rights will continue to own any warrants to acquire Stone common stock owned by such stockholder as such warrants will remain outstanding and unaffected by the exercise of redemption rights.

Prior to exercising redemption rights, Stone stockholders should verify the market price of Stone's common stock as they may receive higher proceeds from the sale of their common stock in the public market than from exercising their redemption rights. Stone's shares of common stock are listed on the Over-the-Counter Bulletin Board under the symbol "SCDE."

### **Engagement of Morgan Joseph**

At the time of the initial public offering, Stone engaged Morgan Joseph & Co., Inc. to act as Stone's investment banker in connection with a business combination. Stone agreed to pay Morgan Joseph, upon the successful completion of a business combination, a \$1,200,000 investment banking fee for acting in such capacity. Since such time, as Stone's investment banker, Morgan Joseph has provided industry comparable data, leads with respect to possible target businesses and assisted Stone in preparing investor presentations in connection with the proposed business combination. During this period, Morgan Joseph has participated in numerous telephone calls, email exchanges and in-person meetings, the majority of which have been in connection with the preparation of investor presentations. Morgan Joseph assisted in arranging an investor conference call that took place on June 29, 2006 during which Stone updated its investors with respect to the proposed acquisition. From time to time, such firm has facilitated individual conference calls with investors who sought to speak with management and between October 23 and October 27, 2006, it arranged for a series of investor meetings at which questions regarding the proposed acquisition were addressed. To date, Morgan Joseph's activities have not included actions that would deem such firm to be engaged in the solicitation of proxies for Stone, although the firm may be so engaged in the future. The only agreement governing this arrangement is the Underwriting Agreement, which was entered into in connection Stone's initial public offering. In connection with its initial public offering, Stone sold to Morgan Joseph, for \$100, an option to purchase 1,000,000 units. The units issuable upon exercise of this option are identical to the units offered in the initial public offering except that the warrants underlying this option are exercisable at \$6.25 per share. This option is exercisable at \$7.50 per unit commencing on the later of the consummation of a business combination or August 15, 2006 and expiring August 15, 2010 and may be exercised on a cashless basis.

In connection with the initial public offering, Stone granted Morgan Joseph the right to have a designee present at all meetings of Stone's board of directors until consummation of a business combination. Morgan Joseph has not exercised this right to date.

After the completion of Stone's initial public offering, Messrs. Stone, Kaplan, Chapman, Furer and Rahman, in accordance with the disclosure contained in the prospectus, delivered a limit order on a "not held" basis to Morgan Joseph to purchase up to 3,500,000 warrants at prices not to exceed \$.70 per warrant during the first 40 trading days that the warrants were eligible to trade separately. A "not held" order gives the broker discretion with respect to price, size and time of execution with the expectation that the broker can obtain a better price than what might be available at the time, but does not hold the broker responsible (hence "not held") for any losses that might result from their exercise of such discretion. Morgan Joseph has advised us that the firm's head of equity trading executed the trades at his sole discretion and used his discretion for the sole purpose of obtaining the 3,500,000 warrants at the lowest possible aggregate cost. Details of the purchases, which were made on almost a daily basis between September 14, 2005 and November 7, 2006, were reported to the individuals and Stone's counsel and publicly reported in filings with the Securities and Exchange Commission.

### **Proxies**

Proxies may be solicited by mail, telephone or in person. We have engaged Morrow and Co., Inc. to assist us in the solicitation of proxies.

If you grant a proxy, you may still vote your shares in person if you revoke your proxy before the special meeting or if you attend the special meeting and vote in person.

### Stone's Recommendations to Stockholders; Reason for the Acquisition

Stone's board of directors unanimously recommends that Stone's stockholders vote:

FOR the acquisition proposal;

FOR the name change amendment;

FOR the Article SIXTH amendment; and

FOR the incentive plan proposal.

In reaching its decision with respect to the acquisition and the transactions contemplated by the Purchase Agreement, the board of directors of Stone reviewed various industry and financial data and the due diligence and evaluation materials provided by IP and KPB, as well as independent evaluations performed by financial, legal and other consultants in order to determine that the proposed acquisition transaction is in the best interest of Stone's stockholders and that the consideration to be paid to IP is reasonable. Stone engaged an accounting firm solely for the purpose of performing financial due diligence and identifying issues on behalf of management with respect to the business combination, and a law firm, who performed legal due diligence and advised Stone in the negotiations of the terms of the Purchase Agreement. Stone also engaged three individuals with industry experience to perform due diligence with respect to specific aspects of the KPB operations, including environmental matters. The three individuals are independent consultants with extensive experience in the paper and forest products industry. In addition, Stone engaged an individual financial expert to act as a financial consultant to assist with the financial due diligence and analysis. These consultants are paid primarily based on the amount of time spent on the engagement and are reimbursed reasonable out-of-pocket expenses.

Stone's board of directors did not seek a fairness opinion because the board believed that collectively its members, together with the consultants it retained, have as much, if not greater, experience in evaluating business opportunities in the paper and packaging industry than an investment bank. Accordingly, the board of directors determined that no additional benefit was to be derived from the considerable additional expense (anticipated to be in excess of \$400,000) to obtain a fairness opinion.

### Interests of Stone Directors and Officers in the Acquisition

When you consider the recommendation of Stone's board of directors that you vote in favor of adoption of the acquisition proposal, you should keep in mind that certain of Stone's officers and directors, and certain of their affiliates and associates, have interests in the acquisition that are different from, or in addition to, your interest as a stockholder. These interests include, among other things:

Stone's officers and directors, together with their affiliates and associates, were issued a total of 5,000,000 shares of Stone common stock prior to Stone's initial public offering, and Stone's CEO purchased 500,000 IPO shares as part of units purchased in the initial public offering. These shares, without taking into account any discount that may be associated with certain restrictions on these shares, collectively have a market value of approximately \$ \_\_\_\_\_ based on Stone's share price of \$ \_\_\_\_\_ as of November \_\_\_\_\_, 2006. The 5,000,000 shares acquired prior to Stone's initial public offering by these individuals cannot be sold until the first anniversary of the acquisition during which time the value of the shares may increase or decrease; however, since such shares were acquired for \$.005 per share, the holders are likely to benefit from the acquisition notwithstanding any decrease in the market price of the shares.

Stone's officers and directors, together with their affiliates and associates, own a total of 4,500,000 of Stone's warrants, of which 3,500,000 were acquired in the aftermarket during a 40-day period between September 14, 2005 and November 7, 2005 pursuant to a discretionary order that was submitted to Morgan Joseph immediately following the initial public offering, and 1,000,000 of which were purchased by Mr. Stone as part of his purchase of 500,000 units in the initial public offering. These warrants, without taking into account any discount that may be associated with the restrictions on the transfer of such warrants, collectively have a market value of approximately \$ \_\_\_\_\_ based on Stone's warrant price of \$ \_\_\_\_\_ as of November \_\_\_\_\_, 2006. The warrants held by Stone's officers



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and directors and their affiliates and associates (as well as all other warrants) will expire and become worthless if the acquisition is not approved and Stone fails to consummate an alternative transaction by the later of February 19, 2007, or August 19, 2007, in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed but a business combination was not consummated by February 19, 2007, pursuant to Stone's certificate of incorporation.

If the acquisition is not approved and Stone fails to consummate an alternative transaction within the time allotted pursuant to its certificate of incorporation and Stone is therefore required to liquidate, the shares of common stock beneficially owned by Stone's officers and directors and their affiliates and associates that were acquired prior to Stone's initial public offering may be worthless because no portion of the net proceeds of Stone's initial public offering that may be distributed upon liquidation of Stone will be allocated to such shares.

After the completion of the acquisition, Roger Stone will continue to serve as Stone's Chief Executive Officer and as Chairman of Stone's board of directors and Matthew Kaplan will continue to serve as Stone's President. It is expected that the current directors will continue to serve on Stone's board of directors. Such individuals will, following the acquisition, be compensated in such manner, and in such amounts, as determined by the independent members of Stone's board of directors. At present, there have been no agreements entered into, or discussions regarding, the terms of employment with Stone's officers. It is contemplated that if the acquisition is approved, the compensation and other terms of employment of Stone's officers will be determined by a compensation committee which has not yet been established and will be commensurate with the compensation packages of comparable level executives at similarly situated companies in the paper and packaging industry. Messrs. Stone and Kaplan have agreed not to receive any compensation until a recommendation has been made by such committee and approved by the board. Because Stone has made a determination to postpone such discussions until after the closing of the transaction and the formation of the compensation committee, you will not have information you may deem material to your decision on whether or not to vote in favor of the acquisition.

In July 2000, Messrs. Stone and Kaplan and certain of their affiliates purchased an approximately 33% indirect ownership interest in Box USA Holdings, Inc., a company engaged in the full service conversion of corrugated packaging materials. A fund affiliated with Messrs. Chapman, Furer and Rahman, Stone's other directors, was a co-investor in Box USA. In July 2004, Box USA was sold to IP at an enterprise valuation of \$405,000,000 which was paid in cash and a \$15,000,000 note payable by IP to the Box USA shareholders. In connection with such sale, Messrs. Stone and Kaplan entered into non-competition agreements with IP that expire in July 2007. Under the terms of these agreements, they are prohibited from participating or owning a significant equity interest in any company in the corrugated packaging and containerboard business. The consummation of the acquisition will terminate the non-competition agreements.

### **Conditions to the Completion of the Acquisition**

Completion of the acquisition is subject to the satisfaction or waiver of the following specified conditions:

#### *Conditions to Stone's and KapStone Kraft's obligations*

The representations and warranties of IP that are qualified as to materiality or material adverse effect must be true and correct as of the closing date, and those not qualified as to materiality or material adverse effect must be true and correct in all material respects, as of the closing date, except that representations and warranties that address matters as of another date, must be true and correct as of such other date;

IP must have performed and observed in all material respects all covenants and obligations required to be performed by it prior to closing pursuant to the terms of the Purchase Agreement and related documents;

The consummation of the transactions must not be prohibited by any legal requirement or subject Stone or KapStone Kraft or any of their affiliates, KPB or any of the KPB assets to any material penalty or liability arising under any legal requirement or imposed by any governmental authority that is not otherwise disclosed in the Purchase Agreement or in any schedule to the Purchase Agreement;

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There must be no judgment, order, decree, stipulation, injunction or charge existing before any governmental authority in each case which could reasonably be expected to prevent or prohibit consummation of any transactions pursuant to the transaction documents, cause the transactions to be rescinded following such consummation or materially and adversely affect KapStone Kraft's right to acquire the KPB assets or conduct the business, or Stone's or KapStone Kraft's or IP's performance of their respective obligations pursuant to the transaction documents; no action, suit or proceeding shall be pending that a reasonable person knowledgeable in such matters would conclude could have a high likelihood of having any such effect;

All material filings, notices, licenses, consents, authorizations, accreditation, waivers, approvals and the like of, to or with any governmental authority or any other person that are required to be obtained by IP will have been made or obtained and all applicable waiting periods under antitrust or trade regulation laws and regulations, including, without limitation, under the HSR Act, will have expired or been terminated;

Stone's stockholders must have approved the transaction with holders of less than 20% of the IPO shares exercising their redemption rights;

All liens, except for permitted exceptions, with respect to the KPB assets, must be released and terminated, or insured by the title company;

IP's auditor shall have given its consent to Stone to use IP's audited financial statements with respect to the KPB business in Stone's proxy statement;

The senior debt financing must be concurrently completed;

IP must have entered into an amendment to Tim Keneally's Confidentiality and Non-Competition Agreement. IP customarily enters into confidentiality and non-competition agreements with its officers which provides certain covenants that the officers are bound by after the termination of employment with IP. The amendment will allow Mr. Keneally to carry out his duties as a member of Stone's management without violating his confidentiality and non-competition agreement;

IP must deliver all closing documents and take all corporate actions required to be taken to effect the sale of the KPB assets; and

IP must obtain third-party consents to assign certain contracts.

### *Conditions to IP's obligations*

The representations and warranties of Stone and KapStone Kraft that are qualified as to materiality or material adverse effect must be true and correct as of the closing date, and those not qualified as to materiality or material adverse effect must be true and correct in all material respects, as of the closing date, except that representations and warranties that address matters as of another date, must be true and correct as of such other date;

Each of Stone and KapStone Kraft must have performed and observed in all material respects all covenants and obligations required to be performed by each pursuant to the Purchase Agreement and related documents prior to the closing date;

The consummation of the transactions will not be prohibited by any legal requirement or subject IP to any material penalty or liability arising under any legal requirement or imposed by any governmental authority that is not otherwise disclosed in the Purchase Agreement or in any schedule to the Purchase Agreement;

All material filings, notices, licenses, consents, authorizations, accreditation, waivers, approvals and the like of, to or with any governmental authority or any other person will have been made or any other person will have been made or obtained and all applicable waiting periods under antitrust or trade regulation laws and regulations, including, without limitation, under the HSR Act,

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will have expired or been terminated;

There must be no judgment, order, decree, stipulation, injunction or charge existing before any governmental authority in each case which could reasonably be expected to prevent or prohibit consummation of any



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transactions pursuant to the transaction documents, cause any such transaction to be rescinded following such consummation or materially and adversely affect KapStone Kraft's right to acquire the KPB assets or conduct the business, or Stone's or KapStone Kraft's or IP's performance of their respective obligations pursuant to the transaction documents; no action, suit or proceeding shall be pending that a reasonable person knowledgeable in such matters would conclude could have a high likelihood of having any such effect; and

Stone and KapStone Kraft must have delivered all closing documents and taken all corporate actions required to be taken to purchase the KPB assets.

If permitted under applicable law, either Stone or IP may waive conditions for their own respective benefit, and consummate the acquisition even though one or more of these conditions have not been met.

### Termination

The Purchase Agreement may be terminated at any time prior to the closing of the acquisition, as follows:

by mutual consent of Stone and IP;

by Stone or IP if the acquisition proposal is not approved by the required vote of Stone's stockholders or if holders of 20% or more of the IPO shares exercise their redemption rights;

by Stone or IP if the other party has breached any of its material covenants, or if any representations or warranties are false or misleading in any material respect, provided that such termination cannot be the result of any breach of any covenant, representation or warranty of the terminating party and provided further that each party shall have ten business days to cure any such breach after notice;

by Stone or IP if any governmental authority takes any action to permanently restrain, enjoin or prohibit the acquisition and such action becomes final and nonappealable; and

by Stone or IP if the closing has not occurred by December 31, 2006, provided the right to terminate shall not be available to any party whose breach of the Purchase Agreement caused or resulted in the delay of the closing.

### Acquisition Financing

Stone has received a commitment from LaSalle Bank, N.A. with respect to a \$95,000,000 senior secured credit facility to be used by Stone at the closing of the acquisition to fund a portion of the purchase price and to provide working capital for KPB following the acquisition. This senior secured credit facility will be comprised of a \$35,000,000 senior secured revolving credit facility and a \$60,000,000 senior secured term loan. KapStone Kraft will be the borrower under the senior secured credit facility. The senior secured credit facility has a five year term. At KapStone Kraft's option, the facility will bear interest at a rate per annum equal to either (1) the "Base Rate" (which is the higher of (a) the rate publicly announced from time to time by the Administrative Agent as its "prime rate" and (b) the Federal Funds Rate plus 0.5% per annum), plus a Base Rate Margin (as defined below) or (2) LIBOR, plus the LIBOR Margin as defined below. The Base Rate Margin will be 0% with respect to the senior secured revolving credit facility and 0.25% with respect to the term loan, subject to upward or downward adjustment after December 31, 2006 based upon the total leverage ratio of KapStone Kraft at the end of each fiscal quarter. The LIBOR Margin will be 1.50% with respect to the senior secured revolving credit facility and 1.75% with respect to the senior secured term loan, subject to upward or downward adjustment after December 31, 2006 based upon the total leverage ratio of KapStone Kraft at the end of each fiscal quarter.

LaSalle Bank's obligation to make the senior secured credit facility available is subject to certain conditions, including execution and delivery of final loan documents and satisfactory completion of its due diligence. The commitment, which had an expiration date of December 31, 2006, has been extended to February 1, 2007. For a more detailed description of the financing arrangements, see "*The Acquisition Financing*" on page .

**United States Federal Income Tax Consequences of the Acquisition**

The U.S. federal income tax consequences of the acquisition of KPB are discussed in the section entitled "*U.S. Federal Income Tax Consequences of the Acquisition*" on page .

**Regulatory Matters**

The acquisition and the transactions contemplated by the Purchase Agreement are not subject to any federal, state or provincial regulatory requirement or approval, except for the filing and delivery of this Proxy Statement in connection with the special meeting of stockholders of Stone under the Securities Exchange Act of 1934, as amended, and compliance under the Hart-Scott-Rodino Antitrust Improvements Act 1976, as amended.

**Quotation of Securities**

Stone's common stock, warrants to purchase common stock and units consisting of one share of common stock and two warrants to purchase common stock are listed on the Over-the-Counter Bulletin Board under the symbols "SCDE," "SCDEW" and "SCDEU," respectively.

**Risk Factors**

In evaluating the acquisition proposal, the name change amendment, the Article SIXTH amendment and the incentive plan proposal, you should carefully read this proxy statement and especially consider the factors discussed in the section entitled "*Risk Factors*" on page .

## SELECTED HISTORICAL FINANCIAL INFORMATION

The following financial information is provided to assist you in your analysis of the financial aspects of the acquisition. Stone's historical information is derived from its audited financial statements as of and for the period from April 15, 2005 (Date of Inception) through December 31, 2005, and its unaudited condensed financial statements as of and for the nine month period ended September 30, 2006. KPB's historical information is derived from its audited combined financial statements (restated) as of and for the years ended December 31, 2005, 2004 and 2003 and its unaudited condensed combined financial statements as of and for the years ended December 31, 2002 and 2001 and as of and for the nine month periods ended September 30, 2006 and 2005.

The information is only a summary and should be read in conjunction with each of KPB's and Stone's historical consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained elsewhere herein. The historical results included below and elsewhere in this document are not indicative of the future performance of KPB or Stone.

**Stone Arcade Acquisition Corporation**  
(a development stage company)  
(amounts in thousands except share data and per share data)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005	From Inception (April 15, 2005) to December 31, 2005
<b>Statement of Operations Data:</b>			
Operating expenses	\$ 892	\$ 39	\$ 221
Net income	\$ 2,003	\$ 258	\$ 818
Deferred interest, net of taxes, attributable to common stock subject to possible redemption	\$ (510)	\$ (56)	\$ (189)
Net income allocable to holders of non-redeemable common stock	\$ 1,493	\$ 202	\$ 628
<b>Earnings per Share:</b>			
Basic	\$ 0.08	\$ 0.03	\$ 0.05
Diluted	\$ 0.07	\$ 0.02	\$ 0.05
<b>Weighted Average Shares:</b>			
Basic	25,000,000	10,000,000	15,307,692
Diluted	28,963,964	10,548,204	16,547,715
<b>Earnings per share exclusive of interest and shares subject to redemption:</b>			
Basic	\$ 0.07	\$ 0.02	\$ 0.05
Diluted	\$ 0.06	\$ 0.02	\$ 0.04
<b>Weighted-average number of shares outstanding exclusive of shares subject to possible redemption:</b>			
Basic	21,002,000	9,000,500	13,247,185
Diluted	24,965,964	9,548,704	14,487,208
	<b>September 30, 2006</b>		<b>December 31, 2005</b>
<b>Balance Sheet Data:</b>			
Total assets	\$ 117,545		\$ 114,306
Long-term debt			
Common stock subject to possible redemption for cash inclusive of deferred interest income	\$ 22,160		\$ 22,349
Total stockholders' equity	\$ 93,223		\$ 91,730

**Kraft Papers Business A Division of International Paper Company**  
(amounts in thousands)

	Nine Months Ended September 30,		Year Ended December 31,					
	2006	2005	2005 <sup>(1)</sup>	2004 <sup>(1)</sup>	2003 <sup>(1)</sup>	2002 <sup>(2)</sup>	2001 <sup>(2)</sup>	
<b>Statement of Operations Data:</b>								
Net sales	\$ 189,164	\$ 162,349	\$ 221,972	\$ 188,293	\$ 231,198	\$ 248,743	\$ 236,068	
Operating income (loss)	\$ 25,110	\$ 7,521	\$ 9,478	\$ (4,681)	\$ 5,112	\$ 21,695	\$ 36,616	
Net income (loss)	\$ 14,758	\$ 3,953	\$ 4,933	\$ (3,756)	\$ 2,413	\$ 12,529	\$ 21,832	
<b>Earnings per Share Data:</b>								
	N/A		N/A		N/A		N/A	
	As of September 30,		As of December 31,					
	2006	2005	2005 <sup>(1)</sup>	2004 <sup>(1)</sup>	2003 <sup>(1)</sup>	2002 <sup>(2)</sup>	2001 <sup>(2)</sup>	
<b>Balance Sheet Data:</b>								
Total assets	\$ 262,086	\$ 275,569	\$ 269,328	\$ 279,227	\$ 272,789	\$ 281,709	\$ 210,743	
Long-term liabilities	\$ 24,166	\$ 24,033	\$ 24,064	\$ 23,936	\$ 23,811	\$ 22,202	\$ 22,138	
Divisional control account	\$ 220,945	\$ 235,482	\$ 228,557	\$ 239,648	\$ 231,547	\$ 240,612	\$ 175,126	

(1) These amounts reflect the restatements as discussed in Note 15 to the combined financial statements as of and for the three years ended December 31, 2005.

(2) Similar correcting entries have been made to these amounts for the effects of the restatements noted in (1).

**SELECTED UNAUDITED PRO FORMA FINANCIAL INFORMATION**

The following selected unaudited pro forma financial information has been derived from, and should be read in conjunction with, the unaudited pro forma condensed consolidated financial statements included elsewhere in this proxy.

The unaudited pro forma condensed consolidated balance sheet information combines the historical unaudited balance sheets of Stone and KPB as of September 30, 2006, giving effect to the transactions described in the Purchase Agreement (with purchase accounting applied to the acquired KPB business and related financing) as if they had occurred on September 30, 2006.

The unaudited pro forma condensed consolidated statements of income combine (i) the historical statements of income of Stone and KPB for the nine month period ended September 30, 2006, and (ii) the historical statements of income of Stone for the period from April 15, 2005 (Date of Inception) to December 31, 2005, and KPB for the year ended December 31, 2005 (as restated), giving effect to the transactions described in the Purchase Agreement (with purchase accounting applied to the acquired KPB business and related financing) as if they had occurred on January 1, 2005.

The historical financial information has been adjusted to give effect to pro forma events that are directly attributable to the transaction, are factually supportable and, in the case of the pro forma income statements, have a recurring impact.

The purchase price allocation has not been finalized and is subject to change based upon recording of actual transaction costs, finalization of working capital adjustments, and completion of appraisals of tangible and intangible assets of the acquired KPB business.

The unaudited pro forma condensed consolidated balance sheet information at September 30, 2006 and unaudited pro forma condensed consolidated statement of income information for the nine months ended September 30, 2006 and the year ended December 31, 2005 have been prepared using two different levels of approval of the transaction by the Stone stockholders, as follows:

Assuming No Redemption: This presentation assumes that none of the Stone stockholders exercise their redemption rights; and

Assuming Maximum Redemption: This presentation assumes that 19.9% of the Stone stockholders exercise their redemption rights.

Stone is providing this information to aid you in your analysis of the financial aspects of the transaction. The unaudited pro forma financial information is not necessarily indicative of the financial position or results of operations that may have actually occurred had the transaction taken place on the dates noted, or the future financial position or operating results of the combined company.

**Stone Arcade Acquisition Corporation**  
**Unaudited Pro Forma Condensed Consolidated Balance Sheet Information**  
(amounts in thousands)

	As of September 30, 2006	
	No Share Redemption	Maximum Share Redemption
Total assets	\$ 199,835	\$ 176,976
Long term debt	\$ 52,500	\$ 52,500
Total stockholders' equity	\$ 113,053	\$ 90,194

**Stone Arcade Acquisition Corporation**  
**Unaudited Pro Forma Condensed Consolidated Statement of Income Information**  
(amounts in thousands except share data and per share data)

	Nine Months Ended September 30, 2006		Year Ended December 31, 2005	
	No Share Redemption	Maximum Share Redemption	No Share Redemption	Maximum Share Redemption
Net sales	\$ 189,164	\$ 189,164	\$ 221,972	\$ 221,972
Operating income (loss)	\$ 32,526	\$ 32,526	\$ 23,486	\$ 23,486
Net income	\$ 18,410	\$ 18,410	\$ 11,814	\$ 11,814
Earnings per share:				
Basic	\$ 0.74	\$ 0.88	\$ 0.47	\$ 0.56
Diluted	\$ 0.64	\$ 0.74	\$ 0.43	\$ 0.50
Weighted-average number of shares outstanding:				
Basic	25,000,000	21,002,000	25,000,000	21,002,000
Diluted	28,963,964	24,965,964	27,406,015	23,408,015

**MARKET PRICE OF SECURITIES**

Stone's common stock, warrants and units are currently quoted on the Over-the-Counter Bulletin Board under the symbols "SCDE," "SCDEW" and "SCDEU," respectively. On June 23, 2006, the last day for which information was available prior to the date of the public announcement of the signing of the Purchase Agreement, the last quoted sale prices of SCDE, SCDEW and SCDEU were \$5.53, \$6.26 and \$0.42, respectively. Each unit of Stone consists of one share of Stone common stock and two redeemable common stock purchase warrants.

The following table sets forth, for the calendar quarter indicated, the quarterly high and low bid information of Stone's common stock, warrants and units as reported on the Over-the-Counter Bulletin Board. The quotations listed below reflect interdealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions:

	Common Stock		Warrants		Units	
	High	Low	High	Low	High	Low
<b>2005</b>						
Third Quarter (commencing August 16)	\$ 5.35	\$ 5.00	\$ 0.58	\$ 0.35	\$ 6.40	\$ 5.95
Fourth Quarter	\$ 5.40	\$ 5.23	\$ 0.59	\$ 0.39	\$ 6.50	\$ 6.05
<b>2006</b>						
First Quarter	\$ 5.80	\$ 5.32	\$ 0.74	\$ 0.37	\$ 7.30	\$ 6.10
Second Quarter	\$ 5.67	\$ 5.45	\$ 0.67	\$ 0.40	\$ 6.95	\$ 6.20
Third Quarter	\$ 5.78	\$ 5.44	\$ 0.83	\$ 0.44	\$ 7.29	\$ 6.35
Fourth Quarter (through October 31)	\$ 5.80	\$ 5.62	\$ 1.00	\$ 0.78	\$ 7.70	\$ 7.05

## RISK FACTORS

You should carefully consider the following risk factors, together with all of the other information included in this proxy statement, before you decide whether to vote or instruct your vote to be cast to adopt the acquisition proposal. As Stone's operations will consist of the KPB assets upon completion of the acquisition, the risk factors relating to the business and operations of KPB also apply to Stone and KapStone Kraft as the successor to KPB's business.

### Risks Associated with the Acquisition

*If the acquisition's benefits do not meet the expectations of the marketplace, or financial or industry analysts, the market price of Stone's common stock may decline.*

The market price of Stone's common stock may decline as a result of the acquisition if KPB does not perform as expected, or Stone does not otherwise achieve the perceived benefits of the acquisition 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 Stone may not be able to raise future capital, if necessary, in the equity markets.

*Stone's directors may have certain conflicts in determining to recommend the acquisition proposal since certain of their interests, and certain interests of their affiliates and associates, are different from, or in addition to, your interests as a stockholder.*

Members of Stone's board of directors have interests in the acquisition that are different from, or in addition to, your interests as a stockholder, including the fact that the shares of common stock owned by them, or their affiliates and associates, that were acquired prior to the IPO would become worthless if the acquisition is not approved and Stone otherwise fails to consummate a business combination prior to its liquidation date. Such shares, as of November 1, 2006, without taking into account any discount that may be associated with certain restrictions on these shares, had a market value of approximately \$ . Similarly, the warrants owned by such directors, affiliates and associates to purchase 4,500,000 shares of common stock would expire and become worthless. Moreover, if the acquisition is approved, it is expected that Stone's officers and directors will continue in their respective roles and be compensated in such manner, and in such amounts, as Stone's board of directors may determine to be appropriate. The consummation of the acquisition will terminate certain non-competition agreements between Messrs. Stone and Kaplan and IP that otherwise would not terminate until July 2007. You should take these potential conflicts into account when considering the recommendation of Stone's board of directors to vote in favor of the acquisition proposal.

*KPB will be dependent upon key management executives whose loss may adversely impact Stone's business.*

KPB depends on the expertise, experience and continued services of KPB's management. The loss of management, or an inability to attract or retain other key individuals following the acquisition, could materially adversely affect Stone. Stone will 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 Stone to retain key management executives or hire new key employees.

*KPB's operations may not be able to generate sufficient cash flows to meet KapStone Kraft's debt service obligations.*

KapStone Kraft's ability to make payments on its indebtedness will depend on its ability to generate cash from KPB's operations. KPB's business may not generate sufficient cash flow from operations to enable it to repay KapStone Kraft's indebtedness and to fund other liquidity needs, including capital expenditure requirements. The indebtedness to be incurred by KapStone Kraft under the credit facility will bear interest at variable rates, and therefore if interest rates increase, KapStone Kraft's debt service requirements will increase. In such case,



KapStone Kraft may need to refinance or restructure all or a portion of its indebtedness on or before maturity. KapStone Kraft may not be able to refinance any of its indebtedness, including the new credit facility, on commercially reasonable terms, or at all. Following the acquisition, KapStone Kraft's expected debt service obligation is initially estimated to be approximately \$4,000,000 in interest payments per annum, which amount will be reduced each year in accordance with scheduled debt amortization payments, if made. In addition, debt service requirements will also include scheduled quarterly principal payments starting at \$1,875,000 during the first year and rising to \$2,250,000 in the final year of the facility. If KapStone Kraft 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 KPb's operations and financial condition.

***A default under KapStone Kraft's indebtedness may have a material adverse effect on KapStone Kraft's business and Stone's financial condition.***

In the event of a default under KapStone Kraft's new 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 new credit facility are secured by a first priority lien on all of the assets of KPb and, in the event of a default under that facility, the lenders generally would be entitled to seize the collateral. Moreover, upon the occurrence of an event of default under the new credit facility, the commitment of the lenders to make any further loans would be terminated. Accordingly, a default under any debt instrument, unless cured or waived, would likely have a material adverse effect on KPb's business and Stone's results of operations and financial condition.

***Servicing debt could limit funds available for other purposes.***

Following the acquisition, Stone will use KapStone Kraft's cash from KPb's operations to pay the principal and interest on its debt. These payments limit funds available for other purposes, including expansion of Stone's operations through acquisitions, funding future capital expenditures and the payment of dividends.

***Stone's working capital will be reduced if Stone stockholders exercise their right to redeem their shares for cash. This would reduce Stone's cash reserve after the acquisition.***

As provided in Stone's certificate of incorporation, holders of IPO shares may, if the stockholder votes against the acquisition proposal, demand that Stone redeem their shares for cash. Stone will not consummate the acquisition if holders of 4,000,000 or more IPO shares, representing 20% or more of the total number of IPO shares, exercise their redemption rights. To the extent the acquisition is consummated and holders have demanded to redeem their shares, there will be a corresponding reduction in the amount of funds available to Stone following the acquisition. Based on the amount of cash held in the trust account at November , 2006, assuming the acquisition proposal is adopted, the maximum amount of funds that could be disbursed to stockholders upon the exercise of the redemption rights is approximately \$ , or approximately 20% of the funds then held in the trust account. Any payment upon exercise of redemption rights will reduce Stone's cash after the acquisition, which will reduce working capital available for the business.

***KapStone Kraft's loan agreements will contain restrictive covenants that will limit its liquidity and corporate activities.***

KapStone Kraft's loan agreements will impose operating and financial restrictions that will limit KapStone Kraft's ability to:

incur additional indebtedness;

create additional liens on its assets;

make investments;

engage in mergers or acquisitions;

pay dividends; and

sell any of KPB's assets outside the ordinary course of business.

In addition, the loan agreement will also impose certain limited restrictions on Stone. Therefore, Stone will need to seek permission from its lender in order to engage in certain corporate actions. The lender's interests may be different from Stone's, and no assurance can be given that Stone will be able to obtain its lender's permission when needed. This may prevent Stone from taking actions that are in its best interest.

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

Stone intends to pursue other acquisition opportunities following the closing of the KPB acquisition in an effort to diversify its investments and/or grow the KPB business. Any business acquired by Stone may cause it to be affected by numerous risks inherent in the acquired business's operations. If Stone acquires a business in an industry characterized by a high level of risk, it may be affected by the currently unascertainable risks of that industry. Although Stone's management will endeavor to evaluate the risks inherent in a particular industry or target business, Stone cannot assure you that it will be able to properly ascertain or assess all of the significant risk factors.

In addition, the financing of any acquisition completed by Stone after the KPB acquisition could adversely impact Stone's 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 Stone's stockholders and/or adversely affect prevailing market prices for Stone's common stock. Increasing Stone's 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 Stone's capital structure and your equity interest in Stone.

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

***Stone did not receive an opinion as to the fairness of the terms and conditions of the acquisition of KPB. Accordingly, you will not be able to rely on a third party valuation in determining the fairness of the transaction.***

Stone did not receive an opinion from an independent third party with respect to whether the terms and conditions of the transaction are fair to stockholders from a financial perspective. In making the determination that the acquisition is fair and in the best interest of the stockholders, Stone's board of directors relied on the expertise and experience of its members, together with its consultants, in analyzing businesses in general, and businesses in the paper and packaging industries in particular. Members of Stone's board of directors are regularly engaged in the evaluation of businesses and their securities in connection with mergers, acquisitions, divestitures and for other purposes. In making your decision to approve the acquisition, you will not have an independent valuation on which to rely.

*If Stone fails to maintain effective systems for disclosure controls and internal controls over financing reporting as a result of the acquisition of the KPB assets, it may be unable to comply with the requirements of Section 404 of the Sarbanes Oxley Act of 2002 in a timely manner.*

Because Stone is acquiring assets of a division of IP, and not a stand-alone entity with its own management information and reporting systems in place, after the consummation of the acquisition Stone will initially depend on IP's systems to monitor the operation of the KPB business. As a division of IP, KPB's internal controls over financial reporting have been maintained as part of IP's overall enterprise wide reporting system. In assuming assets that are part of an ongoing business operation, Stone will face the risk that deficiencies and weaknesses in internal controls over financial reporting may be identified during the transition phase to a stand-alone business. Stone will be responsible for developing and establishing its own systems, processes and procedures to adequately and effectively monitor disclosure controls and internal controls over financial reporting. Stone believes that the cost involved to develop these systems will range from \$3,500,000 to \$4,800,000 and will take approximately 10 months to complete.

Section 404 of the Sarbanes-Oxley Act of 2002 will require Stone 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 will also require an independent registered public accounting firm to test Stone's internal controls over financial reporting and report on the effectiveness of such controls for Stone's fiscal year ending December 31, 2006 and subsequent years. An independent registered public accounting firm will also be required to test, evaluate and report on the completeness of Stone's assessment. It may cost Stone more than it expects to comply with these controls and procedure related requirements. If Stone discovers areas of its internal controls that need improvement, Stone cannot be certain that any remedial measures taken will ensure that it implements and maintains 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 Stone's operating results or cause Stone to fail to meet its reporting obligations.

#### **Risks Associated With KPB's Business**

*Operation of KPB will be dependent upon certain operating agreements with IP.*

Following the acquisition, KapStone Kraft will be initially dependent upon IP for certain operational support services as well as certain supply and purchase arrangements. In this regard, KapStone Kraft will rely upon a transition services agreement for support, will rely upon IP (or buyers of certain IP businesses) to supply pulpwood, residual woodchips, valve and chucks and containers, and will rely upon IP (or buyers of certain IP businesses) to purchase unbleached rollwrap base paper, crude tall oil, black liquor soap, crude sulfate turpentine, dunnage bags and linerboard from KapStone Kraft.

IP will be the exclusive supplier of corrugated containers to KapStone Kraft. KapStone Kraft currently believes that containers and the other materials to be supplied by IP as described above are readily available from other sources on the open market. However, in the event that IP, or any other supplier of key materials, for any reason fails to meet KapStone Kraft's supply requirements, the loss of supply could prevent KapStone Kraft from meeting its scheduled product deliveries and/or lead to increases in the prices of such supplies, which could have a material adverse effect on Stone's operating results and financial condition.

KapStone Kraft has agreed to supply to IP 100% of IP's requirements of dunnage bags. Also, KapStone Kraft agreed to supply to IP, the buyer of IP's beverage packaging business and the buyer of IP's coated paper business, 100% of each of their requirements of unbleached rollwrap paper. Any reduction in market prices or in the volume of products to be purchased by such parties, whether due to decreased demand, adverse market conditions or otherwise, could have a potential adverse effect on Stone's operating results and financial condition. In addition, if KapStone Kraft is unable to supply to such parties their requirements of the foregoing products, such parties would have the right to obtain their requirements from other suppliers, which could have a material adverse effect on Stone's operating results and financial condition.

In addition, KapStone Kraft will rely upon a patent license agreement with IP, whereby it can continue to use certain patented technology used in constructing dunnage bags on a royalty-free basis for the life of the patent. The failure of IP to protect the patent could have a material adverse effect on KPB's business and Stone's operating results and financial condition.

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

All of KPB's hourly paid employees (approximately 390 at Roanoke Rapids and 150 at Ride Rite® Converting) are represented by the United Steelworkers Union. KPB is a party to collective bargaining contracts, which represent approximately 81% and 78% of its employees at Roanoke Rapids and Ride Rite® Converting, respectively. No assurance can be given that KapStone Kraft 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 Roanoke Rapids through January 31, 2007 and with respect to Ride Rite® Converting through June 30, 2008. If KapStone Kraft fails to extend or renegotiate its collective bargaining agreements, if disputes with the union arise, or if the unionized workers engage in a strike or other work stoppage, KapStone Kraft could incur higher ongoing labor costs or experience a significant disruption of operations, which could have a material adverse effect on KapStone Kraft's business and Stone's results of operations. The impact of future negotiations, including changes in wages and benefit levels that are collectively bargained for as part of the overall contracts with the unions, could have a material impact on Stone's financial results.

***A few customers account for a significant portion of Stone's revenues.***

During the year ended December 31, 2005, the top three customers (Altivity Packaging (formerly a division of Smurfit-Stone Container Corporation), Exopack, LLC and Hood Packaging Corporation) accounted for 53.6% and the top ten customers accounted for 88.0% of revenues generated by Roanoke Rapids. Similarly, in 2005, two customers accounted for 29.9% and the top ten customers accounted for 66.6% of revenues generated by Ride Rite® Converting. The contracts with KPB's clients typically have a two-year term and pricing is market-indexed, based on volume and do not contain any penalty provisions. The loss of or reduced sales to these key customers could result in decreased revenues and adversely impact KPB's cash flows.

***The Roanoke Rapids facility consists of a single paper mill from which all of its kraft paper products are manufactured. If the equipment at the mill malfunctions, KPB may be unable to manufacture its products.***

KPB relies on a single paper mill with two papermaking machines to produce its kraft paper products. The mill operates 24 hours a day, seven days a week, which may lead to extensive wear and tear on the equipment. Further, since the Roanoke Rapids facility relies solely on two papermaking machines, any breakdown in one or both machines could result in an interruption in production at the mill and KapStone Kraft may be unable to fulfill its product delivery obligations to its customers. KapStone Kraft's failure to produce and deliver its products could lead to cancellation of customer contracts, which could adversely affect KapStone Kraft's results of operations, financial condition and relationship with customers.

***Although IP has agreed to indemnify KapStone Kraft with respect to environmental liabilities that are being assumed, KapStone Kraft 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 \$1,000,000 threshold and a cap of \$15,000,000. 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 \$1,800,000 every six months during the three year survival period. Because Stone is 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 KapStone Kraft is 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 Stone's results of operations and financial condition.

***If the actual employee pension and post-retirement liabilities KapStone Kraft has assumed are greater than currently estimated, it could have a negative effect on KapStone Kraft's results of operations and financial condition.***

KapStone Kraft has agreed to assume certain collective bargaining agreements and to provide benefits through the expiration of those agreements, including the provision of pension and post-retirement medical benefits that are substantially similar to the collectively bargained benefits previously negotiated by IP. To the extent entitlement to pension and post-retirement medical benefits under these agreements is vested at the time of the transaction, the liabilities associated with the provision of those benefits are excluded liabilities that are retained by IP under the Purchase Agreement, and KapStone Kraft will not assume those liabilities. However, to the extent post-retirement liabilities for collectively bargained employees at the time of the closing are greater than the liabilities for vested benefits retained by IP, KapStone Kraft intends to provide credits after the closing to the applicable employees under the benefits plans it establishes such that these employees receive benefits after the closing that are substantially similar to those previously negotiated by IP under the collective bargaining agreements. Consequently, these liabilities will be KapStone Kraft's obligation. The amount of these assumed liabilities, for financial accounting purposes, have been determined to be approximately \$3,015,000. If the actual liabilities are greater than the estimate, KapStone Kraft's pension obligations and related expense will be increased, which could have a material adverse effect upon Stone's operating results and financial condition.

***The decline in the volume of roundwood supplied to KPB could result in production delays.***

Currently, approximately 27% of Roanoke Rapids' roundwood requirement is supplied by IP's Forest Resources Division. However, the sale of IP's forestlands to third parties is expected to result in a reduction in such supply to approximately 7% of contracted roundwood supplied to KPB by the future owners of the forestlands. Any delays in finding alternative suppliers could interrupt production, which could have a negative impact on KapStone Kraft's results of operations and financial condition.

#### **Risks Associated With the Paper and Packaging Industries**

***The paper and packaging industries are highly cyclical. Fluctuations in the prices of and the demand for KPB's 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 profit margins for products in the paper and packaging 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 and 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, as well as foreign currency exchange rates. The foregoing factors could materially and adversely impact KPB's sales and profitability.

***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 segments of the packaging industry. Wood fiber is a commodity, and prices for wood fiber 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. 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.

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 that country as well as transportation difficulties.

***An increase in the cost of purchased energy or other raw materials could lead to higher manufacturing costs, thereby reducing profit margins.***

Energy is a significant raw material in the paper and packaging industries. Energy prices, particularly for electricity, natural gas, coal and fuel oil, have been volatile in recent years and currently exceed historical averages. These fluctuations have historically impacted manufacturing costs of companies in the paper and packaging industries, often contributing to volatility in earnings. Recent significant increases in energy prices can be expected to adversely impact businesses in the paper and packaging industries. KPB does not have any long-term arrangements to purchase energy at a fixed price, thus this lack of long-term supply contracts at fixed prices could result in price volatility in KPB's supply of energy. In addition, KPB has no long-term contracts to purchase raw materials, thus KPB could be materially adversely impacted by supply disruptions. Further, KPB does not use any forward contracts or other financial instruments to hedge its exposure to price risks related to these commodities.

***Paper and packaging companies face strong competition.***

The paper and packaging industries are highly fragmented, and KPB faces competition from numerous domestic, as well as foreign competitors. Some of KPB's competitors are 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 than KPB.

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

Companies in the paper and packaging 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 paper and wood products to competing technologies or materials could result in a material decrease in sales. While Stone would seek to have KPB adapt its product offerings to changes in market demand, such efforts may not be successful or sufficient.

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

Companies in the paper and packaging industries 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. KapStone Kraft will, in all likelihood, incur substantial expenditures to maintain compliance with applicable environmental laws and regulations. In addition, new laws enacted in the future could require substantial expenditures for compliance. Failure to comply with applicable environmental laws and regulations could expose KapStone Kraft 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 Stone's Warrants**

*Stone may choose to redeem its 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 Stone's initial public offering, during the entire period between the notice of redemption and the actual redemption date, Stone 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 therefor 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 Stone is required to (and intends to) use its best efforts to have an effective registration statement covering the issuance of the shares underlying the warrants issued in its initial public offering at the time that the warrant holders exercise their warrants, Stone cannot guarantee that a registration statement will be effective, in which case the warrant holders may not be able to exercise their warrants.*

Holders of the warrants issued in Stone's 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 Stone has agreed in the warrant agreement, and therefore has a contractual obligation, to use its best efforts to maintain a current registration statement covering the shares underlying the warrants to the extent required by federal securities laws, and Stone intends to comply with such agreement, Stone cannot give assurance that it will be able to do so. In addition, some states may not permit Stone to register the shares issuable upon exercise of its warrants for sale. Since Stone has 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 Stone, it may exercise its redemption right even if it is 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.

**FORWARD-LOOKING STATEMENTS**

Stone believes that some of the information in this proxy statement constitutes forward-looking statements within the definition of the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as "may," "expect," "anticipate," "contemplate," "believe," "estimate," "intends," and "continue" or similar words. Any information in this proxy statement regarding the contingent earn-out payments should also be considered forward-looking statements. You should read statements that contain these words carefully because they:

discuss future expectations;

contain information which could impact future results of operations or financial condition; or

state other "forward-looking" information.

Stone believes it is important to communicate its expectations to the Stone stockholders. However, there may be events in the future that Stone is not able to accurately predict or over which Stone has little or no control. The following factors, among others may cause actual results to differ materially from the expectations described by Stone in its forward-looking statements:

continued compliance with government regulations;

legislation or regulatory environments, requirements or changes affecting the businesses in which KPB is engaged;

paper and packaging industry trends, including factors affecting supply and demand;

KPB's customer concentration;

labor and personnel relations;

credit or currency risks affecting KPB's revenue and profitability;

changing interpretations of generally accepted accounting principals;

cost of raw materials and energy; and

general economic conditions.

You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this proxy statement.

All forward-looking statements included herein attributable to Stone, KPB or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except to the extent required by applicable laws and regulations, Stone undertakes no obligations to update these forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

Before you grant your proxy or instruct how your vote should be cast you should be aware that the occurrence of the events described in the "Risk Factors" section and elsewhere in this document could have a material adverse effect on Stone or KPB.





**THE STONE SPECIAL MEETING**

**General**

Stone is furnishing this proxy statement to you as part of the solicitation of proxies by Stone's board of directors for use at the special meeting of Stone's stockholders to be held on \_\_\_\_\_, 2006, and at any adjournment or postponement thereof. This proxy statement is first being furnished to our stockholders on or about \_\_\_\_\_, 2006 in connection with the vote on the acquisition proposal, the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal. This document provides you with the information you need to know to be able to vote or instruct your vote to be cast at the special meeting.

**Date, Time and Place**

Stone will hold the special meeting at 10:00 a.m., Central time, on \_\_\_\_\_, 2006, at the offices of Stone, located at One Northfield Plaza, Suite 480, Northfield, IL 60093, to vote on the adoption of the acquisition proposal, the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal.

**Purpose of the Special Meeting**

At the special meeting, Stone is asking holders of Stone common stock to:

adopt the acquisition proposal;

adopt the name change amendment proposal;

adopt the Article SIXTH amendment proposal; and

adopt the incentive plan proposal.

Stone's board of directors:

unanimously recommend that Stone common stockholders vote "FOR" the acquisition proposal;

unanimously recommend that Stone common stockholders vote "FOR" the name change amendment proposal;

unanimously recommend that Stone common stockholders vote "FOR" the Article SIXTH amendment proposal; and

unanimously recommend that Stone common stockholders vote "FOR" the incentive plan proposal.

Adoption by Stone stockholders of the acquisition proposal is not conditioned upon the adoption of the name change amendment proposal, the Article SIXTH amendment proposal or the incentive plan proposal. However, the adoption of the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal are conditioned upon the adoption of the acquisition proposal. If the acquisition proposal is not approved, none of the other proposals will be presented at the meeting for adoption.

**Record Date; Who is Entitled to Vote**

The record date for the special meeting is November 17, 2006. Holders of record of Stone common stock at the close of business on the record date are entitled to vote or have their votes cast at the special meeting. On the record date, there were 25,000,000 outstanding shares of Stone common stock.

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Each share of Stone common stock is entitled to one vote at the special meeting. Stone's issued and outstanding warrants do not have voting rights and holders of Stone warrants will not be entitled to vote at the special meeting.

Stone's officers and directors have agreed to vote their 5,000,000 shares of Stone common stock acquired prior to Stone's initial public offering, representing an aggregate of 20% of the outstanding shares of Stone common stock, in accordance with the vote of the majority of the IPO shares voted at the meeting with respect to the acquisition proposal. In addition, Stone's Chief Executive Officer intends to vote 500,000 shares of common stock that are part

of the 500,000 units acquired by him in Stone's initial public offering, representing 2% of the outstanding shares of Stone common stock, and 2.5% of the outstanding IPO shares, "FOR" the adoption of the acquisition proposal. Stone's officers and directors, including Stone's Chief Executive Officer, intend to vote all of their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" each of the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal. To date, only Mr. Stone owns IPO shares through his purchase of units in the initial public offering. None of the other officers and directors of Stone acquired units, or IPO shares, in the initial public offering or in the aftermarket.

### **Quorum**

The presence, in person or by proxy, of a majority of all issued and outstanding shares of Stone's common stock constitutes a quorum at the special meeting.

### **Abstentions and Broker Non-Votes**

If your broker holds your shares in its name and you do not give the broker voting instructions, under the rules of the NASD, your broker may not vote your shares on the acquisition proposal or the incentive plan proposal. If you do not give your broker voting instructions and the broker does not vote your shares, this is referred to as a "broker non-vote."

An abstention or a broker non-vote will not be considered a vote cast at the meeting with respect to the acquisition proposal and will not have the effect of electing to exercise your redemption rights since a stockholder must vote against the acquisition proposal and affirmatively exercise their redemption rights in order to redeem their shares. Abstentions or broker non-votes have the same effect as a vote "against" the name change amendment proposal and the Article SIXTH amendment proposal. An abstention also has the effect as a vote "against" the incentive plan proposal, but a broker non-vote has no effect on the incentive plan proposal.

### **Voting Your Shares**

Each share of Stone common stock that you own in your name entitles you to one vote. Your proxy card shows the number of shares of Stone common stock that you own as of the record date. No vote of the warrant holders is necessary to adopt the acquisition proposal, the name change amendment proposal, the Article SIXTH amendment proposal or the incentive plan proposal and Stone is not asking the warrant holders to vote on any of the foregoing proposals.

There are two ways to vote your shares of Stone common stock at the special meeting:

You can vote by signing and returning the enclosed proxy card. If you vote by proxy card, your "proxy," whose name is listed on the proxy card, will vote your shares as you instruct on the proxy card. If you sign and return the proxy card but do not give instructions on how to vote your shares, your shares will be voted as recommended by Stone's board "FOR" the adoption of the acquisition proposal, the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal.

You can attend the special meeting and vote in person. We will give you a ballot when you arrive. However, if your shares are held in the name of your broker, bank or another nominee, you must get a proxy from the broker, bank or other nominee. That is the only way we can be sure that the broker, bank or nominee has not already voted your shares.

### **Vote Required to Adopt the Acquisition Proposal**

The affirmative vote in favor of the acquisition proposal by a majority of the IPO shares that are voted at the meeting is required to adopt the acquisition proposal. Adoption of the acquisition proposal is not conditioned upon the adoption of the name change amendment proposal, the Article SIXTH amendment proposal or the incentive plan proposal. However, if the holders of 4,000,000 or more IPO shares, representing 20% or more of the total number of IPO shares, vote against the acquisition and affirmatively demand redemption of their shares for their pro rata

portion of the trust account, then, in accordance with Stone's certificate of incorporation, the acquisition will not be consummated. See "Redemption Rights" below.

At the close of business on November 17, 2006, there were 25,000,000 shares of Stone common stock outstanding, 20,000,000 of which were issued in Stone's initial public offering.

Stone's officers and directors have agreed to vote their 5,000,000 shares of Stone common stock acquired prior to Stone's initial public offering, representing an aggregate of 20% of the outstanding shares of Stone common stock, in accordance with the vote of the majority of the IPO shares voted at the meeting with respect to the acquisition proposal. In addition, Stone's Chief Executive Officer intends to vote 500,000 shares of common stock that are part of the 500,000 units acquired by him in Stone's initial public offering, representing 2% of the outstanding shares of Stone common stock, and 2.5% of the outstanding IPO shares, "FOR" the adoption of the acquisition proposal.

### **Redemption Rights**

As provided in Stone's certificate of incorporation, holders of IPO shares may, if the stockholder votes against the acquisition, demand that Stone redeem their shares for cash. This demand must be made on the proxy card at the same time that the stockholder votes against the acquisition proposal.

Stockholders who abstain from voting or fail to instruct their broker how to vote may not exercise their redemption rights. To exercise your redemption rights, you must vote against the acquisition proposal and affirmatively elect to have your shares redeemed by checking the appropriate box, or directing your broker to check the appropriate box on the proxy card and ensure that the proxy card is delivered prior to the Stone special meeting. If so demanded, subject to the conditions described further below, Stone will redeem each share of common stock for a pro rata portion of the trust account in which \$ \_\_\_\_\_ of the net proceeds of Stone's initial public offering are held, plus interest earned thereon. Based on the amount of cash held in the trust account at November \_\_\_\_\_, 2006, you will be entitled to redeem each share of common stock that you hold for approximately \$ \_\_\_\_\_. If you exercise your redemption rights, you will be exchanging your shares of Stone's common stock for cash and will no longer own these shares. You will only be entitled to receive cash for these shares if you continue to hold these shares through the closing date of the acquisition and then tender your stock certificate to Stone. If the acquisition is not completed, then these shares will not be redeemed into cash.

Prior to exercising redemption rights, Stone stockholders should verify the market price of Stone's common stock as they may receive higher proceeds from the sale of their common stock in the public market than from exercising their redemption rights. Stone's shares of common stock are listed on the Over-the-Counter Bulletin Board under the symbol "SCDE."

### **Vote Required to Adopt the Name Change Amendment Proposal**

Adoption of the name change amendment proposal requires the affirmative vote of a majority of the issued and outstanding shares of Stone's common stock. Adoption of the name change amendment proposal is conditioned upon the adoption of the acquisition proposal, but is not conditioned upon adoption of the Article SIXTH amendment proposal or the incentive plan proposal.

Stone's officers and directors intend to vote their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" the name change amendment proposal.

### **Vote Required to Adopt the Article SIXTH Amendment Proposal**

Adoption of the Article SIXTH amendment proposal requires the affirmative vote of a majority of the issued and outstanding shares of Stone's common stock. Adoption of the Article SIXTH amendment proposal is conditioned upon the adoption of the acquisition proposal, but is not conditioned upon adoption of the name change amendment proposal or the incentive plan proposal.

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Stone's officers and directors intend to vote their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" the Article SIXTH amendment proposal.

### **Vote Required to Adopt the 2006 Incentive Plan Proposal**

Adoption of the incentive plan proposal requires the affirmative vote of a majority of the shares of Stone's common stock represented in person or by proxy and entitled to vote at the special meeting. Adoption of the incentive plan proposal is conditioned upon the adoption of the acquisition proposal, but is not conditioned upon adoption of the name change amendment proposal or the Article SIXTH amendment proposal.

Stone's officers and directors intend to vote their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" the incentive plan proposal.

### **Who Can Answer Your Questions About Voting Your Shares**

If you have questions about voting your shares, you may write, e-mail or call Stone's Proxy Solicitor, Morrow & Co., Inc., 470 West Avenue 3rd Floor, Stamford, CT 06902, E-mail: Stone.info@morrowco.com. Banks and brokerage firms, please call (203) 658-9400. Stockholders, please call (800) 607-0088, or Roger Stone, our Chairman and Chief Executive Officer at (847) 441-0929.

### **No Additional Matters May Be Presented at the Special Meeting**

This special meeting has been called only to consider the adoption of the acquisition proposal, the name change amendment proposal, the Article SIXTH amendment proposal and the incentive plan proposal. Under Stone's by-laws, other than procedural matters incident to the conduct of the meeting, no other matters may be considered at the special meeting, if they are not included in the notice of the meeting.

Representatives of Stone's accountants are not expected to be present at the special meeting and, accordingly, will not make any statement or be available to respond to any questions.

### **Revoking Your Proxy**

If you give a proxy, you may revoke it at any time before it is exercised by doing any one of the following:

You may send another proxy card with a later date;

You may notify Roger Stone, Stone's Chairman and Chief Executive Officer, in writing before the special meeting that you have revoked your proxy; and

You may attend the special meeting, revoke your proxy, and vote in person.

### **Solicitation Costs**

Stone will bear all expenses incurred in connection with the solicitation of proxies. Stone will, upon request, reimburse brokerage firms and other nominee holders for their reasonable expenses incurred in forwarding the proxy solicitation materials to the beneficial owners of our shares. Our officers and directors may solicit proxies by mail, personal contact, letter, telephone, telegram, facsimile or other electronic means. They will not receive any additional compensation for those activities, but they may be reimbursed for their out-pocket-expenses. In addition, we have hired Morrow & Co., Inc. to solicit proxies on our behalf. The cost of soliciting proxies on our behalf will be approximately \$5,500 plus costs and expenses.

### **Stone Insider Stock Ownership**

At the close of business on the record date, Roger Stone, Matthew Kaplan, John Chapman, Jonathan Furer and Muhit Rahman, who together comprise all of Stone's directors and officers, together with their affiliates, beneficially owned and were entitled to vote 5,500,000 shares of Stone common stock, or 22% of the outstanding shares of



Stone common stock. Such number does not include 4,500,000 shares of common stock issuable upon exercise of warrants purchased by Stone's executive officers and directors of which 3,500,000 warrants were purchased in the aftermarket between September 14, 2005 and November 7, 2005 pursuant to a discretionary order that was submitted to Morgan Joseph immediately following the initial public offering, and the remaining 1,000,000 warrants were purchased by Mr. Stone as part of his purchase of 500,000 units in the initial public offering. The shares held by Stone's management, without taking into account any discount that may be associated with certain restrictions on these shares, have a market value of approximately \$ [redacted] based on Stone's common stock price of \$ [redacted] per share as of November [redacted], 2006. Other than the IPO shares held by Mr. Stone, which will participate in any liquidating distributions made from the trust account, Stone's officers and directors will not receive any value associated with their share ownership in the event that a business combination is not consummated. The warrants, without taking into account any discount that may be associated with certain restrictions on the transfer of these warrants, collectively have a market value of approximately \$ [redacted] based on Stone's warrant price of \$ [redacted] per warrant as of November [redacted], 2006. The 3,500,000 warrants purchased in the aftermarket were purchased at prices ranging from \$0.3991 per warrant to \$0.60 per warrant, for an aggregate purchase price of \$1,821,806. The remaining 1,000,000 warrants owned by Mr. Stone were purchased as part of units in the initial public offering for \$6.00 per unit, for an aggregate purchase price of \$3,000,000. The warrants held by Stone's officers and directors and their affiliates and associates (as well as all other warrants) will expire and become worthless if the acquisition is not approved and Stone fails to consummate an alternative business combination by the later of February 19, 2007, or August 19, 2007, in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed but not consummated by February 19, 2007, pursuant to Stone's certificate of incorporation. For information on beneficial ownership of Stone's common stock by executive officers, directors and 5% stockholders, see "*Beneficial Ownership of Securities*" on page [redacted].



**PROPOSAL I**  
**THE ACQUISITION PROPOSAL**

The discussion in this document of the acquisition and certain principal terms of the Purchase Agreement, dated as of June 23, 2006, by and among Stone, KapStone Kraft, and IP is subject to, and is qualified in its entirety by reference to, the Purchase Agreement, a copy of which is attached as *Annex A* to this document and is incorporated in this document by reference.

**General Description of the Acquisition**

The Purchase Agreement provides for the acquisition of substantially all of the assets of Roanoke Rapids and Ride Rite® Converting, which assets comprise the business of KPB, a division of IP, and the assumption of certain limited liabilities.

**Background of the Acquisition**

The terms of the Purchase Agreement are the result of arm's-length negotiations between representatives of Stone and IP. The following is a brief discussion of the background of these negotiations, the acquisition and related transactions.

Stone is a blank check company organized as a corporation under the laws of the State of Delaware on April 15, 2005. On August 19, 2005, Stone successfully consummated an initial public offering of its equity securities from which it derived net proceeds of approximately \$113,236,000. Stone's common stock, warrants to purchase common stock and units consisting of one share of common stock and two warrants to purchase common stock are listed on the Over-the-Counter Bulletin Board under the symbols "SCDE," "SCDEW" and "SCDEU," respectively. \$110,854,000 of the net proceeds of the initial public offering was placed in a trust account and will be released to Stone upon consummation of the acquisition or upon the dissolution and liquidation of Stone in accordance with the Delaware General Corporation Law. Subsequent to its initial public offering, Stone's officers and directors commenced an active search for a prospective business combination. Other than its initial public offering and the pursuit of a business combination, Stone has not engaged in any business to date. If Stone does not consummate a business combination by the later of February 19, 2007, or August 19, 2007, in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed but a business combination was not consummated by February 19, 2007, then, pursuant to Article SIXTH of its certificate of incorporation, as amended, Stone's officers must take all actions necessary to dissolve and liquidate Stone in accordance with the Delaware General Corporation Law. As of November 1, 2006, approximately \$110,854,000, including interest, was held on deposit in the trust account.

Following its initial public offering in August 2005, Stone's officers and directors contacted various principals and intermediaries such as investment banks, private equity firms and business brokers, as well as other industry contacts, in order to generate ideas for a suitable business combination. Stone informed its business contacts that it had consummated an initial public offering and was seeking an operating business in the paper, packaging, forest products and related industries for a business combination. Stone encouraged business brokers to contact clients who might constitute potential acquisition targets and explore the possibility of a transaction. In addition, at Stone's request, Morgan Joseph & Co., Inc., the managing underwriter of Stone's initial public offering, generated lists of various industry participants that might constitute potential business targets. Stone was also aware of the strategic realignments that had been publicly announced by a number of the large industry players, such as IP's public announcement on July 19, 2005 that IP planned to transform its business and performance and was undertaking a strategic alternatives review. As knowledge of Stone's interest in an acquisition spread through the industry, Stone also began to receive unsolicited calls from various parties that included both principals and agents regarding specific opportunities.

Stone's officers and directors reviewed the list of potential business targets compiled by Morgan Joseph, as well as leads from other sources, and selected for follow-up those businesses that they believed had the most potential as an acquisition. While no master list of the selected target businesses was maintained, potential business targets were pursued until they were deemed either unsuitable or potentially too expensive. Criteria for suitability included

management's assessment of the competitive strengths and weaknesses of the potential business targets, the outlook for the sectors in which the targets operated, the strength of the management team, and the quality of the assets to be acquired. In some cases, the geographic location of the business target's operations and customers was considered as well. Certain potential targets were considered unsuitable because they operated in sectors of the paper and packaging industry that management believed did not have good economic potential. Other targets were considered by management to have too great a level of business risk due to poor asset quality or poor or erratic financial results. Stone reviewed numerous potential business targets, which led to more than 10 confidentiality agreements being executed. Stone made offers for specific businesses or assets to approximately half of those targets, including, for example, a verbal indication of interest for a potential target which was communicated during the first week of January 2006, a written indication of interest relating to another division of IP delivered during the last week of January 2006, and a written indication of interest relating to a large division of a major packaging company delivered on February 16, 2006. Discussions with the first company were discontinued in March 2006 when Stone and IP agreed to exclusivity regarding the purchase of the KPB assets. Discussions with the second and third examples were discontinued when management was informed that the price expectations of the owners of those divisions (based on other indications they had received) exceeded what management believed to be appropriate.

On October 27, 2005, one of Stone's directors met with certain representatives of Banc of America Securities LLC to introduce them to Stone and seek their help in identifying a suitable target. An investment banker at Banc of America Securities, who specializes in the healthcare services industry, is a personal friend of one of Stone's directors and arranged the meeting so that Stone could meet certain investment bankers specializing in the forest products industries at Banc of America Securities. During the meeting, Stone's strategy and goals were explained. During the discussion it was disclosed to Stone that Banc of America Securities had been selected to market KPB (such engagement was entered into on July 25, 2005) and that Banc of America Securities was in the process of preparing marketing materials. KPB is the Kraft Papers Business, which is a division of IP and is comprised of IP's operations at Roanoke Rapids, North Carolina and Ride Rite® Converting in Fordyce, Arkansas. Stone's director expressed interest in receiving the confidential information memorandum when it was available. No conversations regarding IP's sale of the KPB assets took place between this investment banker and the Stone director prior to the October 27, 2005 meeting, and this investment banker was not engaged in the marketing of the KPB assets. Prior to this meeting, none of Stone's officers or directors had any knowledge (other than what had been publicly announced) about IP's business transformation plans. While potential business targets were discussed in general, the discussions at this meeting primarily focused on Stone explaining its strategy and goals.

Between October 27, 2005 and November 21, 2005, Stone's officers and directors stayed in periodic contact with Banc of America Securities to continue to express their interest in receiving detailed confidential information about the KPB assets when such information became available. Also, since the sale of Box USA to IP in July 2004, Roger Stone has had periodic contact on a quarterly basis with IP's Vice President of Corporate Development relating to post-closing issues, including the release of certain holdback payments, from the July 2004 sale of Box USA to IP. In the context of one of those conversations he likewise expressed a similar interest in receiving information about IP's publicly announced divestitures once such information was available. At the time of that conversation, no such information was available, nor any provided (confidentially or otherwise), and no transactions were discussed.

On November 21, 2005, Stone received a short information summary regarding KPB and a draft confidentiality agreement. After brief negotiations, the confidentiality agreement was executed on November 23, 2005 by one of the Stone directors on behalf of Stone. Each of the Stone directors received a copy of the KPB confidential information memorandum on or around November 24, 2005. The first direct contact concerning this transaction between Stone and IP occurred a day or two thereafter in the form of a conference call on which the Banc of America Securities team was accompanied by the transaction team at IP that was responsible for the sale of KPB. On November 29, 2005, Roger Stone and Matthew Kaplan met with representatives of Banc of America Securities where, among other things, they discussed Stone's possible interest in KPB.

On December 6, 2005, Stone's directors met, and after discussing the KPB confidential information memorandum, decided to submit a preliminary and non-binding indication of interest for KPB. On December 15, 2005, Stone submitted a written indication of interest with respect to its potential acquisition of KPB. Stone's indication of interest

proposed a valuation range of \$140,000,000 to \$165,000,000 in cash for KPB on a cash-free/debt-free basis. Stone also requested that as part of any transaction IP terminate certain agreements not to compete that had previously been signed individually by our officers in favor of IP in connection with an unrelated transaction. Management believes that the first discussions with IP concerning the termination of the non-competition agreements in the context of a potential sale of the KPB assets to Stone Arcade took place between the time that Stone executed the confidentiality agreement with IP on November 23, 2005 and the date that Stone submitted its initial indication of interest on December 15, 2005, which contained the release as a term of the transaction. Stone's internal discussions with respect to the non-competition agreements began at the time of the initial public offering when it evaluated such agreements' effect on Stone's ability to complete a business combination. In early January 2006, Roger Stone was informed by telephone that based on the indication of interest, Stone was invited to visit the Roanoke Rapids facility and meet with management. Members of Stone's board continued to analyze the KPB information and to evaluate additional market information.

On January 20, 2006, Stone's officers and directors were provided with access to an electronic "data room" containing detailed KPB information. On January 26 and 27, 2006, Stone's officers and directors visited KPB's facilities in Roanoke Rapids, North Carolina. During that visit, they met with several senior operating managers, members of IP corporate staff and representatives from Banc of America Securities. KPB management made a business presentation, conducted a tour of the facility, and were available to answer questions from the Stone directors and officers. Over the next several days, Stone was encouraged to submit a revised proposal.

Stone's directors reviewed the available information, and on February 15, 2006, Mr. Stone submitted a revised indication of interest. In the revised letter, Stone indicated it would consider a purchase price of \$165,000,000, for the assets of KPB consisting of \$90,000,000 in cash and \$75,000,000 in the form of a subordinated note to IP. Stone further indicated it would consider additional payments of up to \$60,000,000 contingent upon the profitability of KPB for the five calendar years 2006-2010 for an aggregate consideration of \$225,000,000. The letter also indicated flexibility on Stone's part with respect to the relative amount of cash and notes to be paid at closing, as well as willingness to assume the liabilities related to certain KPB industrial revenue bonds.

On February 22, 2006, Stone received an invitation to submit a final written proposal, to which Stone responded on February 24, declining to submit a further revised bid. Over the next several days, Stone and representatives from IP had several telephonic conversations, and Stone was asked to revise its indication to eliminate the subordinated note to IP as part of the consideration and instead provide a greater amount of cash at closing. After further review and discussion, Stone verbally informed IP that it would revise its indication to increase the cash consideration payable at closing from \$90,000,000 to \$155,000,000 and would eliminate the subordinated note. The amount and conditions of the contingent payments remained unchanged for an aggregate cash consideration of \$215,000,000, reflecting a reduction in the total maximum cash consideration that could be payable to IP by \$10,000,000. Within the ensuing few days, Stone received a draft purchase agreement and was notified that it was being invited to mark up the agreement and submit its best and final offer. Stone declined to mark up the purchase agreement or to further revise its offer. However, on March 6, 2006, Stone sent a short letter confirming the \$155,000,000 all-cash indication to IP. Stone was informed that the board of directors of IP would meet on March 13, 2006 and make a decision with respect to the various indications for KPB.

On March 16, 2006, Stone was informed that IP had agreed to negotiate exclusively with Stone towards a definitive agreement along the terms proposed in Stone's indication letters. On March 17, 2006, Stone's board of directors met in Chicago and authorized its officers to negotiate exclusively with IP for the purchase of KPB, and to retain the professional services necessary to complete due diligence and documentation. On March 29, 2006, Stone and IP executed an exclusivity agreement, whereby Stone obtained the right to exclusively evaluate and negotiate a transaction with respect to KPB for a period of 60 days. At the time the exclusivity agreement with IP was signed, Stone had outstanding two other non-binding indications of interest for potential business targets where Stone had been advised that it was a leading candidate for the potential transaction. Over the next several weeks, Stone personnel, as well as its consultants and professional advisors, made several trips to IP's headquarters in Memphis, Tennessee, and to Roanoke Rapids, North Carolina and Fordyce, Arkansas in order to conduct due diligence. On May 25, 2006, KapStone Kraft was formed solely for the purposes of the acquisition. On May 30, 2006, while the

parties were negotiating a definitive agreement, the exclusivity agreement was extended by mutual consent to June 20, 2006.

On June 23, 2006, Stone, KapStone Kraft and IP signed the definitive documents whereby Stone agreed to purchase substantially all of the assets of KPB for \$155,000,000 in cash (subject to certain working capital adjustments), two separate contingent payments of up to \$35,000,000 and of \$25,000,000 based upon the EBITDA of KPB over the five years immediately following the acquisition, and to assume approximately \$4,800,000 in long-term liabilities.

Between March 16, 2006, when Stone and IP began exclusive negotiations, and June 23, 2006 when a Purchase Agreement was signed, Stone and IP and their respective representatives engaged in extensive negotiations concerning the terms and language contained in the Purchase Agreement and ancillary agreements. In addition, Stone and its consultants and advisors were simultaneously conducting extensive due diligence through on-site meetings as well as meetings at Stone's offices in Northfield, Illinois. Some of the terms that were modified during these rounds of negotiations include the terms of the contingent payments, the nature and extent of liabilities that would be assumed by Stone in connection with the acquisition of the KPB business and the level of net working capital. More specifically, the negotiations consisted of setting forth in clear and unambiguous detail the terms and concepts that were covered in the various indications that had been made by Stone, including, reaching agreements on various representations and warranties from IP to Stone, various human resource matters, and information technology and administrative matters that would affect the KPB business after the acquisition. During this time, Stone selected LaSalle Bank N.A. as its senior lender and on June 23, 2006, LaSalle and Stone entered into a commitment letter with respect to a \$95,000,000 credit facility to provide partial financing for the acquisition. The commitment, which had an expiration date of December 31, 2006, has been extended to February 1, 2007.

On June 21, 2006, Stone's board of directors unanimously approved the terms of the acquisition and voted to authorize Stone to enter into the Purchase Agreement with IP. The Purchase Agreement was signed on June 23, 2006. On Monday, June 26, 2006, IP issued a press release and Stone filed a Current Report on Form 8-K announcing the execution of the Purchase Agreement and disclosing the terms of the Purchase Agreement.

On November 8, 2006, Stone was advised by IP that due to an isolated information technology account mapping problem that had been identified and subsequently corrected, certain discounts among KPB, IP's bleached kraft paper business, and its forest products division had been misallocated, and that a restatement of KPB's financial statements for the years ended December 31, 2003, 2004 and 2005 and the six month periods ended June 30, 2005 and 2006 would likely be required. On November 16, 2006, IP provided Stone with preliminary restated KPB financial statements. The restated figures included certain additional immaterial corrections to fair value adjustments for Industrial Revenue Bonds that had been incorrectly recorded and a portion of unamortized discount relating to other bonds that had been incorrectly classified as other assets. On November 17, 2006, Stone's board of directors met to review the preliminary figures and discuss their impact, if any, on the board's analysis of the terms of the acquisition. Based on the assumption that the actual restated financial statements would not differ materially from the preliminary figures, Stone's board of directors determined that (i) the net present value of the maximum consideration to be paid to IP for the KPB assets is still well below the range of fair market values as determined by the board; (ii) KPB's actual performance for the nine months ended September 30, 2006 is significantly better than what was projected at the time of the board's initial analysis; and (iii) in light of KPB's improved performance in the marketplace, its business is worth more today than it was at the time the initial analysis was performed. Accordingly, Stone's board of directors concluded that the terms of the acquisition remain fair to, and in the best interest of, all of the shareholders of Stone and that the terms of the Purchase Agreement should remain unchanged. Stone's board of directors also authorized Stone's officers to negotiate and execute an extension to the commitment letter with LaSalle Bank, N.A. and, if it were determined to be necessary, the Purchase Agreement.

#### **Factors Considered by the Stone Board in Approving the Acquisition**

In making the determination that the proposed acquisition transaction is in the best interest of Stone's stockholders and that the consideration to be paid to IP is reasonable, Stone's board of directors relied on its significant industry

and transactional experience as well as independent reviews and analyses of KPB performed by various professionals including financial, legal, accounting and other consultants, retained for such purpose.

Stone engaged an accounting firm solely for the purpose of performing financial due diligence and identifying issues on behalf of management with respect to the business combination, and a law firm, who performed legal due diligence and advised Stone in the negotiations of the terms of the Purchase Agreement. Stone also engaged three individuals with industry experience to perform due diligence with respect to specific aspects of the KPB operations, including environmental matters. These three individuals are independent consultants with extensive experience in the paper and forest products industry. In addition, Stone engaged an individual financial expert to act as a financial consultant to assist with the financial due diligence and analysis. These consultants are paid primarily based on the amount of time spent on the engagement and are reimbursed reasonable out-of-pocket expenses.

Stone conducted a due diligence review of KPB that included an industry analysis, a review of KPB's existing business model, a valuation analysis, financial projections and a review of reports prepared by Stone's independent consultants in order to enable Stone's board of directors to ascertain the reasonableness of the consideration. In its analysis of market conditions for KPB's products, Stone considered the outlook for growth and decline within the various markets served by the KPB products. Stone's board of directors did not seek a fairness opinion because the board believed that collectively its members have as much, if not greater, experience in evaluating business opportunities in the paper and packaging industry than an investment bank. Accordingly, the board of directors determined that no additional benefit was to be derived from the considerable additional expense (anticipated to be in excess of \$400,000) to obtain a fairness opinion. Roger Stone has over 50 years and Matthew Kaplan has over 25 years of industry experience in the paper, packaging, forest products and related industries. Mr. Stone had served as the Chief Executive Officer and Mr. Kaplan as a Vice President of Smurfit-Stone Container Corporation, one of the nation's largest paper and packaging companies, and they were Chief Executive Officer and Senior Vice President, respectively, of Stone Container Corp. prior to its merger with Jefferson Smurfit Corporation. Subsequently, Messrs. Stone and Kaplan were the CEO and President, respectively, of Box USA Holdings, Inc., a company they controlled and managed, that was ultimately sold to IP. During the course of their careers, they have completed numerous strategic acquisitions in the paper, packaging, forest products and related industries and have extensive contacts and relationships within these industries. In addition, Messrs. Chapman, Furer and Rahman, Stone's remaining directors, collectively have over 70 years experience in investment banking, mergers and acquisitions and private equity transactions and were partners at a firm that was the principal private equity sponsor for Box USA Holdings, Inc.

Stone's board of directors considered a wide variety of factors in connection with its evaluation of the acquisition. In light of the complexity of those factors, the Stone board did not consider it practical to, nor did it attempt to, quantify or otherwise assign relative weights to the specific factors it considered in reaching its decision. In addition, individual members of the Stone board may have given different weight to different factors.

Stone's board of directors considered the nature of KPB's business and assets, the extent of the liabilities to be assumed and the factors below, in addition to the Risk Factors described beginning on page above, in reaching its conclusion that the Purchase Agreement is in the best interests of Stone's stockholders and to approve the acquisition and enter into the Purchase Agreement.

Stone's board of directors also considered the effect of the restatement of KPB's financial statements for the years ended December 31, 2003, 2004 and 2005 and the six month periods ended June 30, 2005 and 2006, the principal effects of which are discussed in greater detail in Note 15 of KPB's Combined Financial Statements (Restated) as of December 31, 2005 and 2004 and for the years ended December 31, 2005, 2004 and 2003 and Note 9 of KPB's Unaudited Condensed Combined Financial Statements as of September 30, 2006 and December 31, 2005 (Restated) and for the three and nine months ended September 30, 2006 and 2005.

#### ***Attractive Valuation***

KapStone Kraft is purchasing KPB at an attractive valuation by most standards of value, including, for example, EBITDA multiples and replacement cost. Stone's board of directors has used several methodologies traditionally employed in merger and acquisition analysis to arrive at its current valuation of the KPB assets, primarily

(i) comparable acquisition multiples; (ii) a publicly-traded comparable company analysis; and (iii) a leveraged buyout/discounted cash flow analysis. The following factors, among others, have been considered in determining KPB's earning power for each methodology employed, (a) EBITDA for the year ended 2005, (b) the average historical EBITDA for the four years ended December 31, 2005 and the nine months ended September 30, 2006, and (c) projections provided to the board of directors by IP. Stone's management believes that it is customary for the industry to use EBITDA multiples as a means of evaluating and comparing potential acquisitions and divestitures.

The cash payment at closing represents 5.0 times KPB's EBITDA for the fiscal year ended December 31, 2005. Stone's management believes that the 2005 EBITDA amount is more representative of KPB's earning power than the four year average in light of the fact that the financial results in 2003 and 2004 were adversely impacted by certain factors, such as the downtime associated with a reconfiguration of one of Roanoke Rapids' two paper machines, which are believed to be unusual or non-recurring events.

### **Comparable Acquisition Multiples**

KPB's valuation compares favorably to the following recently announced acquisitions:

the acquisition of IP's coated and supercalendered papers business by Apollo Management, L.P., announced in June 2006, in which the EBITDA purchase multiple was 7.2x the estimated fiscal 2005 EBITDA;

the acquisition of Smurfit-Stone Container Enterprises Inc.'s consumer packaging business by Texas Pacific, announced in May 2006, in which the EBITDA purchase multiple was 7.3x the adjusted 2005 EBITDA;

the acquisition of Packaging Dynamics Corp. by Thilmany, LLC, announced in February 2006, in which the EBITDA purchase multiple was 8.5x the trailing 12 months' EBITDA prior to the transaction announcement;

the acquisition of Georgia Pacific Corp. by Koch Forest Products, Inc., announced in November 2005, in which the EBITDA purchase multiple was 7.7x the trailing 12 months' EBITDA prior to the transaction announcement; and

the acquisition of Carter Holt Harvey Ltd. by Rank Group Investments Limited, announced in August 2005, in which the EBITDA purchase multiple was 8.3x the adjusted EBITDA for the trailing 12 months prior to the transaction announcement.

The list of recently publicly-announced acquisitions set forth above is not an exhaustive list of comparable acquisitions in the paper, packaging and forest products industry. The transactions are, however, in the opinion of Stone's management, a representative list of companies that were deemed comparable and no other announced transactions were considered. Stone's management believes that the only transaction that included an earn-out provision was the acquisition of IP's coated and super calendered papers business by Apollo Management, LP. However, Stone attempted to evaluate the aggregate consideration paid in each instance and did not consider the specific presence or lack of an earn-out provision to be material in its analysis.

### **Publicly Traded Comparable Companies**

With the assistance of Morgan Joseph, Stone's management compiled an analysis of 14 publicly-traded companies in the paper and packaging business. While this group of companies may not be a complete list of companies in these sectors, and all of the companies are of greater (and some are substantially greater) size than KPB, Stone's management believes that this list provides meaningful information from which to imply a valuation for the KPB transaction. Morgan Joseph compiled the list of companies by combining two sources of data. The first was a listing of financial information on public companies in the "paper and board" packaging sector published by another investment banking firm in a periodic report on the packaging industry. Eight of the nine companies on this list were included in Morgan Joseph's list; one company was excluded because it was the subject of a potential buyout at the time and judged therefore to have a valuation that could have been inflated for unusual reasons. The second source was a commercial database in which Morgan Joseph screened companies using specific criteria including industry classification (paper, packaging, containers, forest products) and size (revenues exceeding \$3 billion and market capitalization exceeding \$1 billion). Of the 13 companies that resulted from this screen, five

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were excluded because they were in non-paper sectors of the packaging industry (such as plastic packaging), and two were already on the prior list. The remaining six companies were added to the eight from the prior list. There were no other companies in the paper and packaging business that were identified and excluded from the list. The publicly-traded comparable companies are listed below:

Company	Enterprise Value	Latest Twelve Month EBITDA <sup>(1)</sup>	Ratio of Enterprise Value to LTM EBITDA	Latest Twelve Month Price/Earnings Ratio
	(millions)	(millions)		
Kimberly-Clark Corp.	\$ 33,828.0	\$ 3,451.1	9.8x	16.9x
Weyerhaeuser Co.	23,701.1	3,158.0	7.5x	17.1x
International Paper Co.	27,962.3	2,722.4	10.3x	34.6x
Temple-Inland Inc.	6,463.4	771.0	8.4x	17.3x
MeadWestvaco Corp.	6,536.0	796.0	8.2x	32.7x
Smurfit-Stone Container Corp.	6,698.4	494.0	13.6x	NM
Sonoco Products Co.	3,990.8	493.7	8.1x	16.3x
Packaging Corp. of America	2,903.9	276.4	10.5x	41.7x
Bowater Inc.	3,626.9	388.2	9.3x	NM
Greif Inc.	2,056.6	287.6	7.2x	18.3x
Cascades, Inc.	1,987.3	244.6	8.1x	NM
Rock-Tenn Co.	1,573.3	194.3	8.1x	35.3x
Graphic Packaging Corp.	2,777.9	291.7	9.5x	NM
Chesapeake Corp.	726.9	91.2	8.0x	45.7x
		Mean	9.0x	27.6x
		Median	8.3x	25.5x

(1) Latest twelve month data based on the most recently-available public information as of October 3, 2006, the date the analysis was completed.

This analysis shows a median ratio of total enterprise value (the market value of such companies' equity plus outstanding debt) to latest 12-month EBITDA of 8.3x.

### Discounted Cash Flow Analysis

Stone's management also completed a discounted cash flow analysis in which projections provided by IP were used to forecast free cash flows for the business over a five-year period following the transaction. The projections represented IP management's judgement as of the date the information was provided to Stone (late January 2005), and incorporated the following major assumptions:

**Pricing:** Prices for 2006 were based on management's pricing forecasts; prices for 2007 and beyond were based on nominal trend-line pricing;

**Volume:** Volume was adjusted to reflect maintenance related facility downtime and capacity additions related to debottlenecking initiatives;

**Costs:** Input costs were inflation adjusted based on IP Global Sourcing and Forest Resources Division inflation estimates. In addition, management projected \$1.7 million of incremental annual cost savings related to IP's Business Manufacturing Excellence program as well as approximately \$0.4 million in incremental annual cost savings related to capital investments.

Stone's management made certain adjustments to these projections. The only adjustments that management believes are material were: (i) an increase in SG&A expenses of \$4 million, representing an assumed incremental \$2.7 million of costs at the business level and \$1.3 million for Stone's corporate overhead; and (ii) a reduction in depreciation expense of roughly \$14 million per year to reflect the reduced basis of the fixed assets being acquired, as described more fully in Note (K) of the Unaudited Pro Forma Condensed Consolidated Financial Statements.





The discounted cash flow valuation was taken using discount rates from 8% to 10%, reflecting what Stone's management believed to be a reasonable range of rates to discount future cash flows based on the risk characteristics of KPB. Stone's management used a terminal value of 11x projected net income in the final year of the model. Stone's management believes this multiple to be conservative when compared to the current comparable median P/E multiple of 25.5x for the public paper and packaging companies shown in the table above.

Another way management judged the reasonableness of using an 11x P/E multiple to calculate a terminal value was to take the total undiscounted terminal value so derived, which was approximately \$286,000,000, and divide this into the projected EBITDA in the final year of the financial model. This yielded an implied ratio of enterprise value to EBITDA of 5.7x, which compared favorably with the similar ratios for comparable acquisitions and publicly-traded companies shown in the sections above.

### **Summary of Valuation Methods**

Based on the information and the methodologies described above, KPB has a value ranging from low to high of approximately \$237,000,000 based on comparable acquisition transactions, approximately \$246,000,000 based on a discounted cash flow analysis and approximately \$255,000,000 based on publicly-traded comparable companies. The average of the three methods yields a value of approximately \$254,000,000. The actual price was determined through negotiations with IP's representatives. Assuming full payment of both contingent payments and a discount rate of 8%, the present value of the maximum cash consideration paid to IP is estimated to be \$196,000,000.

Stone's board of directors also considered that in the event Stone pays all of the contingent earn-out payment A of \$35,000,000, but none of the contingent earn-out payment B, the purchase price paid would be no more than 5.0 times the average EBITDA for the five year period immediately following the acquisition. Further, in the event Stone pays all of the contingent earn-out payment A of \$35,000,000 and contingent earn-out payment B of \$25,000,000, the purchase price paid would be no more than 4.4 times the average EBITDA for the five year period immediately following the acquisition.

In addition, based on its extensive industry experience including the construction of many paper mills and most recently, pricing the construction of a 1,000 TPD (360,000 tons per year) recycled linerboard plant, Stone's management estimates that the current replacement cost of a kraft paper mill similar to Roanoke Rapids would range from \$400,000 to \$500,000 per ton of daily production. Accordingly, assigning even a nominal value to all other assets, Stone is acquiring Roanoke Rapids at less than \$150,000 per ton of daily production, which constitutes a significant discount to the estimated replacement cost.

### ***Potential as Acquisition Platform***

Stone's business strategy includes growth through possible future acquisitions. Stone's board of directors believes that KPB's steady cash flows, production capacity and longstanding customer relationships make it an excellent platform for future acquisitions. Stone further believes that by managing KPB as a standalone business, it may be able to eliminate some of the volatility in KPB's historical earnings that was the result of IP operating Roanoke Rapids as part of a large, integrated business operation, and making decisions that optimized enterprise-wide profitability and not necessarily KPB's profitability. The KPB acquisition will position Stone to take advantage of further consolidation in the kraft paper industry, as well as enable it to pursue a wide range of downstream opportunities.

### ***Leading Position in Market***

An important criterion to Stone's board of directors was that KPB is the leading manufacturer of unbleached kraft paper in North America and enjoys a solid market and competitive position across many of the market segments in which it competes. KPB is also a leading converter of inflatable dunnage bags in North America.

***Extensive Product Portfolio***

KPB's extensive product portfolio was another important factor considered by Stone's board of directors. Roanoke Rapids currently produces a broad range of unbleached kraft paper products to meet the exacting standards and specifications of its customers who desire product qualities that include strength, durability, stiffness and porosity. KPB's unbleached kraft paper products meet these qualities at basis weights ranging from 35 lbs to 100 lbs per 3,000 square feet. In addition, Roanoke Rapids can produce lightweight linerboard at basis weights below 37 lbs per 1,000 square feet.

Ride Rite® Converting produces and sells over 230 varieties of inflatable dunnage bags. With paper 2-ply, 4-ply, 6-ply, 8-ply, as well as poly-woven and poly bags, available in numerous size offerings and with durability ranging from one pound per square inch ("psi") to ten psi, KPB offers its customers a broad variety of products to meet requirements to secure freight to minimize movement and potential damage of goods and products during transport.

***Niche Regional Lightweight Linerboard Opportunity***

Historically, Roanoke Rapids produced a balanced mix of both kraft paper and lightweight linerboard. During 2003 and 2004, Roanoke Rapids was repositioned to primarily produce kraft paper as part of an IP system-wide optimization plan. Stone's board of directors believes that implementation of a plan to address niche, regional lightweight linerboard demand, as well as to evaluate further product mix opportunities, provides significant opportunities for expanding facility capacity.

***Financial Performance Characterized by Stable Customer Base***

Because KPB's customers rely on it for consistent and high quality products and reliable supply, their customers tend to request long-term contracts as opposed to purchase orders. During 2005, approximately 64% of Roanoke Rapids' production capacity was contracted. During 2005, approximately 39% of Ride Rite® Converting's capacity was contracted. Stone's board of directors considered customer stability as an important factor in its decision.

***Ride Rite® Converting's Record of Growth and Potential for Future Growth***

Over the past three years, Ride Rite® Converting has generated consistent growth by focusing on its core markets, including distributors, manufacturers and less-than-truckload carriers. Stone's board of directors believes an opportunity exists to further enhance growth by focusing national account efforts on the largely untapped retail regional distribution center market, where dunnage could significantly reduce the cost of goods damaged in transit between a regional distribution center and a retail location.

***Well Invested Asset Base with Low Ongoing Maintenance Costs***

Over the past five years, IP has invested \$63,000,000 in capital in KPB's production infrastructure. \$27,000,000 in capital has been invested to maintain the production plants, \$12,000,000 has been invested to ensure environmental and regulatory compliance and \$24,000,000 has been invested strategically to enhance product quality, reduce costs and gain production efficiencies. These investments have resulted in reduction in maintenance spending of approximately \$3.2 million in 2005 compared to 2000.

IP compares peer-to-peer maintenance costs using POR ("price of reliability") as a percent of RAV ("replacement asset value"). POR is the cost to maintain the productive capacity of a facility, including all repair labor and material expenses. RAV is the replacement asset value for the facility. The Roanoke Rapids mill is ranked 5th lowest by POR as a percentage of RAV within IP's 23 mill system with a POR as a percentage of RAV of 2.65% against a company average of 2.9%. KPB's management believes that the Roanoke Rapids mill's low POR as percentage of RAV is due to new equipment installed over the past five years. Stone's board of directors believes that the substantial capital expenditures made in the business during the 2002 to 2005 period will result in reduced ongoing maintenance costs for the next several years.

***Reputation for Quality and Service***

Roanoke Rapids has a reputation with its customers for producing consistently high quality unbleached kraft paper across a spectrum of paper grades. KPB's customers place a significant value on its papers' roll-to-roll consistency and high tensile strength, which maximizes converting efficiency and throughput. KPB has historically been recognized as a preferred supplier of lightweight linerboard to independent box converters.

Ride Rite® Converting introduced the inflatable paper dunnage bag in 1965. Since then, KPB has invested in extensive research to ensure that Ride Rite® Converting remains the dunnage system of choice. Ride Rite® Converting's inflatable dunnage bags are well regarded for their high quality, product strength, large size variety, reusability and efficient fill rate. In addition to delivering high quality products, Ride Rite® Converting provides value-added initial and follow-up training for its customers on effective product use.

***Strong Relationships with Long-Term Customers***

Roanoke Rapids' customers value stability and predictability of supply, as well as consistent quality and the ability of a kraft paper roll to run reliably through their own converting equipment. Based on KPB's commitment to consistent and high quality products, manufacturing excellence and service reliability, KPB enjoys longstanding relationships with its kraft paper customers, with some relationships dating back more than 50 years. Roanoke Rapids' customers include leading, world-class converters of kraft paper for production of multiwall sacks, rollwrap, lawn and leaf bags, dunnage, shinglewrap and grocery bags.

Ride Rite® Converting customers similarly value product quality and strength, supply reliability as well as technical support to train their staff on effective use of the dunnage product. Based on KPB's reputation for high quality products, service reliability and availability of value-added training, KPB enjoys longstanding relationships with its Ride Rite® Converting customers, including major North American distributors, less-than-truckload carriers, manufacturers and retail regional distribution centers.

***The Experience of KPB's Management***

Another important criteria to Stone's board of directors was its belief in the strength and experience of KPB's management team and its ability to develop strong customer relationships and operate the business on an efficient basis.

***Termination of Management's Non-Competition Agreements***

In July 2000, Messrs. Stone and Kaplan and certain of their affiliates purchased an indirect ownership interest in Box USA Holdings, Inc., a company engaged in the full service conversion of corrugated packaging materials. In July 2004, Box USA was sold to IP at an enterprise valuation of \$405,000,000 which was paid in cash and a \$15,000,000 note payable by IP to the Box USA shareholders. In connection with such sale, Messrs. Stone and Kaplan entered into non-competition agreements with IP that expire in July 2007. Under the terms of these agreements, they are prohibited from participating or owning a significant equity interest in any company in the corrugated packaging and containerboard business. The corrugated containerboard business, which consists primarily of shipping boxes, comprises the largest segment of the packaging business, however, this business constitutes only a small segment of Stone's intended industry focus as disclosed in its prospectus (i.e., paper, packaging, forest products and related industries) and in 2005 it constituted less than 4% of KPB's business. In connection with the acquisition, IP has agreed to terminate the non-competition agreements. The board of directors considered Stone's ability to pursue opportunities in this segment of the industry an important factor in its decision.

Stone's board of directors believes that each of the above factors strongly supported its determination and recommendation to approve the acquisition. Stone's board of directors did, however, consider the Risk Factors, among others, in its deliberations concerning the acquisition. See "Risk Factors" beginning on page . Stone's board of directors, in determining to recommend the acquisition, concluded that these potentially negative factors were outweighed by the potential benefits of the acquisition, including the opportunity for Stone stockholders to share in KPB's future possible growth and anticipated profitability.

**Satisfaction of 80% Test**

It is a requirement that the target of Stone's initial business combination have a fair market value equal to at least 80% of Stone's net assets at the time of acquisition, inclusive of the amount in the trust account. Based on the financial analysis of KPB generally used to approve the transaction, Stone's board of directors determined that this requirement has been met. Stone's board of directors has determined that the fair market value of the assets being purchased is between approximately \$237,000,000 and approximately \$255,000,000. This determination is based on an analysis of KPB's earnings, as compared to other publicly-traded businesses of a similar nature and the acquisition multiples for other similar transactions in the paper and packaging industry that have recently been publicly announced or completed. In addition, a leveraged buyout/discounted cash flow analysis has been performed to determine the present economic value of the assets being acquired. The average of these three methods yields a fair market value of approximately \$246,000,000. The range of the fair market value exceeds \$92,000,000, which is 80% of Stone's net asset value of approximately \$116,000,000 as of September 30, 2006. Accordingly, the board of directors determined that the requirement that the fair market value of the assets be greater than 80% of Stone's net asset value has been met.

**Structure Following Completion of the Acquisition**

Immediately following completion of the acquisition, KapStone Kraft will be a wholly-owned subsidiary of Stone holding all of the assets of KPB.

**Directors and Executive Officers Following Completion of the Acquisition**

If the acquisition is completed, the directors and executive officers of Stone will remain unchanged except for the addition of Tim Keneally as an executive officer:

Name	Age	Position
Roger W. Stone	71	Chairman of the Board and Chief Executive Officer
Matthew Kaplan	49	President, Secretary and Director
Tim Keneally	59	Vice President and General Manager
John M. Chapman	46	Director
Jonathan R. Furer	49	Director
Muhit U. Rahman	50	Director

**Roger W. Stone** has been Stone's Chairman of the Board since Stone's inception. Mr. Stone has been Manager of Stone-Kaplan Investments, LLC, a private investment company, since July 2004. 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 Stone's President and a member of Stone's board of directors since Stone's inception. Mr. Kaplan has been Manager of Stone-Kaplan Investments, LLC, a private investment company, since July 2004. 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 received a B.A. 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.

**Tim Keneally** is presently the Vice President and General Manager of KPB. Mr. Keneally led the IP team that assessed the review of strategic alternatives relating to KPB. He was the lead person in presenting the historical performance of KPB and assisted in defining the future strategy for KPB. Mr. Keneally has 34 years of experience in the paper and packaging industry. He has been with IP since the merger of Union Camp Corporation and IP in 1999 and has been a corporate officer of IP since October 2002. He has been involved with plant start-ups and closures, new product launches, and the sale or acquisition of a number of converting businesses since the mid 1980's.

**John M. Chapman** has been a member of Stone's board of directors since Stone's inception. Mr. Chapman is a co-founder and has been a managing member of Arcade Partners LLC, a private equity firm since November 2003. Since January 2004, he has been a Managing Director of Washington & Congress Managers, a private equity firm. From March 1990 through December 2003, he was employed by Triumph Capital Group, Inc, a private equity firm, last serving as a Managing Director. Mr. Chapman received a B.A. from Bates College and an M.B.A. from the Tuck School of Business at Dartmouth College.

**Jonathan R. Furer** has been a member of Stone's board of directors since Stone's inception. Mr. Furer is a co-founder and has been a managing member of Arcade Partners LLC since November 2003. Since January 2004, he has been a Managing Director of Washington & Congress Managers. From March 2000 through December 2003, he was a Managing Director of Triumph Capital Group, Inc. From December 1998 until February 2000, he was a Managing Director of MG Group, LLC, a private equity firm he co-founded. Mr. Furer received a B.B.A. from George Washington University.

**Muhit U. Rahman** has been a member of Stone's board of directors since Stone's inception. Mr. Rahman is a co-founder and has been a managing member of Arcade Partners LLC since November 2003. Since January 2004, he has been a Managing Director of Washington & Congress Managers. From November 1993 through December 2003, he was a Managing Director of Triumph Capital Group. Mr. Rahman received a B.S. from Yale University and an M.B.A. from the Anderson School of Management at UCLA.

Messrs. Stone and Kaplan have agreed not to receive any compensation until a recommendation has been made by a compensation committee which has not yet been established and such recommendation has been approved by the board. Such compensation committee will be comprised of independent directors as such term is defined by the rules of the NASDAQ Stock Market, or such other exchange as Stone's securities may in the future be listed. Because Stone has made a determination to postpone such discussions until after the closing of the transaction and the formation of the compensation committee, you will not have information you may deem material to your decision on whether or not to vote in favor of the acquisition.

#### **Appraisal or Dissenters Rights**

No appraisal or dissenters rights are available under the Delaware General Corporation Law for the stockholders of Stone in connection with the acquisition proposal.

#### **United States Federal Income Tax Consequences of the Acquisition**

The following discusses the U.S. Federal income tax consequences of the acquisition of KPB by Stone. This discussion is based on the United States Internal Revenue Code of 1986, as amended. The statements set forth in this section as to tax consequences of the transaction to Stone common stockholders are those of Stone. Stone does not intend to obtain an opinion of counsel with respect to such matters. Accordingly, you should consult your personal tax advisor as to the tax consequences of the transaction.

Stone common stockholders who do not exercise their redemption rights will continue to hold their Stone common stock and as a result will not recognize any gain or loss from the acquisition.

Stone common stockholders who exercise their redemption rights will recognize gain or loss to the extent that the amount received by such common stock holders upon redemption is greater than or less than, respectively, such holder's tax basis in their shares. A holder's tax basis in the shares generally will equal the cost of the shares. A stockholder who purchased Stone's units will have to allocate the cost between the shares and the warrants of the units based on their fair market values at the time of the purchase. Assuming the shares are held as a capital asset,

the gain or loss will be a capital gain or loss and will be long-term capital gain or loss if such holder's holding period in the shares is longer than one year.

### **Regulatory Matters**

The acquisition and the transactions contemplated by the Purchase Agreement are not subject to any federal, state or provincial regulatory requirement or approval, except for the filing and delivery of this proxy statement in connection with the special meeting of stockholders of Stone under the Securities Exchange Act of 1934 as amended, and compliance under the Hart-Scott-Rodino Antitrust Improvements Act 1976, as amended.

### **Consequences if Acquisition Proposal is Not Approved**

If the acquisition proposal is not approved by the stockholders, Stone will not acquire KPB and Stone will continue to seek other potential business combinations. If Stone does not consummate a business combination by the later of February 19, 2007, or August 19, 2007, in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed by February 19, 2007 but not consummated by August 19, 2007, then, pursuant to Article SIXTH of its certificate of incorporation, and in accordance with Section 281(b) of the Delaware General Corporation Law Stone will adopt a plan of dissolution, and as soon as reasonably possible after dissolution make liquidating distributions to our stockholders.

### **Required Vote**

The affirmative vote in favor of the acquisition proposal by a majority of the IPO shares that are voted at the meeting is required to adopt the acquisition proposal. However, in accordance with its certificate of incorporation and the terms governing the trust account, Stone will not be able to complete the acquisition if the holders of 4,000,000 or more IPO shares, representing an amount equal to 20% or more of the total number of IPO shares, vote against the acquisition and demand that Stone redeem their shares for their pro rata portion of the trust account in which a substantial portion of the net proceeds of Stone's initial public offering are held.

Stone's officers and directors have agreed to vote their 5,000,000 shares of Stone common stock acquired prior to Stone's initial public offering, representing an aggregate of 20% of the outstanding shares of Stone common stock, in accordance with the vote of the majority of the IPO shares voted at the meeting with respect to the acquisition proposal. In addition, Stone's Chief Executive Officer intends to vote 500,000 shares of common stock that were part of the units acquired by him in Stone's initial public offering, representing 2% of the outstanding shares of Stone common stock, and 2.5% of the outstanding IPO shares, "FOR" the adoption of the acquisition proposal.

Adoption of the acquisition proposal is not conditioned upon the adoption of the name change amendment proposal, the Article SIXTH amendment proposal or the incentive plan proposal.

### **Recommendation**

**After careful consideration, the board of directors unanimously recommends that the stockholders vote "FOR" the acquisition proposal.**

### **Interest of Stone Directors and Officers in the Acquisition**

In considering the recommendation of the board of directors of Stone to vote for the proposal to adopt the acquisition, you should be aware that certain members of Stone's board, and their affiliates and associates, have agreements or arrangements that provide them with interests in the acquisition that differ from, or are in addition to, those of Stone stockholders generally. In particular:

Stone's officers and directors, together with their affiliates and associates, were issued a total of 5,000,000 shares of Stone common stock prior to Stone's initial public offering, and one of Stone's directors purchased 500,000 units in the initial public offering, consisting of 500,000 IPO shares and 1,000,000 warrants. These shares, without taking into account any discount that may be associated with certain restrictions on these shares, collectively have a market value of approximately \$ \_\_\_\_\_ based on Stone's share price of \$ \_\_\_\_\_ as of November \_\_\_\_\_,

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2006. The 5,000,000 shares acquired prior to Stone's initial public offering by these individuals cannot be sold until the first anniversary of the acquisition during which time the value of the shares may increase or decrease; however, such shares were acquired for \$.005 per share, the holders are likely to benefit from the acquisition notwithstanding any decrease in the market price of the shares.

Stone's officers and directors, together with their affiliates and associates, own a total of 4,500,000 of Stone's warrants, of which 3,500,000 were acquired in the aftermarket during the 40-day period between September 14, 2005 and November 7, 2005 pursuant to a discretionary order that was submitted to Morgan Joseph immediately following the initial public offering, and 1,000,000 of which were purchased by Mr. Stone as part of his purchase of units in the initial public offering. These warrants, without taking into account any discount that may be associated with the restrictions on the transfer of such warrants, collectively have a market value of approximately \$ based on Stone's warrant price of \$ as of November , 2006. The warrants held by Stone's officers and directors and their affiliates and associates (as well as all other warrants) will expire worthless if the acquisition is not approved and Stone fails to consummate an alternative transaction within the time allotted pursuant to its certificate of incorporation.

If the acquisition is not approved and Stone fails to consummate an alternative transaction within the time allotted pursuant to its certificate of incorporation and Stone is therefore required to liquidate, the shares of common stock beneficially owned by Stone's officers and directors and their affiliates and associates that were acquired prior to Stone's initial public offering may be worthless because no portion of the net proceeds of Stone's initial public offering that may be distributed upon liquidation of Stone will be allocated to such shares.

After the completion of the acquisition, Roger Stone will continue to serve as Stone's Chief Executive Officer and as Chairman of the Stone board and Matthew Kaplan will continue to serve as Stone's President. It is expected that the directors will continue to serve on Stone's board of directors. Such individuals, will, following the acquisition, be compensated in such manner, and in such amounts, as determined by the independent members of Stone's board of directors. At present, no employment agreements have been entered into with, nor have there been any discussions regarding the terms of employment of, Stone's officers. It is contemplated that if the acquisition is approved, the compensation and other terms of employment of Stone's officers will be determined by a compensation committee which has not yet been formed and will be commensurate with the compensation packages of comparable level executives at similarly situated companies in the paper and packaging industry. Such compensation committee will be

comprised of independent directors as such term is defined by the rules of the Nasdaq Stock Market, or such other exchange as Stone's securities may in the future be listed. Messrs. Stone and Kaplan have agreed not to receive any compensation until a recommendation has been made by such committee and approved by the board. Because Stone has made a determination to postpone such discussions until after the closing of the transaction and the formation of the compensation committee, you will not have information you may deem material to your decision on whether or not to vote in favor of the acquisition.

In July 2000, Messrs. Stone and Kaplan and certain of their affiliates purchased an approximately 33% indirect ownership interest in Box USA Holdings, Inc., a company engaged in the full service conversion of corrugated packaging materials. A fund affiliated with Messrs. Chapman, Furer and Rahman, Stone's other directors, was a co-investor in Box USA. In July 2004, Box USA was sold to IP at an enterprise valuation of \$405,000,000 which was paid in cash and a \$15,000,000 note payable by IP to the Box USA shareholders. In connection with such sale, Messrs. Stone and Kaplan entered into non-competition agreements with IP that expire in July 2007. Under the terms of these agreements, they are prohibited from participating or owning a significant equity interest in any company in the corrugated packaging and containerboard business. The consummation of the acquisition will terminate the non-competition agreements.

Stone's board of directors was aware of these agreements and arrangements during its deliberations on the merits of the acquisition and in determining to recommend to the stockholders of Stone that they vote for the adoption of the acquisition proposal.

## THE KPB PURCHASE AGREEMENT

The following summary of certain material provisions of the Purchase Agreement is qualified by reference to the complete text of the Purchase Agreement, a copy of which is attached as *Annex A* to this document. All stockholders are encouraged to read the Purchase Agreement in its entirety for a more complete description of the terms and conditions of the acquisition.

### Structure of the Acquisition

Upon completion of the acquisition, Stone's wholly-owned subsidiary, KapStone Kraft, will own substantially all of the assets of Roanoke Rapids and Ride Rite® Converting (except for certain excluded assets, including, among others, cash, tax credits and IP trademarks), representing the business of KPB, free and clear of any pre-existing debts or liens, other than certain permitted liens, and will assume certain limited liabilities.

### Purchase Price

The purchase price for substantially all of the assets of KPB is \$155,000,000 in cash payable at closing (subject to the working capital adjustment described below), plus two contingent earn-out payments, the first in an amount up to \$35,000,000 and the second in an amount equal to \$25,000,000, and the assumption of certain liabilities described below.

### Working Capital Purchase Price Adjustment

No later than two business days prior to the closing date, IP will deliver to Stone and KapStone Kraft the good faith estimated working capital of KPB as of the close of business on the closing date. At the closing of the acquisition, the target purchase price of \$155,000,000 will be adjusted by either adding the amount by which the estimated closing working capital is greater than \$42,637,709 or subtracting the amount by which the estimated closing working capital is less than \$42,637,709. An unaudited statement of working capital shall be prepared by IP as of the close of business on the closing date, which will be subject to review and dispute by the parties, until a final closing date statement is determined. To the extent the final determination of the closing working capital is greater or less than the estimated working capital at closing, the purchase price will be adjusted dollar-for-dollar, together with interest thereon at six percent per annum, and will be paid by the appropriate party within 10 business days after the determination of the final closing date statement.

### Contingent Earn-Out Payments

The first contingent earn-out payment is equal to 5.3 times the average annual EBITDA of KPB's business for the five-year period immediately following the acquisition, less \$165,000,000; provided that such payment may not exceed \$35,000,000 or be less than \$0 ("Contingent Earn-Out A"). The second contingent earn-out payment of \$25,000,000 is generally payable if and only if the average annual EBITDA of KPB's business equals or exceeds \$49,200,000 for the five-year period immediately following the acquisition ("Contingent Earn-Out B").

For purposes of calculating the contingent earn-out payments, the "EBITDA" of KPB's business is defined as its net income or loss before interest income or expense, income taxes, depreciation and amortization, subject to certain adjustments described in the Purchase Agreement. The following items are excluded for purposes of calculating EBITDA:

"extraordinary items" of gain or loss as that term is defined by generally accepted accounting principles;

gains, losses or profits realized from the sale of capital assets or marketable securities;

commitment fees or other expenses payable to any financing source;

legal fees, accounting fees and other transaction expenses arising out of the Purchase Agreement;



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income, expense, gain or loss realized from a cumulative effect of a change in accounting principles as defined by generally accepted accounting principles;

gains or losses realized on the sale (if any) of the Roanoke Rapids or Fordyce facilities; and

income or loss generated from discontinued operations as defined by generally accepted accounting principles.

Prior to the direct or indirect acquisition (if any) by Stone of another business, the EBITDA of KPB's business is equal to the EBITDA of Stone and KapStone Kraft calculated on a consolidated basis, and, subject to the exceptions described above, includes all costs and expenses of Stone and KapStone Kraft other than (i) any compensation or management fees paid directly or indirectly to Roger Stone or Matthew Kaplan or (ii) any expenses of Stone incurred in order to comply with its obligations as a public company under applicable securities laws (other than such as are incurred in connection with the audit of Stone's consolidated financial statements). After a direct or indirect acquisition by Stone of another business, the EBITDA of KPB's business would be calculated on a stand-alone basis and would include a good faith and reasonable allocation of costs and expenses associated with (i) shared services provided or procured by Stone or its affiliates to or for KPB's business, which may include insurance, legal, human resources, employee benefits, accounting, finance, information technology and other centralized functions, and (ii) Stone's expenses for corporate overhead, administration and management, other than certain compensation and public company expenses described above.

The purchase and sales prices of goods and services sold by KPB's business to Stone or its affiliates or purchased by KPB's business from Stone or its affiliates (other than costs and expenses of Stone and its affiliates allocated to KPB's business pursuant to the preceding paragraph) will be adjusted for purposes of calculating KPB's EBITDA to reflect the amounts that KPB's business would have realized or paid if dealing with an independent party in an arm's-length commercial transaction.

During the first five years after the closing, Stone has agreed to maintain such financial reporting systems as are necessary to accurately determine the EBITDA of KPB's business for purposes of calculating the contingent earn-out payments.

### *Capital Expenses Adjustment*

It is anticipated that KapStone Kraft will spend certain minimum amounts on strategic and cost savings capital improvements for KPB's business during the first five years after the closing in accordance with the following timetable:

	Fiscal Year Ending December 31,					
	2006 Stub Period	2007	2008	2009	2010	2011 Stub Period
	(in millions)					
Strategic and Cost Savings Capital Improvements	\$ 1.8 <sup>(1)</sup>	9.0	4.7	2.1	3.5	4.8 <sup>(2)</sup>

(1) To be prorated for the number of days in 2006 following the closing date.

(2) To be prorated for the number of days in 2011 preceding the fifth anniversary of the closing date.

KapStone Kraft may choose the projects for such capital improvements in its sole discretion. In the event that, as at the end of any 12-month earn-out period after the closing date, (x) the aggregate amount of strategic and cost savings capital improvements spent by KapStone Kraft for KPB's business for all periods from the closing date through the end of such earn-out period is less than (y) the aggregate minimum amount of such agreed-upon required capital improvements anticipated to be spent with respect to such periods, then, in lieu of any other right or remedy under the Purchase Agreement, an amount equal to 25% of the amount of such shortfall will be added to KPB's EBITDA for the following 12-month earn-out period for purposes of calculating the contingent earn-out payments.

***Certain Adjustments Upon a Disposition of Assets***

Although the contingent payments, if any, are generally payable at the end of the five year period immediately following the acquisition, there are circumstances under which KapStone Kraft may be obligated to pay the contingent payments earlier. If Roanoke Rapids is sold before such five year period has ended, KapStone Kraft may be obligated to pay IP up to approximately \$30,000,000 of Contingent Earn-Out A at the time of the sale. If the Ride Rite® Converting facility is sold before such five year period has ended, KapStone Kraft may be obligated to pay IP up to approximately \$5,000,000 of Contingent Earn-Out A at the time of such sale. Any such early payment would be discounted to present value from the date that such payment otherwise would have been made absent a sale using a discount rate of eight percent.

Contingent Earn-Out B is generally payable at the end of the five-year period immediately following the acquisition. If both the Roanoke Rapids and Ride Rite® Converting facilities are sold prior to the end of the five-year period immediately following the acquisition and the Contingent Earn-Out B payment of \$25,000,000 is earned, such payment would be made at the time of the later of the two sales. Any such early payment would be discounted to present value from the date that such payment otherwise would have been made absent a sale using a discount rate of eight percent.

In the event either the Roanoke Rapids or Fordyce facility is sold by Kapstone Kraft within five years after closing, the amount payable with respect to Contingent Earn-Out A for each facility would, subject to a maximum of approximately \$30,000,000 for the Roanoke Rapids facility and approximately \$5,000,000 for the Fordyce facility, be equal to 5.3 times the average annual EBITDA (as calculated below) of such facility for the five-year period immediately following the closing of the acquisition by Stone of the KPB assets, less (i) in the case of the Roanoke Rapids facility, \$141,380,643, or (ii) in the case of the Fordyce facility, \$23,619,357.

In the event that the Roanoke Rapids facility is sold by KapStone Kraft within five years after the closing at a price (including assumed debt) which results in a gain as compared to the \$115 million of the base purchase price for the KPB assets allocated to the Roanoke Rapids facility for this purpose pursuant to the Purchase Agreement (as adjusted to reflect the final purchase price upon resolution of the working capital adjustment, to give effect to acquisitions of, and depreciation on, fixed assets at the Roanoke Rapids facility after closing, and to give effect to the payment of the earn-out consideration), then the EBITDA for the Roanoke Rapids facility to be used for purposes of determining the amount of Contingent Earn-Out A payable with respect to the Roanoke Rapids facility and the Roanoke Rapids portion of EBITDA for Contingent Earn-Out B would be (i) for each such twelve-month earn-out period or portion thereof prior to the date of such sale, the actual EBITDA of the Roanoke Rapids facility for such period, and (ii) for each twelve-month earn-out period or portion thereof that follows the date of such sale, an agreed-upon EBITDA for the Roanoke Rapids facility for such period as set forth below.

	<b>Fiscal Year Ending December 31,</b>					
	<b>2006 Stub Period</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011 Stub Period</b>
	(in millions)					
<b>Roanoke Rapids</b>	\$ 38.8 <sup>(1)</sup>	41.8	38.5	45.4	46.2	46.2 <sup>(2)</sup>

(1) To be prorated for the number of days in 2006 following the closing date.

(2) To be prorated for the number of days in 2011 preceding the fifth anniversary of the closing date.

In the event that the Roanoke Rapids facility is sold by KapStone Kraft within five years after the closing at a price (including assumed debt) which results in a loss as compared to the \$115 million of the base purchase price for the KPB assets allocated to the Roanoke Rapids facility for this purpose pursuant to the Purchase Agreement (as adjusted to reflect the final purchase price upon resolution of the working capital adjustment, to give effect to acquisitions of, and depreciation on, fixed assets at the Roanoke Rapids facility after closing, and to give effect to the payment of the earn-out consideration), then the EBITDA for the Roanoke Rapids facility to be used for purposes of determining the amount of Contingent Earn-Out A payable with respect to the Roanoke Rapids facility

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and the Roanoke Rapids portion of EBITDA for Contingent Earn-Out B would be (i) for each such twelve-month earn-out period or portion thereof prior to the date of such sale, the actual EBITDA of the Roanoke Rapids facility for such period, and (ii) for each twelve-month earn-out period or portion thereof that follows the date of such sale, the average actual EBITDA of the Roanoke Rapids facility for all periods included under subsection (i) above.

In the event that the Fordyce facility is sold by KapStone Kraft within five years after the closing, then the EBITDA for the Fordyce facility to be used for purposes of determining the amount of Contingent Earn-Out A with respect to the Fordyce facility and the Fordyce portion of EBITDA for Contingent Earn-Out B would be (i) for each twelve-month earn-out period or portion thereof prior to the date of such sale, the actual EBITDA of the Fordyce facility for such period, and (ii) for each earn-out period or portion thereof that follows the date of such sale, an agreed-upon EBITDA for the Fordyce facility for such period as set forth below.

	Fiscal Year Ending December 31,					2011 Stub Period
	2006 Stub Period	2007	2008	2009	2010	
	(in millions)					
Fordyce	\$ 6.4 <sup>(1)</sup>	6.6	7.2	7.4	7.6	7.6 <sup>(2)</sup>

(1) To be prorated for the number of days in 2006 following the closing date.

(2) To be prorated for the number of days in 2011 preceding the fifth anniversary of the closing date.

### Assumed Liabilities

At the closing, Stone and KapStone Kraft will deliver to IP an instrument of assumption, whereby Stone and KapStone Kraft will solely and exclusively undertake, assume and agree to perform, pay, become liable for and discharge when due the following liabilities and obligations of KPB, as they exist on the closing date:

The current liabilities of KPB for accounts payable and accrued operating expenses that are reflected on KPB's balance sheet as of March 31, 2006 in accordance with GAAP which (i) arose in the ordinary course of business consistent with past practice and (ii) have not been paid prior to the closing, but only to the extent such liabilities are reflected or reserved against as current liabilities on the final closing date statement and provided that such current liabilities to be assumed shall not include any indebtedness of KPB (or related accrued interest) or excluded liabilities;

The current liabilities of KPB for accounts payable and accrued operating expenses which (i) have arisen after March 31, 2006 in the ordinary course of business consistent with past practice, (ii) are of the same specific type and category of expenses as those current liabilities to be assumed as described in the previous bullet point, (iii) would be classified as current liabilities on a balance sheet in accordance with GAAP and past practice and (iv) have not been paid prior to the closing, but only to the extent such liabilities are reflected or reserved against as current liabilities on the final closing date statement and provided that such current liabilities to be assumed shall not include any indebtedness of KPB (or related accrued interest) or excluded liabilities;

Obligations accruing and to be performed after the closing under the executory portion of contracts assumed, whole or in part, from IP (other than liabilities or obligations for breach or indemnification by IP or one of its affiliates);

Liabilities for product liability, toxic tort or similar claims for personal injuries, property damage or losses involving the use of any product manufactured by KPB prior to closing, purchased by KapStone Kraft as inventory and sold by KapStone Kraft after the closing date, but only to the extent the liability arises from contamination or damage of such products by KapStone Kraft after the closing date;

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All environmental liabilities incurred by KPB onsite at the Roanoke Rapids and Fordyce facilities, other than any such liabilities arising out of or related to the closed landfill at Roanoke Rapids and the environmental conditions

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at the Roanoke and Fordyce facilities more specifically described in "*Interim Operations Relating to KPB*" on page .

Certain liabilities of IP with respect to employees of KPB as discussed in more detail in "*Certain Obligations with Respect to Employees and Benefits*" on page ; and

All liabilities for workers' compensation claims that are (i) based on injuries that occurred prior to the closing date and are reported more than five years after the closing date, (ii) long-term exposure claims which are reported within five years of the closing date and allocated to KapStone Kraft based on years of exposure as more specifically described in the Purchase Agreement and (iii) based on injuries occurring after the closing date (other than long-term exposure claims).

In addition, Stone will assume a long-term liability estimated at \$1,797,000 related to the projected future cost of closing that portion of a landfill being acquired in the transaction that was used by KPB prior to the acquisition. These liabilities, some of which are contingent in nature, are difficult to estimate with precision as of a certain date.

### Excluded Liabilities

Stone and KapStone Kraft shall not assume or have any responsibility with respect to any obligation, commitment or liability of IP or its affiliates other than the assumed liabilities, including, without limitation, the following excluded liabilities:

IP's transaction expenses;

IP's taxes, other than KapStone Kraft's share of pro rated real property taxes, transfer taxes and personal property taxes;

Except as specifically assumed under the Purchase Agreement, any liabilities relating to the operation of KPB prior to the closing date, including liabilities for injury or death of any person (other than certain workers compensation claims), property damage or destruction, violations of law, matters relating to any past or present employee plan covering KPB employees, indebtedness of IP or KPB or any other matter;

Except for employment-related liabilities specifically assumed under the Purchase Agreement, any employment-related liability relating to the operation of KPB prior to the closing date, including liabilities related to wages, bonuses, severance or retention pay, vacation, health care continuation coverage, any employment agreement with an employee or former employee of IP, any employee benefit plan or collective bargaining agreement relating to any of the employees (including former employees) of IP or of its affiliates, any liability in connection with the termination of employment of any IP employee, and any liability for medical disability or similar benefits in connection with an employment relationship with IP;

Liabilities for certain environmental claims, including claims in connection with hazardous substances at any location other than Roanoke Rapids or Fordyce, environmental and safety requirements for any formerly owned, operated or leased properties of KPB, the closed landfill at Roanoke Rapids, and liabilities or obligations related to certain recognized environmental conditions more specifically described in "*Interim Operations Relating to KPB*" on page ;

Performance of obligations under the Purchase Agreement and other transaction documents;

All workers' compensation claims that are (i) reported on or prior to the closing date, (ii) based on injuries that occurred before the closing date and are reported within five years after the closing date and (iii) long-term exposure claims reported within five years of the closing date and allocated to IP as described in the Purchase Agreement;

Liabilities (i) under any contracts not specifically assumed under the Purchase Agreement; (ii) under any partially-assumed contracts, that do not relate exclusively to KPB and (iii) under any contract assumed, whole or in part, that relates to a breach by IP prior to the closing or any indemnification with respect to matters occurring prior to closing;



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Liabilities or obligations of IP or its affiliates to a related party or any guaranty or surety obligation or agreement for the benefit of a related party;

Any liability associated with products produced prior to closing unless specifically assumed under the Purchase Agreement;

Liabilities associated with any excluded assets;

Liabilities or obligations related to IP's tax-exempt bonds; and

Liabilities under any retention or similar agreement between IP and any KPB employee.

### **Closing of the Acquisition**

The closing of the acquisition will take place on the last business day of the calendar month following the satisfaction or waiver of the conditions described below under "*The KPB Purchase Agreement Conditions to the Completion of the Acquisition*," unless Stone and IP agree in writing to another date.

### **Representations and Warranties**

The Purchase Agreement contains a number of representations and warranties that IP has made to Stone and KapStone Kraft as to itself and to KPB, and which Stone and KapStone Kraft have made to IP. The representations and warranties made by IP as to itself include representations regarding:

organization and good standing; authority and enforceability of the Purchase Agreement and the ancillary transaction documents;

absence of conflicts or violations under organizational documents, certain agreements and applicable laws;

ownership of the assets of KPB;

litigation; and

brokerage commissions and finders' fees.

The representations and warranties made by IP as to KPB include representations regarding:

accuracy of the information contained in the financial statements;

accounts receivable; inventory; equipment and internal controls;

absence of undisclosed liabilities;

sufficiency of assets;

clear title to assets, other than permitted exceptions and liens disclosed on the balance sheet as of March 31, 2006;

absence of certain changes or events since March 31, 2006;

taxes;

contracts and commitments;

intellectual property;

litigation;

employment and labor related agreements and actions;

employee benefit plans;

real property and leasehold interests;



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compliance with applicable laws and governmental permits;

environmental and safety matters;

product liability; and

relationships with the 10 largest customers.

The representations and warranties made by Stone and KapStone Kraft as to themselves include representations regarding:

organization and good standing;

authority and enforceability of the Purchase Agreement and the ancillary transaction documents;

absence of conflicts or violations under organizational documents, certain agreements and applicable laws;

receipt of senior lender commitment letter;

litigation;

reliance on results of Stone's own due diligence with respect to KPB and IP's representations set forth in the Purchase Agreement in making the determination to proceed with the transaction;

no implication that information included in the schedules, or dollar amounts specified in the representations and warranties is material;

brokerage commissions and finders' fees; and

absence of knowledge of any inaccuracies in or breach of any representation, warranty, covenant or agreement by IP in the Purchase Agreement.

### **Materiality and Material Adverse Effect**

Several of the representations and warranties of IP are qualified by materiality or material adverse effect. For the purposes of the Purchase Agreement, a material adverse effect means with respect to IP, any change, event or effect that is materially adverse to KPB's business, taken as a whole, provided, however, that a material adverse effect shall not include any such change, event or effect to the extent arising from or relating primarily to the following:

the United States or global economy or securities markets in general;

the pending sale of KPB to KapStone Kraft or the announcement of the execution of the Purchase Agreement;

the parties' express obligations under the Purchase Agreement; or

the industry in which KPB operates; provided, that such change in the industry does not disproportionately affect KPB.

**Interim Operations Relating to KPB**

Under the Purchase Agreement, IP has agreed, prior to completion of the acquisition, not to take any action with respect to KPB's business other than in the ordinary course, on an arm's length basis and in accordance with all applicable legal requirements in all material respects and past custom and practice. In addition to this agreement regarding the conduct of the business generally, subject to specific exceptions, IP has agreed that it will not, directly or indirectly with respect to KPB:

sell, pledge, dispose of or encumber any of the assets, other than sales of inventory in the ordinary course of business and consistent with past practice;

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engage in any activity which would materially accelerate the collection of its accounts receivable, delay the payment of its accounts payable, or reduce or otherwise restrict the amount of inventory on hand, in each case, other than in the ordinary course of the conduct of business and consistent with past practice;

acquire any corporation, partnership, joint venture or other business organization or division or material assets thereof;

except for (a) salary increases not to exceed 2% in the ordinary course of business consistent with past practices, (b) the payment of accrued bonuses in the ordinary course of business consistent with past practices and (c) payments made pursuant to existing commitments, grant any bonuses, salary increases, severance or termination pay;

take any action designed to render any representation or warranty made by IP in the Purchase Agreement untrue at or at any time prior to closing;

adopt or amend any employee benefit or welfare plan with respect to the full-time and part-time employees of KPB immediately prior to closing; or

enter into or modify, or propose to enter into or modify, any agreement, arrangement or understanding with respect to any of the matters referred to in the foregoing bullet points.

Prior to the completion of the acquisition, IP has agreed with respect to KPB to:

use commercially reasonable efforts to cause the insurance policies not to be canceled or terminated, and not to permit any of the coverage pursuant to any such policy to lapse;

use its commercially reasonable efforts to (a) preserve intact the organization and goodwill of the KPB business, (b) keep available the services of its officers and employees as a group, and (c) maintain satisfactory relationships with its material suppliers and customers and other persons having material business relationships with it;

upon reasonable request and subject to applicable legal requirements, confer with representatives of Stone regarding the KPB business;

upon reasonable request, and subject to applicable legal requirements, arrange meetings with the customers of, and suppliers to, the KPB business;

maintain the facilities and assets of the KPB business in the ordinary course of business consistent with past practice;

notify Stone of (a) any material adverse change in the normal course of the KPB business; (b) any governmental or third party proceedings that could reasonably be expected to have a material adverse effect and (c) any findings of any executive, key employee or group of employees planning to terminate employment;

cooperate reasonably with Stone and KapStone Kraft in connection with their respective efforts to fulfill the conditions to the consummation of the Purchase Agreement;

cause all liens, other than permitted liens, with respect to the assets to be released;

prior to the closing, or at such other time thereafter reasonably acceptable to KapStone Kraft, at IP's sole expense, take the following actions with respect to the remediation of certain recognized environmental concerns, the results of each action to be reasonably acceptable to Stone: (i) at the Roanoke Rapids facility, remove all stainless steel piping historically stockpiled on the property, receive

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a revised "Title V" air permit for the facility, complete air modeling to confirm exemption from particulate emissions control requirements, and modify the "wet system," a fire-prevention device, for the steam turbine generator; and (ii) at the Fordyce facility, receive approval for discharge of wastewater from the facility to the municipal waste water treatment system, or install a treatment system, as required;

continue to fund and implement, at its own expense and on a timely basis, each of the capital projects referenced in the 2006 capital plan attached as a schedule to the Purchase Agreement and prior to closing spend an aggregate amount on such capital projects set forth in the Purchase Agreement, and if IP does not fund its pro rata portion of the capital projects for 2006 prior to closing, it shall as promptly as practicable after the closing, pay to KapStone Kraft the amount of such shortfall;

not amend any collective bargaining agreements relating to the KPB business without the prior written consent of Stone;

complete installation of software for the environmental system at Roanoke Rapids; and

provide Stone and its representatives access to all records relating to KPB.

IP has agreed that immediately prior to the consummation of the Purchase Agreement, it will (i) cause KPB to cancel, settle or repay all intercompany liabilities owed to IP and its affiliates, and (ii) repay all accounts payable and all other liabilities and other obligations owed by IP or its affiliates to KPB as of the Closing Date.

#### **Exclusivity**

IP has agreed that it will not and will cause its affiliates, representatives and agents not to (i) solicit, initiate or encourage the submission of any proposal or offer from any person relating to the acquisition of KPB or any substantial portion of the assets, or (ii) participate in any discussions or negotiations regarding, furnish any information with respect to, assist or participate in, or facilitate in any other manner any effort or attempt by any person to do or seek to do any of the foregoing.

#### **Stone Stockholders' Meeting**

Stone agreed to hold a meeting of its stockholders for the purpose of adopting the acquisition proposal and to include in the proxy statement a recommendation from its board of directors that the holders of its common stock vote in favor of the acquisition proposal.

#### **Access to Information; Confidentiality**

IP will afford to Stone and its representatives access to KPB's assets and will make available to Stone and its representatives all books, papers and records relating to KPB, including, but not limited to, all books of account, material contracts and agreements, filings with any regulatory authority, independent auditor's work papers, plans affecting employees, and any other business activities or prospects related to KPB in which Stone and KapStone Kraft and its representatives may have a reasonable interest.

Stone has agreed to hold in confidence all information about KPB which is non-public, confidential or proprietary in nature, other than disclosures that are required by law.

#### **Ancillary Agreements**

The Purchase Agreement provides for the parties to enter into several ancillary agreements pursuant to which certain business arrangements between KapStone Kraft and IP will continue. Additionally, IP has agreed to require the buyers of certain of its other businesses to continue business arrangements with KapStone Kraft. The following is a brief description of each of such arrangements:

A transition services agreement pursuant to which IP will agree to provide operational support to KapStone Kraft commencing on the date of the closing of the sale of the kraft paper business to KapStone Kraft and continuing throughout the respective terms set forth in each schedule attached to the agreement. The services include the following: (1) SAP management and support; (2) financial shared services; (3) telecommunications services; (4) technical services and application support services; (5) payroll health and welfare benefits administration services; (6) real estate services; (7) environment services; (8) treasury transition activities; (9) pulpwood supply services; (10) Sarbanes Oxley compliance services; and (11) fiber procurement services, and may include other

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mutually agreed upon transition services. The terms of each of the above services range from three months to approximately 18 months, provided that KapStone Kraft's goal is to terminate all the services no later than 12 months. The total costs for the transition services would be approximately \$2,500,000 based on the current terms of the respective services. If the services are terminated earlier in accordance with the terms of the agreement, the costs would be correspondingly reduced.

Three unbleached rollwrap base paper supply agreements pursuant to which IP and the buyers of IP's coated papers and beverage packing businesses will agree to require their rollwrap suppliers to purchase certain roll wrap paper produced by KapStone Kraft for a period of five years from the date of the closing of the sale of KPB to KapStone Kraft. Pursuant to these agreements, KapStone Kraft will agree to supply IP's suppliers (and the suppliers of the buyers of IP's coated papers and beverage packing businesses) 100% of IP's (and the respective buyers') requirements. The price of the paper is based on the published market value per ton.

A supply agreement for crude tall oil and black liquor soap ("CTO/BLS Supply Agreement") and a supply agreement for crude sulfate turpentine (the "CST Supply Agreement") each of which are byproducts of the Kraft pulping process, pursuant to which KapStone Kraft will agree to supply 100% of its output of crude tall oil, black liquor soap and crude sulfate turpentine from the Roanoke Rapids mill to Arizona Chemical Company ("Arizona Chemical"), one of IP's subsidiaries, for an initial term of 20 years. KapStone Kraft is not required to produce any minimum quantities of the above byproducts. The pricing under the CTO/BLS Supply Agreement is based on the weighted average of actual prices paid by Arizona Chemical to domestic third party suppliers. The pricing under the CST Supply Agreement is fixed for a limited term and will be adjusted thereafter in accordance with actual changes in the market price.

Pulpwood supply agreements pursuant to which the purchaser of certain timberlands formerly owned by IP will agree to supply certain pulpwood to KapStone Kraft for a period of 20 years from the effective date of the agreement. KapStone Kraft will agree to purchase the base volume that will be established by a minimum harvest plan applicable for each harvest year. KapStone Kraft further has the right to purchase additional option volume each harvest year. The pricing is based on a weighted average cost of open market purchases.

A residual woodchip agreement pursuant to which IP's wood products business or the buyer of such business will agree to sell residual chips produced at IP's Seaboard sawmill to KapStone Kraft for a term of 15 years, unless sooner terminated. KapStone Kraft must purchase IP's or the buyer's total chip production at such sawmill over the term of this agreement, but KapStone Kraft is not precluded from purchasing chips from additional suppliers. The pricing is based on published prices provided by an industry-recognized timber-pricing service.

A container supply agreement pursuant to which IP will agree to be the exclusive provider of certain corrugated paperboard packaging products to KapStone Kraft for a term of five years from the date of the closing of the sale of KPB to KapStone Kraft. The pricing is based on published market value per ton subject to changes in market price.

A joint purchasing agreement pursuant to which IP, KapStone Kraft and other participants (which are formerly owned or businesses which may be sold by IP) will agree to participate in a pooling arrangement for the procurement of certain commodities and services to benefit from volume discounts. Pursuant to the terms of the agreement, KapStone Kraft will commit to purchase through the vendors recommended by IP no less than 90% of the aggregate dollar amount of its actual requirements for the products and services on its participant list. KapStone Kraft, in its sole discretion, can determine the products and services to be included on its participant list.

A valve and chuck agreement pursuant to which IP's beverage packaging business will agree to sell to KapStone Kraft certain valves and chucks used in the construction of dunnage bags. The pricing for the valve assembly is based on market value as adjusted by a formula mutually agreed upon by the parties. The pricing for chucks is fixed. This agreement will expire on December 31, 2008 unless otherwise agreed to by the parties.

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A dunnage bag supply agreement, pursuant to which KapStone Kraft will agree to be the exclusive supplier to IP of certain dunnage bags for a term of five years from the date of the closing of the sale of the kraft paper business to KapStone Kraft. The pricing is based on published market prices.

A sales solicitation agreement pursuant to which KapStone Kraft will earn a commission on its sale of bleached and claycoated kraft paper produced by IP to KPB's current customers for a term of five years from the date of the closing of the sale of KPB to KapStone Kraft.

A patent license agreement pursuant to which IP will grant to KapStone Kraft an exclusive, perpetual, irrevocable, royalty-free, freely transferable, worldwide license to make, use and sell dunnage bags constructed using coated flexible paper substrates.

A proprietary rights license agreement pursuant to which IP will provide KapStone Kraft a perpetual, irrevocable, royalty-free, non-exclusive license to all proprietary rights, such as best practices manuals, used in the operation of KPB that are not otherwise transferred by IP to KapStone Kraft pursuant to the terms of the Purchase Agreement. IP will have the right to terminate the agreement in the event of certain changes of control of KapStone Kraft (for example, a merger, an acquisition of beneficial ownership of more than 50% of KapStone Kraft's common stock or a sale of substantially all of KapStone Kraft's assets) within five years after Stone's acquisition of KPB involving any of the five largest competitors of IP to be named at the time of the closing of the sale of KPB (and updated annually thereafter).

A tax-exempt bond agreement which describes the parties' respective obligations with respect to certain facilities to be transferred by IP to KapStone Kraft pursuant to the terms of the Purchase Agreement which have been financed with tax-exempt bonds to be retained by IP.

A spare parts agreement pursuant to which IP will agree to make available for purchase from time to time in accordance with the agreement certain spare parts, but KapStone Kraft will not be obligated to purchase such parts.

A linerboard supply agreement pursuant to which KapStone Kraft will agree to supply linerboard to IP for a period of nine months from the date of the closing of the sale of KPB to KapStone Kraft. IP may require KapStone Kraft to supply or KapStone Kraft may require IP to purchase up to 3,000 tons of the linerboard a month upon giving the other party 45 days' prior notice. The price of the linerboard is based on the published market price as adjusted by a formula mutually agreed upon by the parties.

Stone believes that the material terms of the foregoing supply agreements are comparable to the terms that would be given to an unrelated third party in an arm's length transaction.

### **Reasonable Efforts; Notification**

Stone, KapStone Kraft and IP have agreed that they will use their commercially reasonable efforts to take all actions, and to do or cause to be done all things, which are necessary, proper or advisable to consummate, close and make effective as promptly as practicable, the transactions contemplated by the Purchase Agreement, including commercially reasonable efforts to obtain certain material consents from governmental entities and third parties.

IP will promptly deliver to Stone and KapStone Kraft in a supplemental schedule any information which existed, had occurred or was known on the date of signing the Purchase Agreement, that was required to be disclosed in a schedule to the Purchase Agreement, or would have been required to correct any inaccuracy in a schedule to the Purchase Agreement, whether or not material. IP's obligation to indemnify Stone and Buyer with respect to any losses arising out of information disclosed on the supplemental schedule depends on whether the loss exceeds \$250,000 and whether the supplemental schedule was delivered to Stone and KapStone Kraft within ten business days after the closing, or after such ten day period.

## **Indemnification**

IP has agreed to hold harmless Stone, KapStone Kraft and their respective affiliates, officers, directors, employees, agents, representatives and permitted successors and assigns against certain losses, suffered or sustained as a result of, in connection with, relating to or by virtue of (i) any misrepresentation or breach of any representation or warranty by IP in the Purchase Agreement or any schedule or closing certificate furnished by IP; provided that IP will not have any liability under this subsection unless and until the aggregate amount of all losses under this subsection (including, losses arising out of assumed environmental liabilities) exceeds \$1,000,000, in which event recovery will be limited to the aggregate amount of such losses in excess of the \$1,000,000 with a cap not to exceed \$15,000,000; (ii) any nonfulfillment or breach of any covenant or agreement of IP; (iii) any liability in connection with the consummation of the transactions to any prospective buyer with whom IP or any of its agents have had discussions regarding the disposition of KPB; (iv) any excluded liability or excluded asset; (v) any failure to comply with "bulk sales" laws applicable to the transactions; or (vi) any claim, action, suit or proceeding relating to any of the foregoing. The \$1,000,000 threshold amount and \$15,000,000 cap do not apply with respect to breaches by IP of representations relating to IP's organization, the due authorization and approval of the Purchase Agreement and title to assets.

IP has also agreed to indemnify Stone, KapStone Kraft and their respective affiliates, officers, directors, employees, agents, representatives and permitted successors and assigns against losses as a result of certain tax matters, including unpaid taxes attributable to tax periods prior to the closing of the acquisition and environmental liabilities that have been assumed by Stone and KapStone Kraft. The overall indemnification by IP for certain losses includes losses resulting from assumed environmental liabilities, subject to a \$1,000,000 threshold and a cap of \$15,000,000. IP's indemnification for assumed environmental liabilities will survive for three years after the closing of the acquisition. However, with respect to environmental claims, the cap described above will be reduced by \$1,800,000 every six months during the three year survival period.

The representations and warranties of IP will survive the closing for a period of two years, except that IP's representations with respect to (i) environmental matters will survive for three years; (ii) due authorization approval of the Purchase Agreement and title to the assets of KPB will survive indefinitely; and (iii) certain tax matters will survive for the applicable statute of limitations. Certain other representations and warranties by IP with respect to the condition of the assets of KPB, the condition of buildings and structures or owned and leased land will survive for a shorter period.

Each of Stone and KapStone Kraft have agreed to hold harmless IP and its affiliates, officers, directors, employees, agents, representatives and permitted successors and assigns against any loss suffered or sustained as a result of, in connection with, relating to or by virtue of (i) any misrepresentation or breach of any representation or warranty, by Stone or KapStone Kraft in the Purchase Agreement or any schedule or closing certificate furnished by Stone or KapStone Kraft; (ii) any nonfulfillment or breach of any covenant or agreement of Stone or KapStone Kraft set forth in the Agreement; (iii) any assumed liability; or (iv) any claim, action, suit or proceeding relating to any of the foregoing.

## **Fees and Expenses**

Each of IP on the one hand, and Stone and KapStone Kraft, on the other, are responsible for their own fees and expenses (including, without limitation, legal and accounting fees and expenses) in connection with the Purchase Agreement and the transactions contemplated thereby.

## **Public Announcements**

Stone and IP have agreed that neither will make any public announcements concerning the transactions provided for in the Purchase Agreement without the prior approval of the other party as to the timing and content of such announcement (which approval may not be unreasonably withheld or delayed), except to the extent advisable under applicable law or rules and regulations of, or an agreement required by or advisable under applicable law or rules and regulations of, or an agreement with, any stock exchange or trading system. If a public announcement is



required by or advisable under applicable law or stock exchange regulation, Stone or IP will, to the extent practicable, provide the other party with reasonable advance notice of, and an opportunity to comment on such public announcement prior to release.

**Conditions to the Completion of the Acquisition**

Each of Stone's, KapStone Kraft's and IP's obligations to effect the acquisition is subject to the satisfaction or waiver of the following specified conditions before completion of the acquisition:

*Conditions to Stone's obligations*

The obligations of Stone and KapStone Kraft to effect the acquisition are subject to the following conditions, which may be waived only in a writing executed by Stone:

The representations and warranties of IP that are qualified as to materiality or material adverse effect must be true and correct as of the closing date and those not qualified as to materiality or material adverse effect must be true and correct in all material respects, as of the closing date, except that representations and warranties that address matters as of another date, must be true and correct as of such other date;

IP must have performed and observed in all material respects all covenants and obligations required to be performed or observed by it prior to closing pursuant to the Purchase Agreement and related documents;

The consummation of the transactions must not be prohibited by any legal requirement or subject Stone or KapStone Kraft or any of their affiliates, KPB or any of the KPB assets to any material penalty or liability arising under any legal requirement or imposed by any governmental authority that is not otherwise disclosed in the Purchase Agreement or in any schedule to the Purchase Agreement;

There must be no judgment, order, decree, stipulation, injunction or charge existing before any governmental authority in each case which could reasonably be expected to prevent or prohibit consummation of any transactions pursuant to the transaction documents, cause any such transaction to be rescinded following such consummation or materially and adversely affect KapStone Kraft's right to acquire the KPB assets or conduct the business or Stone's, KapStone Kraft's or IP's performance of their respective obligations pursuant to the transaction documents; no action, suit or proceeding shall be pending that a reasonable person knowledgeable in such matters would conclude could have a high likelihood of having any such effect;

All material filings, notices, licenses, consents, authorizations, accreditation, waivers, approvals and the like of, to, or with any governmental authority or any other person that are required to be obtained by IP will have been made or obtained, and all applicable waiting periods under antitrust or trade regulation laws and regulations, including, without limitation, under the HSR Act, will have expired or been terminated;

Stone's stockholders must have approved the transaction with holders of less than 20% of the IPO shares exercising their redemption rights;

All liens, except for permitted exceptions, with respect to the KPB assets must be released and terminated, or insured by the title company;

IP's auditor shall have given its consent to Stone to use IP's audited financial statements with respect to KPB in Stone's proxy statement;

KapStone Kraft must have obtained the debt financing referenced in the commitment letter from LaSalle Bank, N.A. with respect to a \$95,000,000 senior secured credit facility to be used by KapStone Kraft to fund a portion of the purchase price of the acquisition;

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IP must have entered into an amendment to Tim Keneally's Confidentiality and Non-Competition Agreement. IP customarily enters into confidentiality and non-competition agreements with its officers which provide certain covenants that the officers are bound by after the termination of employment with IP. The amendment will allow

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Mr. Keneally to carry out his duties as a member of Stone's management without violating the confidentiality and non-competition agreement; and

IP must deliver all closing documents; and take all corporate actions required to be taken to effect the sale of KPB.

### *Conditions to IP's obligations*

The obligation of IP to effect the acquisition is further subject to the following conditions, which may be waived only in a writing executed by IP:

The representations and warranties of Stone and KapStone Kraft that are qualified as to materiality or material adverse effect must be true and correct as of the closing date, and those not qualified as to materiality or material adverse effect must be true and correct in all material respects, as of the closing date, except that representations and warranties that address matters as of another date, must be true and correct as of such other date;

Each of Stone and KapStone Kraft must have performed in all material respects all covenants or obligations required to be performed by each pursuant to the Purchase Agreement and related documents prior to the closing date;

The consummation of the transactions will not be prohibited by any legal requirement or subject IP to any material penalty or liability arising under any legal requirement or imposed by any governmental authority that is not otherwise disclosed in the Purchase Agreement or in any schedule to the Purchase Agreement;

All material filings, notices, licenses, consents, authorizations, accreditation, waivers, approvals and the like of, to or with any governmental authority or any other person that are required for the consummation of the transactions will have been made or obtained, and all waiting periods applicable to the transactions under applicable antitrust or trade regulation laws and regulations, including, without limitation, under the HSR Act, shall have expired or been terminated;

There must be no judgment, order, decree, stipulation injunction or charge existing before any governmental authority in each case which could reasonably be expected to prevent or prohibit the consummation of any transactions pursuant to the transaction documents, cause any such transaction to be rescinded following such consummation or materially and adversely affect KapStone Kraft's right to acquire the KPB assets or conduct the business, or Stone's or KapStone Kraft's or IP's performance of their obligations pursuant to the transaction documents; no action, suit or proceeding shall be pending that a reasonable person knowledgeable in such matters would conclude could have a high likelihood of having any such effect; and

Stone and KapStone Kraft must have delivered all closing documents and taken all corporate actions required to be taken to purchase the KPB assets.

### **Certain Obligations with Respect to Employees and Benefits**

KapStone Kraft has agreed to assume certain collective bargaining agreements and to provide benefits through the expiration of those agreements, including the provision of pension and post-retirement medical benefits that are substantially similar to the collectively bargained benefits previously negotiated by IP. To the extent entitlement to pension and post-retirement medical benefits under these agreements are vested at the time of the transaction, the liabilities associated with the provision of those benefits are excluded liabilities that are retained by IP under the Purchase Agreement, and KapStone Kraft will not assume those liabilities. However, to the extent post-retirement liabilities for collectively bargained employees at the time of the closing are greater than the liabilities for vested benefits retained by IP, KapStone Kraft intends to provide credits after closing to the applicable employees under the benefits plans it establishes such that these employees receive benefits after the closing that are substantially similar to those previously negotiated by IP under the collective bargaining agreements. Consequently, these liabilities will be obligations of KapStone Kraft. The amount of these assumed liabilities, for financial accounting purposes, has been determined to be approximately \$3,015,000. In addition KapStone Kraft has agreed to



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undertake certain other obligations with respect to the KPB employees who continue to work for KapStone Kraft after the closing, including, without limitation:

Offering employment to all KPB employees, at the same base rate of pay, other than any person who has previously indicated to Stone that they do not want to relocate from the Memphis, TN executive office;

Providing credits to KPB employees who participated in certain of IP's employee benefit plans and fringe benefit programs for service (for purposes of eligibility and vesting), co-payments and deductibles, and a waiver of certain pre-existing conditions and waiting period limitations in connection with certain benefit plans to be provided by KapStone Kraft after the closing;

Providing certain agreed upon benefits to KPB employees, who are not members of the union, for a period of 12 months after the closing; provided, that Stone is not obligated to provide any particular plan or benefit that was provided by IP prior to the closing, Stone is not required to establish a defined benefit pension plan, and Stone is not assuming any outstanding options as of the closing date issued to KPB employees;

Establishing a 401(k) plan;

Making severance payments to any KPB employee who accepts KapStone Kraft's offer of employment and participated in the IP severance plan, if such employee is discharged by KapStone Kraft within 12 months of the closing for any reason other than for cause; and

Indemnifying IP for any losses and other liabilities arising out of all salaries, commissions and vacation entitlements, accrued but unpaid as of the closing and assumed by KapStone Kraft under the terms of the Purchase Agreement, and certain liabilities expressly assumed by KapStone Kraft with respect to the KPB employees.

IP has agreed that with respect to the KPB employees, it will remain responsible for:

Certain health and welfare and disability claims that were incurred prior to the closing of the acquisition;

All benefits payable to KPB employees who were determined to be totally and permanently disabled as of the close of business immediately prior to the closing date, and all worker compensation claims not assumed by Stone;

Providing retiree life insurance and health benefits to any KPB employee who was eligible for such benefits as of the close of business immediately prior to the closing date; and

Except as expressly set forth in the Purchase Agreement, paying or providing for the payment of all employment-related obligations, commitments and liabilities of IP that are excluded liabilities retained by IP under the Purchase Agreement, relating to the operation of the KPB business prior to closing.

### **No Claim Against Trust Account**

IP acknowledges that if Stone does not complete a business combination by August 15, 2007, Stone will be obligated to return to its stockholders the amounts being held in its trust account. Accordingly, except for any claim relating to fraud, which in this context would be if Stone, during the course of negotiating the Purchase Agreement, knowingly misrepresented the truth or concealed a material fact to induce IP to enter into the transaction, IP has waived all rights against Stone to collect from Stone's trust account any monies that may be owed to IP by Stone for any reason whatsoever, including but not limited to a breach of the Purchase Agreement by Stone or any negotiations, agreements or understandings with Stone (other than as a result of the consummation of the transaction, pursuant to which IP would have the right to collect the monies in Stone's trust account), and will not seek recourse against Stone's trust account for any reason whatsoever.



## Financing

Stone and KapStone Kraft will use their reasonable commercial efforts to take actions necessary to (i) maintain in effect the acquisition financing and the commitment letter from LaSalle; (ii) enter into definitive financing agreements with respect to the acquisition financing; and (iii) consummate the acquisition financing prior to the closing. In the event that the terms of the commitment letter are due to expire within 45 days, Stone and KapStone Kraft will use their commercially reasonable efforts to extend the terms for an additional 30 days unless this proxy statement has already been mailed to Stone's shareholders and Stone and IP agree that the closing is most likely to occur prior to the expiration of the commitment letter.

If the acquisition financing or the commitment letter (or any definitive financing agreement relating thereto) expires or is terminated prior to the closing, in whole or in part, for any reason, Stone and KapStone Kraft shall (i) promptly notify IP of such expiration or termination and the reasons therefor; and (ii) use commercially reasonable efforts to arrange for alternative financing on substantially the same terms as set forth in the existing commitment letter in an amount sufficient to consummate the transactions contemplated by the transaction documents.

Subject to certain conditions set forth in the Purchase Agreement, Stone has agreed to contribute \$90,000,000 from Stone's trust account to fund part of the purchase price. In the event that the acquisition financing is reduced to an amount that is insufficient to complete the acquisition and to pay the fees and expenses of the transaction, Stone may increase the amount to be funded from the trust account to the extent that amounts are available in the trust account after satisfaction of the redemption right of investors.

## IP Non-Compete

For a period of three years from the closing date, IP will not, and will not permit its affiliates to:

engage in the manufacture, marketing or sale of unbleached kraft paper and inflatable dunnage products;

induce or attempt to solicit or induce any customer, supplier or licensee of KPB to cease doing business with KPB, or interfere with any customer or business relationship with KPB; or

solicit, hire, retain or attempt to solicit, hire, retain or attempt to encourage any KPB employees to leave their employment, unless their employment is terminated by KapStone Kraft.

## Termination

The Purchase Agreement may be terminated at any time prior to the closing of the acquisition, as follows:

by mutual consent of Stone and IP;

by Stone or IP if the acquisition proposal is not approved by the required vote of Stone's stockholders or if holders of 20% or more of the IPO shares exercise their redemption rights;

by Stone or IP if the other party has breached any of its material covenants, or if any representations or warranties are false or misleading in any material respect, provided that such termination cannot be the result of any breach of any covenant, representation or warranty of the terminating party, and provided further that each party shall have ten business days to cure any such breach after notice;

by Stone or IP if any governmental authority takes any action to permanently restrain, enjoin or prohibit the acquisition and such action becomes final and nonappealable; and

by Stone or IP if the closing has not occurred by December 31, 2006, provided that the right to terminate shall not be available to any party whose breach of the Purchase Agreement caused or resulted in the delay of the closing.

**Effect of Termination**

In the event of termination by either IP or Stone, all further obligations and rights of the parties under the Purchase Agreement will terminate, with each party responsible for its own costs and expenses except that, in the event that



the Purchase Agreement is terminated pursuant to the third or fifth bullet point above, a party will remain liable for any breach of the Purchase Agreement that occurred prior to the date of termination.

**Governing Law**

The Purchase Agreement is governed by the laws of the State of New York.

**Assignment**

The Purchase Agreement may not be assigned by any party without prior written consent of the counterparty.

**Amendment**

No waiver, amendment, modification or supplement of the Purchase Agreement will be binding upon IP, Stone or KapStone Kraft unless such waiver, amendment, modification or supplement is set forth in writing and is executed by the parties.

**Further Assurances**

Each of Stone and IP agree that it will, and will cause its affiliates to, execute all documents and take any other action which is reasonably requested by a party to execute or take to further effectuate the transactions contemplated by the Purchase Agreement.

### ACQUISITION FINANCING

Stone has received a commitment letter from LaSalle Bank, N.A. with respect to a \$95,000,000 senior secured credit facility to be used by Stone at the closing of the acquisition to fund up to \$65,000,000 of the purchase price of the acquisition and approximately \$4,200,000 in transaction fees and expenses, and thereafter to provide working capital for KPB. This senior secured credit facility is to be comprised of a \$35,000,000 senior secured revolving credit facility and a \$60,000,000 senior secured term loan. A form of the Credit Agreement is attached to this proxy statement as **Annex D**. The material terms of the commitment for the senior secured credit facility are as follows:

Each of the revolving credit facility and term loan will have a maturity date of five years from the closing date of the acquisition;

The credit facilities will be secured by a first priority security interest in substantially all existing and after acquired real and personal assets of KapStone Kraft, and all products and proceeds of the assets;

At KapStone Kraft's option, the credit facility will bear interest at a rate per annum equal to either (1) the "Base Rate" (which is the higher of (a) the rate publicly announced from time to time by the Administrative Agent as its "prime rate" and (b) the Federal Funds Rate plus 0.5% per annum), plus a Base Rate Margin (as defined below) or (2) LIBOR, plus the LIBOR Margin as defined below. The Base Rate Margin will be 0% with respect to the revolving credit facility and 0.25% with respect to the term loan, subject to upward or downward adjustment after December 31, 2006 based upon the total leverage ratio of KapStone Kraft at the end of each fiscal quarter. The LIBOR Margin will be 1.50% with respect to the revolving credit facility and 1.75% with respect to the term loan, subject to upward or downward adjustment after December 31, 2006 based upon the total leverage ratio of KapStone Kraft at the end of each fiscal quarter;

Availability for borrowing under the senior secured revolving credit facility will be based on advance rates of 85% against eligible accounts receivable and 65% against eligible inventory. The Credit Agreement imposes customary reserves and criteria for determining eligibility of accounts receivable and inventories. In the case of accounts receivable, limitations on eligibility include receivables that are over 90 days past invoice date (with limited exceptions), that arise outside of the ordinary course of business and are not subject to a first priority lien in favor of LaSalle, and receivables for which the account debtor is located in a foreign jurisdiction (with limited exceptions). In the case of inventories, limitations on eligibility include inventory that is not subject to a first priority lien in favor of LaSalle, and inventory that is not saleable, is slow moving or obsolete or is subject to an agreement that would impair the ability of LaSalle to sell such inventories. Certain categories of inventory, such as work-in-progress inventory, supplies, repair materials, butt rolls, pallets or packaging are also considered ineligible;

KapStone Kraft must make scheduled principal payments with respect to the term loan commencing on the date that is the last day of the third month after the closing of the acquisition, and every three months thereafter. The scheduled quarterly payments begin at \$1,875,000 for the first 12 month period after closing, and increase to \$2,250,000 for the final 12 month period. Management believes that KapStone Kraft's cash flow from operations will be sufficient to fund all such payments, and that such payments will not have a material adverse effect on the Company's business plans, liquidity and growth opportunities. Mandatory prepayments of the facilities must also be made upon the issuance of debt or equity securities (subject to certain exceptions), the sale or disposition of assets, and 50% of excess cash flow during 2007 and 2008. Pursuant to the terms of the Credit Agreement, excess cash flow is defined as EBITDA for such period, minus scheduled repayments of principal of the term loan made during such period, minus voluntary prepayments of the term loan during such period, minus cash payments made in such period with respect to capital expenditures, minus all income taxes paid in cash during such period, minus cash interest expense during such period, minus any cash losses (and plus any cash gains) from extraordinary items to the extent excluded from the calculation of EBITDA, minus any increase in adjusted working capital for such period; and

The commitment letter, which had an expiration date of December 31, 2006, has been extended until February 1, 2007.

**UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The following unaudited pro forma condensed consolidated balance sheet combines the historical unaudited balance sheets of Stone and KPB as of September 30, 2006, giving effect to the transactions described in the Purchase Agreement (with purchase accounting applied to the acquired KPB business and related financing) as if they had occurred on September 30, 2006.

The following unaudited pro forma condensed consolidated statements of income combine (i) the historical statements of income of Stone and KPB for the nine month period ended September 30, 2006, and (ii) the historical statements of income of Stone for the period from April 15, 2005 (Date of Inception) to December 31, 2005, and KPB for the year ended December 31, 2005 (Restated), giving effect to the transactions described in the Purchase Agreement (with purchase accounting applied to the acquired KPB business and related financing) as if they had occurred on January 1, 2005.

The historical financial information has been adjusted to give effect to pro forma events that are directly attributable to the transaction, are factually supportable and, in the case of the pro forma income statements, have a recurring impact.

The purchase price allocation has not been finalized and is subject to change based upon recording of actual transaction costs, finalization of working capital adjustments, and completion of appraisals of tangible and intangible assets of the acquired KPB business.

The unaudited pro forma condensed consolidated balance sheet at September 30, 2006 and unaudited pro forma condensed consolidated statement of income for the nine month period ended September 30, 2006 and the year ended December 31, 2005 have been prepared using two different levels of approval of the transaction by the Stone stockholders, as follows:

Assuming No Redemption: This presentation assumes that none of the Stone stockholders exercise their redemption rights; and

Assuming Maximum Redemption: This presentation assumes that 19.9% of the Stone stockholders exercise their redemption rights.

Stone is providing this information to aid you in your analysis of the financial aspects of the transaction. The unaudited pro forma condensed consolidated financial statements described above should be read in conjunction with the historical financial statements of Stone and KPB and the related notes thereto included elsewhere in this proxy. The unaudited pro forma information is not necessarily indicative of the financial position or results of operations that may have actually occurred had the transaction taken place on the dates noted, or the future financial position or operating results of the combined company.

**Unaudited Pro Forma Condensed Consolidated Balance Sheet**  
**At September 30, 2006**  
(amounts in thousands except share data)

	Stone	KPB	Pro Forma Adjustments (assuming no redemption)	Pro Forma (assuming no redemption)	Pro Forma Adjustments (assuming maximum redemption)	Pro Forma (assuming maximum redemption)
<b>Assets</b>						
Current assets:						
Cash	\$ 773	\$ 1	\$ 114,574 A	\$ 25,741	\$ (22,859) I	\$ 2,882
			(152,551) B			
			(1) B			
			65,000 C			
			(1,200) D			
			(855) E			
Cash and investments, held in trust	114,574		(114,574) A			
Accounts receivable, net		31,146		31,146		31,146
Inventories, net		20,835	1,932 B	22,767		22,767
Prepaid expenses	34	1,765	(171) B	1,628		1,628
<b>Total current assets</b>	<b>115,381</b>	<b>53,747</b>	<b>(87,846)</b>	<b>81,282</b>	<b>(22,859)</b>	<b>58,423</b>
Plant, property and equipment, net		204,179	(96,000) B	108,179		108,179
Other assets	1,829	4,160	855 E	5,015		5,015
			(1,829) F			
Intangible assets			700 B	700		700
Goodwill			3,133 G	3,133		3,133
Deferred income taxes	335		1,191 B	1,526		1,526
<b>Total assets</b>	<b>\$ 117,545</b>	<b>\$ 262,086</b>	<b>\$ (179,796)</b>	<b>\$ 199,835</b>	<b>\$ (22,859)</b>	<b>\$ 176,976</b>
<b>Liabilities and Stockholders' Equity</b>						
Current liabilities:						
Revolver	\$	\$	\$ 5,000 C	\$ 5,000	\$	\$ 5,000
Accounts payable		9,105		9,105		9,105
Accounts payable to International Paper Company, net		100	(100) B			
Accrued expenses	1,381	7,770	(1,391) B	7,760		7,760
Deferred income taxes	82			82		82
Current portion long term debt			7,500 C	7,500		7,500
<b>Total current liabilities</b>	<b>1,463</b>	<b>16,975</b>	<b>11,009</b>	<b>29,447</b>		<b>29,447</b>
Long term debt		22,346	(22,346) B	52,500		52,500
			52,500 C			
Asset retirement obligations-matures in 2018		1,820		1,820		1,820
Employment benefit liability			3,015 B	3,015		3,015
Common stock, subject to possible redemption 3,998,000 shares	22,160		(22,160) H			
Deferred interest attributable to common stock subject to possible redemption (net of taxes of \$266)	699		(699) H			
Stockholders' equity:						
Preferred stock \$.0001 par value; 1,000,000 shares authorized; 0 shares issued and outstanding						
Common stock \$.0001 par value, 175,000,000 shares authorized; 25,000,000 shares issued and	2			2		2

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	Stone	KPB	Pro Forma Adjustments (assuming no redemption)	Pro Forma (assuming no redemption)	Pro Forma Adjustments (assuming maximum redemption)	Pro Forma (assuming maximum redemption)
outstanding (including 3,998,000 shares of common stock subject to possible redemption)						
Additional paid-in capital	91,099		22,160 H (1,200) D	112,059	(22,160) I	89,899
Income accumulated during the development stage	2,122		(2,122) F			
Divisional control account		220,945	(220,945) F			
Retained earnings			293 F 699 H	992	(699) I	293
<b>Total stockholders' equity</b>	<b>93,223</b>	<b>220,945</b>	<b>(201,115)</b>	<b>113,053</b>	<b>(22,859)</b>	<b>90,194</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 117,545</b>	<b>\$ 262,086</b>	<b>\$ (179,796)</b>	<b>\$ 199,835</b>	<b>\$ (22,859)</b>	<b>\$ 176,976</b>

Please see notes to unaudited pro forma financial statements.

**Unaudited Pro Forma Condensed Consolidated Statement of Income**  
**For the Year Ended December 31, 2005**  
(amounts in thousands except share data and per share data)

	Stone	KPB <sup>(1)</sup>	Pro Forma Adjustments (assuming no redemption)	Pro Forma (assuming no redemption)	Pro Forma Adjustments (assuming maximum redemption)	Pro Forma (assuming maximum redemption)
Net Sales	\$	\$ 221,972	\$	\$ 221,972	\$	\$ 221,972
Cost and expenses:						
Cost of sales (exclusive of depreciation and amortization)		148,481	J	148,481		148,481
Distribution expenses		19,996		19,996		19,996
Depreciation and amortization		21,285	(14,229) K	7,056		7,056
Selling, general, and administrative expenses and taxes other than income	221	22,732	L	22,953		22,953
Operating expenses	221	212,494	(14,229)	198,486		198,486
Operating income (loss)	(221)	9,478	14,229	23,486		23,486
Other income (expense):						
Bank interest	24			24		24
Interest income on cash and investments subject to redemption	1,436		(1,436) M			
Interest expense		(1,439)	1,439 N	(4,211)		(4,211)
			(4,211) E			
Total other income (expense)	1,460	(1,439)	(4,208)	(4,187)		(4,187)
Income before provision for income taxes:	1,239	8,039	10,021	19,299		19,299
Total provision for income taxes	421	3,106	3,958 O	7,485		7,485
Net income	818	4,933	6,063	11,814		11,814
Deferred interest, net of taxes, attributable to common stock subject to possible redemption	(189)		189 H			
Net income allocable to holders of non-redeemable common stock	\$ 629	\$ 4,933	\$ 6,252	\$ 11,814	\$	\$ 11,814
Earnings per share:						
Basic	\$ 0.05			\$ 0.47		\$ 0.56
Diluted	\$ 0.05			\$ 0.43		\$ 0.50
Weighted-average number of shares outstanding:						
Basic	15,307,692			25,000,000 P		21,002,000 P
Diluted	16,547,715			27,406,015 P		23,408,015 P
Earnings per share exclusive of interest and shares subject to redemption:						
Basic	\$ 0.05					

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	Stone	KPB <sup>(1)</sup>	Pro Forma Adjustments (assuming no redemption)	Pro Forma (assuming no redemption)	Pro Forma Adjustments (assuming maximum redemption)	Pro Forma (assuming maximum redemption)
Diluted	\$ 0.04					
Weighted-average number of shares outstanding exclusive of shares subject to possible redemption:						
Basic	13,247,185					
Diluted	14,487,208					

(1) These amounts reflect the restatements as discussed in Note 15 to the combined financial statements as of and for the three years ended December 31, 2005.

Please see notes to unaudited pro forma financial statements.

**Unaudited Pro Forma Condensed Consolidated Statement of Income**  
**For the Nine Months Ended September 30, 2006**  
(amounts in thousands except share data and per share data)

	Stone	KPB	Pro Forma Adjustments (assuming no redemption)	Pro Forma (assuming no redemption)	Pro Forma Adjustments (assuming maximum redemption)	Pro Forma (assuming maximum redemption)
Net Sales	\$	\$ 189,164	\$	\$ 189,164	\$	\$ 189,164
Cost and expenses:						
Cost of sales (exclusive of depreciation and amortization)		115,251	J	115,251		115,251
Distribution expenses		16,927		16,927		16,927
Depreciation and amortization		13,600	(8,308) K	5,292		5,292
Selling, general, and administrative expenses and taxes other than income	892	18,276	L	19,168		19,168
Operating expenses	892	164,054	(8,308)	156,638		156,638
Operating income (loss)	(892)	25,110	8,308	32,526		32,526
Other income (expense):						
Bank interest	58			58		58
Interest income on cash and investments subject to redemption	3,864		(3,864) M			
Interest expense		(1,059)	1,059 N	(2,777)		(2,777)
			(2,777) E			
Total other income (expense)	3,922	(1,059)	(5,582)	(2,719)		(2,719)
Income before provision for income taxes:	3,030	24,051	2,726	29,807		29,807
Total provision for income taxes	1,027	9,293	1,077 O	11,397		11,397
Net income	2,003	14,758	1,649	18,410		18,410
Deferred interest, net of taxes, attributable to common stock subject to possible redemption	(510)		510 H			
Net income allocable to holders of non-redeemable common stock	\$ 1,493	\$ 14,758	\$ 2,159	\$ 18,410	\$	\$ 18,410
Earnings per share:						
Basic	\$ 0.08			\$ 0.74		\$ 0.88
Diluted	\$ 0.07			\$ 0.64		\$ 0.74
Weighted-average number of shares outstanding:						
Basic	25,000,000			25,000,000 P		21,002,000 P
Diluted	28,963,964			28,963,964 P		24,965,964 P
Earnings per share exclusive of interest and shares subject to redemption:						
Basic	\$ 0.07					



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	Stone	KPB	Pro Forma Adjustments (assuming no redemption)	Pro Forma (assuming no redemption)	Pro Forma Adjustments (assuming maximum redemption)	Pro Forma (assuming maximum redemption)
Diluted	\$	0.06				
Weighted-average number of shares outstanding exclusive of shares subject to possible redemption:						
Basic		21,002,000				
Diluted		24,965,964				

Please see notes to unaudited pro forma financial statements.

**Notes to Unaudited Pro Forma Condensed Consolidated Financial Statements**  
**(amounts in thousands except share data and per share data)**

Descriptions of the adjustments included in the unaudited pro forma balance sheet and statements of income are as follows:

(A) To record the reclassification of funds held in trust by Stone.

(B) To record the payment for the acquisition of KPB, the estimated working capital adjustment, the transaction costs, and the allocation of the purchase price to the assets acquired and liabilities assumed as follows:

<b>Calculation of Allocable Purchase Price*:</b>	
Cash	\$ 155,000
Working capital adjustment	(4,549)
Transaction costs	2,100
	<hr/>
Total allocable purchase price	\$ 152,551
	<hr/>

<b>Estimated Allocation of Purchase Price**:</b>	
Accounts receivable, net	\$ 31,146
Inventories	22,767
PP&E	108,179
Other assets	5,754
Intangible assets	700
Goodwill	3,133
Deferred income taxes	1,191
Accounts payable	(9,105)
Accrued expenses	(6,379)
Employee benefits	(3,015)
Asset retirement obligation matures in 2018	(1,820)
	<hr/>
KPB net assets acquired	\$ 152,551
	<hr/>

\* The pro forma financial statements have been presented using the estimated purchase price for the assets of KPB of \$152,551, the components of which are reflected above. In addition, there are two contingent earn-out payments which, if paid, would increase the purchase price and result in an increase to goodwill. The first contingent earn-out payment will be equal to 5.3 times the average annual EBITDA for KPB for the five year period immediately following the acquisition, less \$165,000, provided that such payment may not exceed \$35,000. The second contingent earn-out payment of \$25,000 is generally payable only if the average annual EBITDA equals or exceeds \$49,200 for the five year period immediately following the acquisition. These contingent payments, if any, are generally payable at the end of such five year period.

\*\* The purchase price allocation has not been finalized and is subject to change upon recording of actual transaction costs, finalization of working capital adjustments, and completion of appraisals of tangible and intangible assets. The purchase price allocation will be finalized when all necessary information is obtained which is expected to occur within one year of the consummation of the transaction.

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	<u>KPB</u>	<u>Adjustments</u>	<u>Adjusted KPB</u>
<b>Assets</b>			
Current assets:			
Cash	\$ 1	\$ (1) <sup>(i)</sup>	\$
Accounts receivable, net	31,146	<sup>(ii)</sup>	31,146
Inventories, net	20,835	1,932 <sup>(iii)</sup>	22,767
Prepaid expenses	1,765	(171) <sup>(i)</sup>	1,594
<b>Total current assets</b>	<b>53,747</b>	<b>1,760</b>	<b>55,507</b>
Plant, property and equipment, net	204,179	(96,000) <sup>(iv)</sup>	108,179
Intangible assets		700 <sup>(v)</sup>	700
Goodwill		3,133 <sup>(vi)</sup>	3,133
Deferred income taxes		1,191 <sup>(vii)</sup>	1,191
Other assets	4,160		4,160
<b>Total assets</b>	<b>\$ 262,086</b>	<b>\$ (89,216)</b>	<b>\$ 172,870</b>
<b>Liabilities and equity</b>			
Current liabilities:			
Accounts payable	\$ 9,105	\$ <sup>(ii)</sup>	\$ 9,105
Accounts payable to International Paper Company, net	100	(100) <sup>(i)</sup>	
Accrued expenses	7,770	(1,391) <sup>(i)</sup>	6,379
<b>Total current liabilities</b>	<b>16,975</b>	<b>(1,491)</b>	<b>15,484</b>
Long term debt	22,346	(22,346) <sup>(i)</sup>	
Asset retirement obligation	1,820	<sup>(ii)</sup>	1,820
Pension liability		3,015 <sup>(vii)</sup>	3,015
<b>Total liabilities</b>	<b>41,141</b>	<b>(20,822)</b>	<b>20,319</b>
Control account	220,945	(68,394)	152,551
<b>Total liabilities and equity</b>	<b>\$ 262,086</b>	<b>\$ (89,216)</b>	<b>\$ 172,870</b>

(i) Adjusted for KPB assets and liabilities not acquired or assumed.

(ii) Recorded at book value carried on KPB's books, which is estimated by Stone management to approximate fair value.

(iii) Adjusted to estimated fair market value less the costs to sell.

(iv) Adjusted KPB book value to Stone management's estimate of fair value, pending completion of appraisals.

(v) Recorded estimated \$700 based on Stone management's estimate of fair value for intangible assets consisting of \$450 for customer contracts and relationships amortized over 12 years and \$250 for ancillary agreements including the buying consortium amortized over 5 years. The average preliminary period for amortization of intangibles is 8 years. These estimates are management's best estimates and are subject to change pending completion of appraisals by experts upon completion of the purchase.

(vi)

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Recorded excess purchase price over estimated fair value of net KPB assets acquired, pending completion of appraisals.

(vii)

Adjusted for pension liabilities assumed and related deferred income taxes.

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(C) To record the receipt of \$65,000 of bank loans, consisting of \$12,500 of current liabilities (\$5,000 borrowed against \$35,000 revolver and \$7,500 current portion of \$60,000 term loan), and \$52,500 long-term portion of \$60,000 term loan.

(D) To record additional investment banking fees (\$1,200) related to Stone share issuance directly attributable to the transaction.

(E) To record interest and bank fee amortization expense and deferred financing costs on the \$60,000 term loan and the \$35,000 revolving credit facility. The term loan principal was reduced from \$60,000 to \$52,500 during the first year due to scheduled repayments of \$7,500. An additional \$4,000 will be paid down in the following six months bringing the outstanding term loan balance to \$48,500. Interest expense recorded for the year ended December 31, 2005 was charged at the rate of 6.87% per annum per the loan agreement (amounting to \$3,865 per year). For the year ended December 31, 2005, bank fees and amortization of deferred financing costs were \$346. Interest expense recorded for the nine months ended September 30, 2006, was charged at a rate of 6.87% (amounting to \$2,602). For the nine months ended September 30, 2006, bank fees and amortization of deferred financing costs were \$175. If interest rates had changed by 0.125%, interest expense would change by \$70 for the year ended December 31, 2005 and by \$48 for the nine months ended September 30, 2006. Although the cash flows are projected to be sufficient to cover operating costs without the use of the revolving credit facility, the company may draw down on the facility. In the event that the company does utilize additional loans from the revolving credit facility, interest charges will increase. The September 30, 2006 balance sheet reflects \$855 of deferred financing costs.

(F) To eliminate income accumulated during development stage to retained earnings (\$2,122), prepaid acquisition costs (\$1,829), and KPB division control account (\$220,945).

(G) To record excess purchase price over the estimated fair value of the net KPB assets acquired, pending completion of appraisals.

(H) Assuming no redemption, reclassify common stock subject to redemption to permanent equity (\$22,160) and to record related deferred interest net of taxes as income (\$699 since inception), \$189 for the period ended December 31, 2005 and \$510 for the nine months ended September 30, 2006.

(I) Assuming maximum redemption, record refund of funds (\$22,160) to dissenting shareholders and related deferred interest (\$699).

(J) For the major cost components of cost of sales, KPB will enter into a buying consortium together with IP to enable the continuation of procurement advantages that arise from the economies of scale. Therefore, KPB does not anticipate any significant cost increases resulting from a lack of leverage with its suppliers.

(K) To record decrease in depreciation expense due to write-down of PP&E and the establishment of new estimated useful lives and to record amortization of intangible assets. Depreciation is recorded using estimated useful lives of 40 years for buildings and 15 years for machinery and equipment. Amortization of intangible assets is recorded using estimated useful lives of 8 years.

(L) Certain corporate services are currently performed by IP for the KPB business including corporate management, legal, accounting and tax, treasury, payroll and benefits administration, public warehouse space, risk management, information technology, and centralized transaction processing. On a stand-alone basis, SG&A costs were estimated by Stone management to be higher by \$2,710 for the year ended December 31, 2005, and \$1,722 higher for the nine months ended September 30, 2006. In addition to these increased costs at the business level, Stone anticipates an additional \$1,300 of general and administrative costs at the corporate level. However, since these costs are estimates and not currently factually supportable, they have not been included as pro forma

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adjustments. The company is anticipating relocation expenses of less than \$100,000 for employees' relocation from the IP corporate headquarters in Memphis.

(M) To eliminate interest income on cash and investments subject to redemption.

(N) To eliminate interest expense on environmental bonds not assumed.

(O) To adjust income taxes due to pro forma income adjustments.

(P) Pro forma net income per share was calculated by dividing pro forma net income by the weighted average number of shares as follows:

	Year ended December 31, 2005	
	Assuming no redemption (0%)	Assuming maximum redemption (19.9%)
Stone pro forma weighted average shares-basic*	25,000,000	21,002,000
Incremental shares on exercise of warrants**	2,406,015	2,406,015
<b>Stone pro forma weighted average shares-diluted</b>	<b>27,406,015</b>	<b>23,408,015</b>

\* Assuming IPO occurred at January 1, 2005

\*\* Assuming stock price of \$5.32 per share based on the average share price from April 15, 2005 through December 31, 2005

	Nine months ended September 30, 2006	
	Assuming no redemption (0%)	Assuming maximum redemption (19.9%)
Stone pro forma weighted average shares-basic	25,000,000	21,002,000
Incremental shares on exercise of warrants**	3,963,964	3,963,964
<b>Stone pro forma weighted average shares-diluted</b>	<b>28,963,964</b>	<b>24,965,964</b>

\*\* Assuming stock price of \$5.55 per share based on the average share price from January 1, 2006 through September 30, 2006

**PROPOSAL II**

**THE NAME CHANGE AMENDMENT PROPOSAL**

**General Description of the Amendment**

The amendment would change the name of Stone to "KapStone Paper and Packaging Corporation." The form of the certificate of amendment of the certificate of incorporation to, among other things, change the name, is attached hereto as *Annex B*.

**Stone's Reasons for the Amendment**

Stone's board of directors has concluded that the name "KapStone Paper and Packaging Corporation" better reflects the business Stone will conduct after the acquisition, and will enable industry and financial market participants to more closely associate Stone with its operating business and, accordingly, believes the amendment is in the best interests of the stockholders.

**Recommendation and Vote Required**

The approval of the name change amendment proposal will require the affirmative vote of the holders of a majority of the issued outstanding shares of Stone's common stock on the record date.

Stone's initial stockholders intend to vote their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" the name change amendment proposal.

**Stone's board of directors unanimously recommends that its stockholders vote "For" the approval of the name change amendment proposal.**

**PROPOSAL III**

**THE ARTICLE SIXTH AMENDMENT PROPOSAL**

**General Description of the Amendment**

Stone is proposing to remove the preamble and sections A through D, inclusive, of Article SIXTH of Stone's certificate of incorporation and to redesignate section E of Article SIXTH as Article SIXTH upon consummation of the acquisition. If the acquisition is not approved, the Article SIXTH amendment will not be presented at the meeting. The certificate of amendment to the certificate of incorporation to, among other things, revise Article SIXTH, is attached hereto as *Annex B*.

**Stone's Reasons for the Amendment**

In the judgment of Stone's board of directors, the Article SIXTH amendment is desirable, as sections A through D relate to the operation of Stone as a blank check company prior to the consummation of a business combination and by virtue of the preamble to the Article SIXTH, will terminate once a business combination is effected. The proposed Article SIXTH amendment removes language that will be rendered moot by virtue of the acquisition.

**Recommendation and Vote Required**

The approval of the Article SIXTH amendment proposal will require the affirmative vote of the holders of a majority of the issued and outstanding shares of Stone's common stock on the record date.

Stone's officers and directors intend to vote their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" the Article SIXTH amendment proposal.

**Stone's board of directors unanimously recommends that its stockholders vote "For" the approval of the Article SIXTH Amendment.**



**PROPOSAL IV**

**THE STONE 2006 INCENTIVE PLAN PROPOSAL**

**General Description of the Incentive Plan Proposal**

Stone's 2006 incentive plan, or the Plan, has been approved by Stone's board of directors and will take effect upon consummation of the acquisition, subject to stockholder approval. References to "we," "us," or "our" refer to Stone.

The purpose of the 2006 incentive plan is to enable us to attract, retain, motivate and provide additional incentives to certain directors, officers, employees, consultants and advisors, whose contributions are essential to our growth and success by enabling them to participate in our long-term growth through the exercise of stock options and the ownership of our stock.

The following is a summary of the material provisions of the 2006 incentive plan and is qualified in its entirety by reference to the complete text of the plan, a copy of which is attached to this proxy statement as *Annex C*.

**Summary of the Incentive Plan**

**Administration.** The 2006 incentive plan will be administered by a committee of our board of directors of not less than two members of the board, each of whom shall be an outside director. The term "outside director" is defined in Section 162(m) of the Internal Revenue Code and is distinct from "independent director" as such term is defined by the various stock exchanges and SEC regulations. A member of the board of directors would be deemed to be an "outside director" if the director (1) is not a current employee of Stone; (2) is not a former employee of Stone who receives compensation for prior services during the taxable year (other than benefits under a tax-qualified retirement plan); (3) has not been an officer of Stone; and (4) does not receive remuneration (*e.g.*, any payment in exchange for goods or services) from Stone, either directly or indirectly, in any capacity other than as a director. For purposes of the following discussion, the term "Administrator" means the committee to which the board of directors delegated its authority as provided above. The Administrator has the authority, subject to the terms of the 2006 incentive plan, to determine the individuals to whom options will be granted, the times at which options will be granted and the terms and conditions of the options.

**Shares That May Be Issued Under the 2006 Incentive Plan.** A maximum of 3,000,000 shares of our common stock, which number may be adjusted as described below, are available for issuance pursuant to options, restricted stock awards or stock appreciation rights, which we refer to herein collectively as Awards, granted under the 2006 incentive plan. If any Award is forfeited or expires without being exercised, or if restricted stock is repurchased by Stone, the shares of stock subject to the Award shall be available for additional grants under the Plan. The number of shares available under the 2006 incentive plan is subject to adjustment in the event of any stock split, stock dividend, recapitalization, spin-off or other similar action.

**Eligibility.** Awards may be granted to employees, officers and directors of, and consultants or advisors to, Stone and any subsidiary corporations. Options intended to qualify, under the standards set forth in certain federal tax rules, as incentive stock options ("ISOs") may be granted only to employees while actually employed by us. Non-employee directors, consultants and advisors are not entitled to receive ISOs.

**Estimate of Benefits.** Until and unless approved by Stone's stockholders, no grants will be made under the 2006 incentive plan. We cannot determine the benefits to be received by our directors or officers under the 2006 incentive plan or the benefits that would have been received by our directors and officers in 2005 had the plan been in effect in 2005.

**Types of Awards.**

**Stock Options.** ISOs granted under the 2006 incentive plan are exercisable for a period fixed by the Administrator, but no longer than 10 years from the date of grant, at an exercise price which is not less than the fair market value of

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the common stock on the date of the grant, except that the term of an incentive option granted under the 2006 incentive plan to a stockholder who owns (or is deemed to own) more than 10% of the outstanding voting power may not exceed five years and its exercise price may not be less than 110% of the fair market value of the Shares on the date of grant. To the extent that the aggregate fair market value, as of the date of grant, of the shares for which incentive options become exercisable for the first time by an optionee during the calendar year exceeds \$100,000, the portion of such option which is in excess of the \$100,000 limitation will be treated as a nonqualified option. Nonqualified options granted under the 2006 incentive plan are exercisable for a period fixed by the Administrator, but no longer than 10 years from the date of grant, at an exercise price which is not less than the fair market value of the Shares on the date of the grant.

Options granted under the 2006 incentive plan to employees (including officers) of Stone may be exercised only while the optionee is employed by Stone or within three months of the date of termination of the employment relationship, except that: (i) if the individual is terminated for cause, the option shall terminate immediately and no longer be exercisable, (ii) if such options are nonqualified options which are exercisable at the time the optionee's employment is terminated by death or permanent disability, such options may be exercised within two years of the date of termination of the employment relationship, (iii) if such options are incentive options which are exercisable at the time the optionee's employment is terminated by death or permanent disability, such options may be exercised within one year of the date of termination of the employment relationship, and (iv) in the case of the retirement of an optionee, (a) nonqualified options will be exercisable prior to the date which is the earlier of two years following the date of retirement or the expiration date of the option and (b) incentive options will be exercisable prior to the earlier of the date which is three months following the date of retirement or the expiration of the option. With respect to options granted to individuals who are not employees of Stone, the Administrator shall determine the consequences, if any, of the termination of the optionee's relationship with Stone. Payment of the exercise price of an option may be made by cash, by surrender of shares having a fair market value equal to the exercise price, or by any other means that the Administrator determines.

*Restricted Stock.* Each restricted stock award will be evidenced by a written restricted stock grant agreement. No cash or other consideration will be required to be paid by the plan participant to receive the shares other than in the form of services performed under the terms and conditions determined by the Administrator and specified in the restricted stock agreement. Terms and conditions for shares that are part of the award may include the completion of a specified number of years of service or attaining certain performance goals prior to the restricted shares subject to the award becoming vested. Upon termination, if the restricted stock is not vested, Stone may repurchase the restricted stock from the participant on the terms and conditions contained in the restricted stock grant agreement.

*Stock Appreciation Rights or SARs.* A stock appreciation right means the right to receive payment in shares of common stock or, if permitted by Section 409A of the Code without causing the stock appreciation rights to be treated as deferred compensation subject thereto, cash in an amount equal to the excess of the fair market value of the shares on the date of exercise and the fair market value of the shares at the time of grant. Each stock appreciation right will be evidenced by a written stock appreciation right agreement. No cash or other consideration will be required to be paid by the plan participant to receive the cash or shares, other than the terms and conditions determined by the Administrator and specified in the stock appreciation right agreement. Terms and conditions for shares that are part of the award could include the completion of a specified number of years of service or attaining certain performance goals prior to the rights subject to the award becoming vested. A plan participant holding a stock appreciation right will have none of the rights of a stockholder (including the right to receive the payment of cash dividends) until such time as shares, if any, are actually issued. Upon termination of the employment of an employee, any unvested portion of a stock appreciation right will be forfeited.

A participant may be granted more than one Award under the 2006 incentive plan. The Administrator will, in its discretion, determine (subject to the terms of the 2006 incentive plan), among other things, who will be granted an Award, the time or times at which Awards shall be granted, and the number of shares subject to each Award, whether options are incentive options or nonqualified options, the manner in which options may be exercised and the vesting schedule of any Award. In making such determination, consideration may be given to the value of the services rendered by the respective individuals, their present and potential contributions to the success of Stone

and its subsidiaries and such other factors deemed relevant in accomplishing the purposes of the 2006 incentive plan.

**Federal Income Tax Consequences.** The following is a general summary of the federal income tax consequences under current tax law of options, stock appreciation rights and restricted stock. It does not purport to cover all of the special rules, including special rules relating to participants subject to Section 16(b) of the Exchange Act and the exercise of an option with previously-acquired shares, or the state or local income or other tax consequences inherent in the ownership and exercise of stock options and the ownership and disposition of the underlying shares or the ownership and disposition of restricted stock.

*Stock Options.* A participant will not recognize taxable income for federal income tax purposes upon the grant of a nonqualified option or an incentive option. Upon the exercise of an incentive option, the optionee will not recognize taxable income. If the optionee disposes of the shares acquired pursuant to the exercise of an incentive option more than two years after the date of grant and more than one year after the transfer of the shares to him or her, the optionee will recognize long-term capital gain or loss and Stone will not be entitled to a deduction. However, if the optionee disposes of such shares within the required holding period, all or a portion of any gain will be treated as ordinary income and Stone will generally be entitled to deduct such amount. Long-term capital gain is generally subject to more favorable tax treatment than ordinary income or short-term capital gain.

Upon the exercise of a nonqualified option, the optionee will recognize ordinary income in an amount equal to the excess, if any, of the fair market value of the shares acquired on the date of exercise over the exercise price thereof, and Stone will generally be entitled to a deduction for such amount at that time. If the optionee later sells shares acquired pursuant to the exercise of a nonqualified option, he or she will recognize long-term or short-term capital gain or loss, depending on the period for which the shares were held.

In addition to the federal income tax consequences described above, an optionee may be subject to the alternative minimum tax, which is payable to the extent it exceeds the optionee's regular tax. For this purpose, upon the exercise of an incentive option, the excess of the fair market value of the shares over the exercise price therefore is an adjustment which increases alternative minimum taxable income. In addition, the optionee's basis in such shares is increased by such excess for purposes of computing the gain or loss on the disposition of the shares for alternative minimum tax purposes. If an optionee is required to pay an alternative minimum tax, the amount of such tax which is attributable to deferral preferences (including the incentive option adjustment) is allowed as a credit against the optionee's regular tax liability in subsequent years. To the extent the credit is not used, it is carried forward.

*Restricted Stock.* A participant who receives a grant of restricted stock will generally receive ordinary income equal to the fair market value of the stock at the time the restriction lapses. Alternatively, the participant may elect to be taxed on the value at the time of grant. Stone is generally entitled to a deduction at the same time and in the same amount as the income required to be included by the participant.

*Stock Appreciation Rights.* A participant does not recognize income upon the grant of a stock appreciation right. The participant has ordinary income upon exercise of the stock appreciation right equal to the increase in the value of the underlying shares, and Stone will generally be entitled to a deduction for such amount. Awards of SARs under the 2006 Plan may, in some cases, result in the deferral of compensation that is subject to the requirements of section 409A of the Code. To date, the U.S. Treasury Department and Internal Revenue Service have issued only preliminary guidance regarding the impact of section 409A of the Code on the taxation of these types of awards. Generally, to the extent that deferrals of these awards fail to meet certain requirements under section 409A of the Code, such awards will be subject to immediate taxation and tax penalties in the year they vest unless the requirements of section 409A of the Code are satisfied. It is the intent of the Company that awards under the 2006 Plan will be structured and administered in a manner that either complies with or is exempt from the requirements of section 409A of the Code.

The foregoing discussion does not purport to be a complete analysis of all the potential tax consequences relevant to recipients of Awards or to Stone or its subsidiaries. The above discussion does not take into account the effect of

state and local tax laws. Moreover, no assurance can be given that legislative, administrative, regulatory or judicial changes or interpretations will not occur which could modify such analysis. In addition, an individual's particular tax status may result in different tax consequences from those described above. Therefore, any participant in the 2006 incentive plan should consult with his own tax adviser concerning the tax consequences of the grant, exercise and surrender of any such Award and the disposition of any stock acquired pursuant to such Awards.

**Termination of and Amendments to the 2006 Incentive Plan.** The 2006 incentive plan may be amended or terminated by the board of directors at any time, provided that no amendment requiring stockholder approval by law or by the rules of any securities exchange or other market on which the shares are traded may be made without stockholder approval, and further, that there shall be no amendment to the terms of any options under the 2006 incentive plan which would result in the repricing of an Award, the cancellation of an Award and substitution with an Award with a lower exercise price or any similar amendment without stockholder approval. Also, no amendment or termination may materially adversely affect any outstanding Award without the written consent of the participant. No Awards may be granted under the 2006 incentive plan after \_\_\_\_\_, 2016.

#### **Recommendation and Vote Required**

Approval of our 2006 incentive plan will require the affirmative vote of the holders of a majority of the outstanding shares of our common stock represented in person or by proxy and entitled to vote at the meeting.

Stone's initial stockholders intend to vote their shares of Stone common stock, representing an aggregate of 22% of the outstanding shares of Stone common stock, "FOR" the Article SIXTH amendment proposal.

**Stone's board of directors unanimously recommends that its stockholders vote "For" the approval of the 2006 incentive plan.**

## OTHER INFORMATION RELATED TO STONE

### Business of Stone

Stone is a blank check company organized as a corporation under the laws of the State of Delaware on April 15, 2005. Prior to executing the Purchase Agreement with IP, Stone's efforts were limited to organizational activities, completion of its IPO and the evaluation of possible business combinations.

### Offering Proceeds Held in Trust

On August 19, 2005, Stone successfully consummated an initial public offering of its equity securities from which it derived net proceeds of approximately \$113,236,000. \$110,854,000 of the net proceeds of the initial public offering was placed in a trust account and will be released to Stone upon consummation of the acquisition. The balance of the net proceeds of \$2,382,000 is being used by Stone to pay the expenses incurred in its pursuit of a business combination. A portion of the interest earned on the trust account has been released to Stone for the payment of taxes on interest earned on the proceeds held in trust. The trust account will not be released until the earlier of the consummation of a business combination or the dissolution and liquidation of Stone in accordance with the Delaware General Corporation Law. The trust account contained approximately \$ as of November , 2006. If the acquisition of KPB is consummated, the trust account will be released to Stone, less the amounts paid to stockholders of Stone who do not approve the acquisition and elect to redeem their shares of common stock for their pro-rata share of the trust account. The released funds will be used for working capital.

### Fair Market Value of Target Business

Pursuant to Stone's certificate of incorporation, the initial target business that Stone acquires must have a fair market value equal to at least 80% of Stone's net assets at the time of such acquisition. Based on the financial analysis of KPB generally used to approve the transaction, Stone's board of directors determined that this requirement has been met. Stone's board of directors has determined that the fair market value of the assets being purchased is between \$237,000,000 and \$255,000,000. This determination is based on an analysis of KPB's earnings, as compared to other publicly-traded businesses of a similar nature and the acquisition multiples for other similar transactions in the paper and packaging industry that have recently been publicly announced or completed. In addition, a leveraged buyout/discounted cash flow analysis has been performed to determine the present economic value of the assets being acquired. The average of these three methods yields a fair market value of approximately \$254,000,000. The range of the fair market value exceeds \$92,000,000, which is 80% of Stone's net asset value of approximately \$115,000,000 as of September 30, 2006. Accordingly, the board of directors determined that the requirement that the fair market value of the assets be greater than 80% of Stone's net asset value has been met.

### Stockholder Approval of Business Combination

Stone will proceed with the acquisition of KPB only if a majority of the IPO shares voted at the meeting vote in favor of the acquisition proposal. Stone's initial stockholders have agreed to vote their 5,000,000 shares of Stone common stock acquired prior to Stone's initial public offering, representing an aggregate of 20% of the outstanding shares of Stone common stock, in accordance with the vote of the majority of the IPO shares voted at the meeting. In addition, one of Stone's initial stockholders who owns 500,000 IPO shares that are part of 500,000 units acquired in Stone's initial public offering, representing 2% of the outstanding shares of Stone common stock, and 2.5% of the shares issued in Stone's initial public offering, intends to vote such shares "FOR" the adoption of the acquisition proposal. If the holders of 20% or more of Stone's common stock vote against the acquisition proposal and affirmatively elect to redeem their shares into their pro rata share of the trust account, then Stone will not consummate the acquisition.

### Liquidation If No Business Combination

If Stone does not consummate a business combination by the later of February 19, 2007, or August 19, 2007 in the event that a letter of intent, an agreement in principle or a definitive agreement to complete a business combination was executed but a business combination was not consummated by February 19, 2007, then, pursuant to Article SIXTH of its certificate of incorporation, and in accordance with Section 281(b) of the Delaware General Corporation Law Stone will adopt a plan of dissolution, and as soon as reasonably possible after dissolution make liquidating distributions from the trust account to our stockholders.

Under the Delaware General Corporation Law, stockholders may be held liable for claims by third parties against a corporation to the extent of distributions received by them in a dissolution. To mitigate against this possibility, Stone has received executed agreements from all significant vendors and IP waiving any right, title, interest or claim of any kind in or to any monies held in the trust account, except that IP has not waived any potential claims with respect to fraud by the Company, which in this context would be if the Company during the course of negotiating the Purchase Agreement knowingly misrepresented the truth or concealed a material fact to induce IP to enter into the transaction. No significant amounts are owed to any vendor that has not signed a waiver. As a result of this, the claims that could be made against Stone are significantly limited and the likelihood that any claim would result in any liability extending to the trust account is minimal. If Stone winds up its affairs in compliance with either Section 280 or 281(b) of the Delaware General Corporation Law following a dissolution, pursuant to Section 282 of the Delaware General Corporation Law, the potential liability of Stone's stockholders will be limited to the lesser of the stockholder's pro-rata share of any claim or the amount distributed to the stockholder. Further, the aggregate liability of any stockholder of Stone for claims against Stone will be limited to the amount distributed to the stockholder in dissolution. Even though compliance with Section 280 would provide additional protections to both Stone's directors and stockholders, because it is Stone's intention to make liquidating distributions to its stockholders as soon as reasonably possible following any dissolution, Stone does not expect that its board of directors would elect to comply with the more complex procedures in Section 280. Under Section 281(b), Stone would be required to seek stockholder approval to comply with Section 281(b), which would require Stone to adopt a plan of dissolution to provide for Stone's payment, based on facts known to Stone at such time, of existing and pending claims, and claims that may be potentially brought against Stone within the subsequent 10 years. Stone estimates the costs associated with the implementation and completion of such a plan of dissolution and liquidation, to be approximately \$50,000 to \$75,000, which would be funded by any funds not held in our trust account and funds released to Stone to fund working capital.

### **Future Acquisitions**

Stone intends to pursue other acquisition opportunities following the closing of the KPB acquisition in an effort to diversify its investments and/or grow KPB business. Stone has been and continues to be engaged in evaluating a number of potential acquisition opportunities, has had preliminary discussions with several potential targets, and has commenced preliminary due diligence on several candidates. There is currently no agreement with respect to any acquisition, nor can an assurance be given that Stone will ever consummate any such transaction. The structuring and financing of any future acquisitions may be dependent on the terms and availability of additional financing to Stone that either replaces or does not conflict with KapStone Kraft's credit facility with LaSalle Bank.

### **Facilities**

We maintain our executive offices at c/o Stone-Kaplan Investments, LLC, One Northfield Plaza, Suite 480, Northfield, IL 60093. Stone-Kaplan Investments has agreed to provide us with certain administrative, technology and secretarial services, as well as the use of certain limited office space at this location at a cost of \$7,500 per month pursuant to a letter agreement between us and Stone-Kaplan Investments. Stone-Kaplan Investments uses a portion of the \$7,500 monthly fee to pay Arcade Partners for overhead expenditures incurred on our behalf. We believe, based on rents and fees for similar services in the Chicago metropolitan area, that the \$7,500 fee is at least as favorable as we could have obtained from an unaffiliated person. We consider our current office space adequate for our current operations. If the business combination is approved, Stone will likely expand its headquarters by leasing additional office space at or near its current corporate headquarters located in Northfield, IL. Stone estimates that it will seek to lease approximately 8,000 sq. ft. of office space to serve as its headquarters. The current leasing rate for such space is estimated to be approximately \$25 per sq. ft. per year, or \$200,000 per year in aggregate. At this time, no arrangements have been made to acquire such additional office space.

### **Employees**

Stone currently has two executive officers and five directors. These individuals are not obligated to contribute any specific number of hours per week and devote only as much time as they deem necessary to our affairs. Stone does not currently have any full time employees.

**Related Party Transactions**

From time to time, Stone retains the services of White Oak Aviation, an aviation services company owned by Messrs. Stone and Kaplan, for the use of an airplane to transport Stone's executive officers and directors, as well as consultants and advisors retained by Stone traveling with them, on due diligence trips with respect to potential business targets and meetings with members of the investment community. During the nine months ended September 30, 2006, Stone paid White Oak Aviation an aggregate of approximately \$61,500. White Oak Aviation invoices Stone using hourly rates and fuel charges and associated costs that are equal to or less than the market prices that it charges its third party customers. Approximately \$15,000 of the total payments represent a reimbursement of a direct cost incurred by White Oak Aviation to a third party aircraft supplier. These payments were not designed to be, nor did they amount to, compensation to Messrs. Stone and Kaplan.

**Legal Proceedings**

To the knowledge of management, there is no litigation currently pending or contemplated against Stone or any of our officers or directors in their capacity as such.

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

*You should read the following discussion of the financial condition and results of operations of Stone in conjunction with Stone's historical consolidated financial statements and related notes contained elsewhere herein. Among other things, those historical consolidated financial statements include more detailed information regarding the basis of presentation for the following information.*

**Overview**

Stone was formed on April 15, 2005, to serve as a vehicle to effect a merger, capital stock exchange, asset acquisition or other similar business combination with an operating business in the paper, packaging, forest products and related industries. Stone's initial business combination must be with a target business or businesses whose fair market value is at least equal to 80% of Stone's net assets at the time of such acquisition. Stone intends to utilize cash derived from the proceeds of its recently completed public offering, its capital stock, debt or a combination of cash, capital stock and debt, in effecting a business combination.

**Critical Accounting Policies**

*Use of Estimates*

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.

**Results of Operations for the Quarters Ending September 30, 2006 and September 30, 2005**

For the quarters ending September 30, 2006 and 2005, Stone's net income attributed to nonredeemable common stock was \$488,585 (\$671,400 before the deduction of \$182,815 of interest net of taxes attributable to common stock subject to possible redemption) as compared to \$203,590 (\$259,311 before the deduction of \$55,721 of interest net of taxes attributable to common stock subject to possible redemption), respectively. Since Stone did not have any operations, all of Stone's income was derived from interest income, most of which was earned on funds held in a trust account. Interest income earned for the quarter ended September 30, 2006 was higher than the prior year's comparable quarter by \$965,611, because the principal balance was not invested until August 19, 2005, upon the completion of Stone's initial public offering and receipt of \$113,235,876 of net proceeds. Stone's operating expenses for the quarters ending September 30, 2006 and September 30, 2005 were \$373,519 and \$37,799, respectively. The expenses for the quarter ended September 30, 2006 were higher than the previous year's corresponding quarter by \$335,720, primarily due to increased expenses related to pursuing a business combination, professional fees, insurance, and franchise taxes. Stone also expensed \$350,872 and \$133,070 for income taxes for the quarters ending September 30, 2006 and 2005, respectively.

**Results of Operations for the Nine Months Ending September 30, 2006**

For the nine months ending September 30, 2006, Stone's net income attributed to nonredeemable common stock was \$1,493,342 (\$2,003,146 before the deduction of \$509,804 of interest net of taxes attributable to common stock subject to possible redemption). Since Stone did not have any operations, all of Stone's income was derived from interest income, most of which was earned on funds held in the trust account. Stone's operating expenses for the nine months ending September 30, 2006 were \$891,687. The expenses consisted primarily of expenses related to pursuing a business combination, professional fees, insurance, franchise taxes, and the monthly administrative fee of \$7,500 paid to Stone-Kaplan Investments. Stone also expensed \$1,027,754 of income tax expense for the nine months ending September 30, 2006.



**Results of Operations for the Period from April 15, 2005 (Date of Inception) to September 30, 2005**

For the period ended September 30, 2005, Stone's net income attributed to nonredeemable common stock was \$202,590 (\$258,311 before the deduction of \$55,721 of net income attributable to common stock subject to possible redemption). Since Stone did not have any operations, all of Stone's income was derived from interest income, most of which was earned on funds held in the trust account. Stone's operating expenses during the period were \$38,799 and consisted primarily of expenses related to pursuing a business combination, professional fees and the monthly administrative fee of \$7,500 paid to Stone-Kaplan Investments. Stone also provided for \$133,070 in income taxes.

**Liquidity and Capital Resources**

At September 30, 2006, \$114,574,151 of the proceeds from Stone's initial public offering, together with interest, was being held in a trust account. At such date, Stone had total current liabilities of \$1,463,534 consisting of \$1,000,000 in accrued legal fees, \$269,241 in accrued operating expenses (\$182,771 in franchise taxes, \$25,000 in accounting fees, \$49,403 in insurance and \$12,067 in miscellaneous expenses), \$111,936 in accrued income taxes and \$82,357 in deferred income taxes. In addition, Stone has received a commitment from LaSalle Bank, N.A., with respect to a \$95,000,000 senior secured credit facility. KapStone Kraft will be the borrower under the senior secured credit facility. At September 30, 2006, Stone had incurred \$1,829,382 of acquisition related costs recorded as deferred acquisition cost consisting of due diligence, legal, accounting and other expenses attendant to the due diligence investigations, structuring and negotiation of the KPB acquisition and the preparation of the proxy statement. Stone estimates that costs of completing the Business Combination with KPB will total approximately \$1,995,000, inclusive of the expenses incurred through September 30, 2006, but exclusive of any investment banking and financing fees. Of such amount, approximately \$345,000 relates to due diligence conducted with respect to prospective business targets and \$1,650,000 represents legal, accounting and other expenses attendant to the due diligence investigations, structuring and negotiation of the KPB acquisition and the preparation of the proxy statement. This estimate exceeds the \$1,450,000 estimate of such expenses (\$750,000 for due diligence on prospective targets and \$700,000 for legal, accounting and other business combination expenses) made by Stone at the time of its initial public offering.

Upon release, \$90,000,000 of the funds held in the trust account will be used to fund the acquisition of KPB. Up to approximately \$22,859,000 will be paid to holders of IPO shares that elect redemption and the balance (approximately \$1,715,170 assuming redemption of 19.99% of all holders of IPO shares and \$24,574,151 assuming no redemption) will be added to Stone's working capital. Proceeds of the credit facility will be used to pay the \$65,000,000 balance of the purchase price, the acquisition costs and financing fees and the \$1,200,000 investment banking fee to the managing underwriter of Stone's initial public offering, with the balance available for working capital. While it is anticipated that the borrowings from the credit facility, together with funds generated from KPB operating activities, will be sufficient for Stone's expected short-term and long-term operating needs, the ability to make payments on amounts outstanding under the credit facility will depend on KPB's ability to generate cash from its operations. Following the acquisition, Kapstone Kraft's expected debt service obligation is initially estimated to be approximately \$4,000,000 in interest payments per annum, which amount will be reduced each year in accordance with scheduled debt amortization payments, if made. In addition, debt service requirements will also include scheduled quarterly principal amortizations starting at \$1,875,000 during the first year and rising to \$2,250,000 in the final year of the facility. Management believes that KapStone Kraft's cash flow from operations will be sufficient to fund all such redemption payments, and that such payments will not have a material adverse effect on the Company's business plans, liquidity and growth opportunities.

Stone has made informal arrangements with its professional advisors to defer payment of any expenses, which exceed the amount currently held outside the trust, until completion of the business combination,

**Off-Balance Sheet Arrangements**

Stone has never entered into any off-balance sheet financing arrangements and has never established any special purpose entities. Stone has not guaranteed any debt or commitments of other entities or entered into any options on non-financial assets.

On June 23, Stone and Kapstone Kraft entered into a Purchase Agreement with IP.

**Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the sensitivity of income to changes in interest rates, foreign exchanges, commodity prices, equity prices, and other market-driven rates or prices. We are not presently engaged in and, if a suitable business target is not identified by us prior to the prescribed liquidation date of the trust fund, we may not engage in, any substantive commercial business. Accordingly, we are not and, until such time as we consummate a business combination, we will not be, exposed to risks associated with foreign exchange rates, commodity prices, equity prices or other market-driven rates or prices. The net proceeds of our initial public offering held in the trust fund have been invested only in money market funds meeting certain conditions under Rule 2a-7 promulgated under the Investment Company Act of 1940. Given our limited risk in our exposure to money market funds, we do not view the interest rate risk to be significant.

## INFORMATION ABOUT KPB

### Business Overview

#### *General*

KPB is currently the unbleached kraft paper division of IP. Prior to IP's transformation announcement on July 19, 2005, the kraft paper product lines consisted of unbleached kraft paper produced at Roanoke Rapids, NC and bleached kraft paper manufactured at facilities in Franklin, VA, Bastrop, LA and Courtland, AL. Ride Rite® Converting, located in Fordyce, AK, manufactured and sold converted kraft paper product through IP's corrugated container division. As a result of the transformation plan, the assets and liabilities of the Roanoke Rapids manufacturing and the Ride Rite® Converting facilities were combined to form KPB. IP will continue to own and operate the bleached kraft paper facilities located in Franklin, VA, Bastrop, LA and Courtland, AL. Beginning in January 2006, KPB marketed certain bleached paper products manufactured at the above mentioned IP facilities and sold to KPB's customers under a sales agreement between IP and KPB, which will continue for five years after the closing of the acquisition.

#### *Business of Roanoke Rapids*

Roanoke Rapids, a production facility consisting of an integrated pulp and paper mill located in Roanoke Rapids, North Carolina, produces kraft paper and lightweight linerboard. Roanoke Rapids began operations in 1907 and, by 1909, was the first business in the United States to produce kraft pulp using southern pine in the sulphate pulping process.

Historically, Roanoke Rapids has produced a mix of both kraft paper and linerboard. Roanoke Rapids currently has an annual production capacity of over 400,000 tons of unbleached kraft paper and lightweight linerboard. Roanoke Rapids offers a portfolio of paper grades, which are sold to customers who convert the paper into a wide range of products. These products include multiwall bags for agricultural products, pet food, cement and chemicals, grocery bags, and specialty conversion products such as wrapping paper products and rollwrap. The linerboard grades are primarily produced for manufacturing corrugated containers for packaging products.

During 2003 and 2004, Roanoke Rapids implemented the kraft paper conversion project. The intent of this conversion project was to increase facility production of kraft paper, and at the same time reduce overall facility production capacity in order to conform to newly implemented environmental regulations. The shift in product mix to primarily kraft paper reduced the pulp production demand of the mill and permitted the shutdown of a recovery boiler and avoided the capital expense of Cluster Rule compliance for this boiler. With the shutdown of this recovery boiler, a second recovery boiler was upgraded to support approximately 440,000 annual tons of production. KPB believes that this conversion project allowed Roanoke Rapids to devote additional resources toward product development in the kraft paper industry and concentrate on facility efficiency.

Unbleached softwood pulp used to make kraft paper and linerboard is produced from a combination of locally sourced roundwood and pine woodchips. KPB has historically purchased approximately 40% of woodchips from IP and approximately 60% from third parties. 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. The pulp is screened and washed through a series of washers, and then stored prior to the paper making process. Roanoke Rapids processes softwood pulp using two kraft paper machines; Paper Machine #3 ("PM3") and Paper Machine #4 ("PM4"), both of which are capable of producing either unbleached kraft paper or linerboard. PM3 produces approximately 570 tons of kraft paper daily, totaling approximately 195,000 tons annually. PM4 produces approximately 600 tons of kraft and linerboard paper daily, totaling approximately 205,000 tons annually. 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.

### ***Business of Ride Rite® Converting***

Ride Rite® Converting introduced the disposable inflatable paper dunnage bag in 1965. The bags are constructed of an internal poly liner encased by multiple layers of high strength kraft paper or linerboard and are used to secure freight to minimize movement and potential damage of goods and products during transport. Ride Rite® Converting relies on Roanoke Rapids for approximately two-thirds of its supply of kraft paper. 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. In 2005, the Ride Rite® Converting segment sold approximately 9.2 million dunnage bags. Ride Rite® Converting products are sold to manufacturers and less-than-trailer-load distributors, as well as retail regional distribution centers.

### ***Corporate Support***

Certain services are currently provided to KPB by IP, including corporate management, legal, accounting and tax, treasury, payroll and benefits administration, public warehouse space, risk management, information technology, and centralized transaction processing. In connection with the proposed sale of the business, Kap Stone Kraft will enter into an agreement with IP to cover the above services (with the exception of legal, risk management, treasury, accounting and tax services) through a transitional services agreement. It is expected that the services under the agreement will not last longer than one year from the commencement of the sale with no significant cost increases to KapStone Kraft.

IP manages and retains for KPB risk of loss for general liability and other claims through an IP wholly owned captive insurance company. KPB is allocated insurance premiums from IP based on past experience and other factors. Costs in excess of \$500,000 are absorbed by the captive insurance company on certain claims.

As a division of IP, certain operating, financing, and investing activities of KPB are funded through inter-divisional transactions with IP and its other operating divisions and subsidiaries. These functions will be taken over by Stone after the closing, except those that are going to be covered by the transitional services agreement between Kap Stone Kraft and IP. Ultimately, Stone will take over all of the functions and services that are currently provided by IP and Stone expects that its cost to provide such services will approximate IP's corporate allocation. The cost of transferring these services from IP to Stone, including applicable relocation costs, is estimated by Stone to be approximately \$3,500,000 to \$4,800,000, consisting primarily of the cost of installing a new IT reporting system.

### ***Transactions with IP after the Acquisition***

After the closing of the sale of KPB to Stone, KPB will sell to IP and certain of IP's businesses which have been sold or may be sold, or their suppliers, rollwrap, dunnage bags, tall oil, turpentine and linerboard and KPB will buy wood chips, pulpwood, plastic valves for dunnage bags, chucks and corrugated boxes from IP. In addition, KPB will continue to market certain bleached paper products manufactured by IP and certain of IP's businesses which have been sold or may be sold, and sold to KPB customers under a sales agreement between IP and KPB.

### ***Industry Overview***

#### ***Kraft Paper Market***

American Forest and Paper Association ("AFPA") estimates that the U.S. unbleached kraft paper market was approximately 1.4 million tons in 2005. An additional 300,000 tons were imported, bringing the 2005 total U.S. demand to approximately 1.7 million tons. The kraft paper industry is comprised of three general product types: (1) Multiwall; (2) Specialty converting (including rollwrap); and (3) Grocery bag and sack.

Multiwall bags are used in a variety of converted products including cement bags, flour bags, pet food bags and charcoal bags. Multiwall bags represented approximately 500,000 tons of the unbleached kraft paper market in 2005. Although the market for multiwall bags experienced a slight decline between 1999 and 2004, the Paper Shipping Sack Manufacturers Association has forecasted a multiwall bag market growth of 0.5% during 2006.

The specialty converting products include a variety of unique products, such as rollwrap, shingle wrap, dunnage bags, lawn and leaf bags and trash compactor bags. Specialty converting products represented approximately 331,000 tons of the unbleached kraft paper market in 2005, of which rollwrap represented approximately 130,000 tons. Rollwrap is used to provide barrier and moisture protection for shipping of paper rolls. The primary markets utilizing rollwrap include uncoated free sheet paper, high value specialty industrial papers, coated papers, newsprint and bleached board rolls.

The grocery bag and sack products represented approximately 560,000 tons of the unbleached kraft paper market in 2005. Although the kraft paper grocery bag market has declined as the industry has increased the use of alternative materials such as plastic, this still remains the largest segment of the unbleached kraft paper market.

#### ***Linerboard Market***

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 and other nondurable goods. AFPA estimates that U.S. demand for unbleached linerboard was approximately 17.3 million tons in 2004. Between 1998 and June 2006, AFPA reported 2.8 million tons of unbleached kraft linerboard capacity closures, which represented approximately 16% of the linerboard capacity. As a result, AFPA reported in the July 2006 Statistical Report for kraft paper that unbleached kraft linerboard machines are running at a 99.1% (2006 YTD) capacity versus 94.2% for the same period in 2005. Additionally, the unbleached linerboard market is expected to grow by 3.9% in 2006, 1.7% in 2007, and 2.3% in 2008.

#### ***Dunnage Bag 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 and is forecasted to grow, on average, 2.5% per year through 2016. ATA also estimates that the annual growth rate for freight transported by rail will be 1.9% through 2016. Historically, the nation's freight industry tracked prevailing economic conditions in the United States.

#### ***Market Trends***

The table below indicates that both the multiwall packaging markets and the grocery bag and sack markets contracted between 2001 and 2005. 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. AFPA is reporting a 1.8% growth in market size during the first seven months of 2006 compared with 2005.

Over the years, the plastic grocery and retail bag has gained an approximately 80% market share in the grocery and retail markets, displacing paper grocery and retail bags and sacks. KPB believes that this conversion has slowed substantially from early 1990's. KPB plans to replace a significant portion of its grocery bag and sack production with lightweight linerboard (20# to 37#).

The lightweight linerboard market as illustrated in the table below has grown over 17% since 2001 and represents a large market compared to the grocery bag and sack market. KPB expects to grow the current lightweight linerboard

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market sales by 45,000 to 60,000 tons over the next 5 years. KPB will be targeting its lightweight linerboard for specialty independent corrugated and laminated products customers who focus on specialty niche packaging.

Sales Volume as reported by AFPA					
	2001	2002	2003	2004	2005
(in tons except dunnage bag data)					
<b>Unbleached Kraft Paper Product Line</b>					
Multiwall	670,200	667,900	530,900	521,200	471,200
Specialty converting	273,900	254,000	253,900	289,000	334,900
Grocery bag	656,700	622,900	600,500	589,700	555,900
Kraft paper totals	1,600,800	1,544,800	1,385,300	1,399,900	1,362,000
Light weight linerboard (37# and below)	5,043,400	5,461,600	5,617,300	5,675,900	5,925,500
Dunnage bags*	12,700,00	13,500,00	14,400,000	15,350,000	17,000,000

\*

The information for dunnage bags is in individual bags sold and KPB's estimate of the dunnage bag market.

### Business Strategy

#### *Roanoke Rapids*

IP's previous strategy was to consolidate unbleached kraft paper production from Savannah, GA and Roanoke Rapids paper mill solely to Roanoke Rapids. Beginning in 2003, IP transferred the linerboard being produced in Roanoke Rapids to linerboard machines at other IP mills. This strategy fostered more of a focus on producing kraft paper at Roanoke Rapids while minimizing the capital expenditures required to meet existing environmental regulations. Unless capacity was reduced at Roanoke Rapids, \$15.0 million would have been required to be spent on a certain recovery boiler to meet environmental regulations. After the conversion of Roanoke Rapids to primarily a kraft paper mill, the Roanoke Rapids mill was able to produce lightweight linerboard more efficiently than in the past.

In the normal course of its business, KPB can produce kraft paper and lightweight linerboard on both of its paper machines. Stone's management intends to remain focused on the kraft papers business and use its ability to manufacture lightweight linerboard only to supplement its current business. The ability to manufacture quality lightweight linerboard on the existing paper machines gives KPB an added degree of flexibility that Stone's management believes can be used both strategically and opportunistically.

As noted above, the market growth rate for the lightweight linerboard that Roanoke Rapids produces (20# to 37#) has been over 17% since 2001. Management expects to establish regular supply relationships with 15 to 20 independent converters that would prefer buying from a non-integrated packaging company. Although historically the Roanoke Rapids mill has been known for its quality linerboard products and service, it currently does not have a significant presence in those markets.

KPB has long, established relationships with four of the top six converters of multiwall sacks. It services the three largest customers in multiwall; these customers have specific strategies that grow business in paper packaging. Additionally, these customers have invested heavily in state-of-the-art printing and converting equipment to allow them to displace less efficient, smaller producers. The PSSMA (Paper Shipping Sack Manufacturers Association) is projecting that multiwall packaging will decline modestly by 0.7% in 2006 versus 2005 (AF&PA is reporting a 1.8% growth in the first 7 months of 2006 as compared with 2005) and 2.5% in 2007 as compared with 2006. Management has assumed a decline in the multiwall packaging market of 2.0% to 2.5% per year through 2010.

KPB intends to grow by supporting the rollwrap market, which KPB believes is 130,000 tons of annual demand. Rollwrap is used to wrap rolls of paper during shipment, storage, and handling as a means to protect the outer plys of the roll of paper as well as the edges from damage during transportation and the elements. The three largest users of rollwrap are Cascades, Wausau Papers, and Covalence. KPB is currently supplying each of these three



converters, and Roanoke Rapids is considered the preferred supplier to two of the three converters due to quality and roll formation.

KPB's future strategy with regards to lightweight linerboard (20# to 37#) is to supplement its grocery bag customers with independent corrugated and laminated products customers. KPB intends to focus on higher end, niche suppliers of corrugated packaging (high graphic printing small boxes). Smaller boxes require a higher performance linerboard sheet, which Roanoke Rapids' linerboard produces.

KPB is among the largest suppliers in North America of unbleached kraft paper. Longview Fibre and Georgia Pacific are the major competitors within the multiwall packaging market. In the grocery bag market, the primary competitors are Delta Natural Kraft and Smurfit-Stone. Within the rollwrap market, Mead-Westvaco and Georgia Pacific are the largest competitors. And finally, within the lightweight linerboard (20# to 37#) market, the following companies produce lightweight linerboard in the South Central region: Georgia Pacific, Mead-Westvaco, Smurfit-Stone, Weyerhaeuser and Temple-Inland. Roanoke Rapids is one of the few non-integrated lightweight linerboard suppliers in the South Central region.

To fully take advantage of the Roanoke Rapids Mill steam and pulping capacity, it is projected that an additional \$5.0 million to \$7.0 million of strategic capital expenditures must be made in the pulping and paper machine areas. These expenditures include approximately \$3.0 to \$5.0 million for machine productivity improvements and \$2.0 million for increased pulping capacity. Management intends to deploy the additional capacity (as well as excess capacity, if any) to the growing lightweight linerboard market described earlier. Management believes that Roanoke Rapids' history of quality and service in the linerboard markets and positioning itself as a supplier to independent converters will enable it to rapidly acquire the necessary customers.

#### ***Ride Rite® Converting***

In the United States, trucking is the predominant mode of transporting freight. Ride Rite® Converting is focused on expanding the market for dunnage products in the trucking industry by developing new innovations, such as the reusable valve, to meet the demands of this market.

The retail regional distribution center market is regarded as a largely untapped source of potential new business. Retailers are continuing to focus on reducing costs associated with goods damaged in transit. Stone believes that the use of dunnage bags could significantly reduce these damage costs with large retailers. Targeted sales and marketing to this particular segment could greatly increase the market size.

Stone believes that Ride Rite® Converting is one of two companies that supply the majority of the U.S. market for inflatable dunnage bags. Strategic acquisitions or partnerships with companies that produce inflatable dunnage bags made with alternative materials, however, may allow Ride Rite® Converting to penetrate new markets for dunnage bags.

#### **Customers**

##### ***Roanoke Rapids***

Roanoke Rapids has over 50 customers, many of which are leading world class converters of kraft paper. Its top ten customers accounted for approximately \$165.0 million in revenues in 2005, representing approximately 88.0% of all revenues generated by Roanoke Rapids. Of this amount, Smurfit-Stone Container Corporation, Exopack, L.L.C. and Hood Packaging Corporation accounted for 28.4%, 13.1% and 12.0% of the revenues in 2005, respectively. Roanoke Rapids has built long-term relationships with its customers averaging in excess of 25 years. KPB's management believes that the risk of losing customers is reduced due to the long-term relationships that have been established.

During 2005, 64.0% of Roanoke Rapids' production capacity was contracted. The contracts are typically two years in length, in which pricing moves with the market and price tiers are determined based on volume. Any risk associated with contracted customer volume is minimal due to exit options for both parties and the absence of



penalty provisions. The loss of, or reduced sales to, these key customers could result in decreased revenues and adversely impact KPB's cash flows.

The following table presents Roanoke Rapids revenues by product category:

Product Category	2005 Revenues
Multiwall	54%
Specialty Converting	22%
Rollwrap	13%
Grocery Bag & Sack	8%
Lightweight Linerboard	3%
<hr/>	
Total	100%

***Ride Rite® Converting***

Ride Rite® Converting's customer base consists of leading distributors of shipping and packing materials, manufacturers, less-than-truckload carriers and retail regional distribution centers. Its top ten customers accounted for an estimated \$23.6 million in revenues in 2005, representing 66.6% of Ride Rite® Converting's revenues. Of this amount, Sunrise Arkansas, Inc. and YRC Worldwide Inc. accounted for 17.7% and 12.2% of revenues in 2005, respectively. IP is one of Ride Rite® Converting's largest customers with purchases originating from various IP paper mills and converting facilities. IP's xpedx distribution business serves as one of Ride Rite® Converting's distributors of dunnage bags. In connection with the acquisition, IP has entered into an agreement to continue purchasing dunnage products from Ride Rite® Converting for a period of five years.

During 2005, approximately 39% of Ride Rite® Converting's capacity was contracted. The following table presents Ride Rite® Converting's revenues by product category:

Product Category	2005 Revenues
2-Ply	67%
4-Ply	11%
6-Ply	17%
8-Ply	4%
Poly	1%
<hr/>	
Total	100%

**Suppliers**

***Roanoke Rapids***

The raw materials needed to process kraft paper and lightweight linerboard consist primarily of roundwood, woodchips, sawdust, chemicals, coal and fuel oil. Stone believes that these raw materials are readily available and that there are a number of large suppliers from whom the materials can be bought in the current market. Roanoke Rapids has a large number of suppliers providing the raw materials that are needed to operate the paper mill. Two of the largest suppliers, aside from wood suppliers, are Coal Resources, which provides coal, and the Amerada Hess Corporation, which supplies No. 6 fuel oil. Roanoke Rapids has long standing relationships with both of these suppliers. Typical contracts for raw materials range from one to three years in length and are tied to a documented moving index for each material. As costs for raw materials, supplies, services and labor go up, paper price increases are implemented to recover these rising material costs, when possible. KPB currently does not use futures contracts or enter into hedging arrangements to manage the risk of fluctuations in coal or fuel prices. Thus, if KPB cannot pass on the rise in energy or other costs to its customers, such rise in costs will have an adverse effect on its profit margins.

The following table summarizes the raw materials required for processing, the number of suppliers of each type of raw material with whom Roanoke Rapids has a relationship and the average length of the relationship.

Raw Materials Purchased	Number of Suppliers	Average Length of Relationship (Years)
Roundwood	49	15
Woodchips	24	23
Sawdust	18	24
Coal	1	4
#6 Fuel Oil	1	20

During 2005, approximately 27% of the Roanoke Rapids mill's wood requirement was supplied from roundwood supplied by IP's Forest Resources Division. Approximately 12% of the wood requirement was supplied from woodchips supplied by IP's Wood Products Division. In addition, 12% of the sawdust used by Roanoke Rapids for fuel was supplied by IP's Wood Products Division. As part of the transaction, KapStone Kraft and IP's Wood Products Division are entering into a long-term supply agreement with market based pricing for woodchips, comprising approximately 13% of the mill's wood requirement. However, as a result of the sale of IP's forestlands to a third party, only approximately 7% of the mill's wood requirement is contracted to be supplied by the future owners of the IP forestlands through a long-term fiber supply agreement for roundwood. The coal requirement for the Roanoke Rapids mill was fulfilled through a contract with Coal Energy Resources. The #6 fuel oil requirement was supplied through a contract with the Amerada Hess Corporation.

For major supplies, KPB will enter into a joint purchasing agreement with IP to enable the continuation of procurement advantages that arise from the economies of scale. Although KPB does not anticipate any significant cost increases resulting from a decrease in volume of purchases with its suppliers, it is estimated that selling, general and administrative expenses on a stand-alone basis will be higher by approximately \$2.7 million per year.

#### ***Ride Rite® Converting***

Ride Rite® Converting has historically purchased most of its raw materials, comprised mainly of flat and extensible kraft paper, boxes and valves from other IP businesses, with Roanoke Rapids being the largest supplier. In connection with the acquisition, KPB is entering into long-term arrangements to ensure steady availability of parts used in construction of the dunnage bags for Ride Rite® Converting.

#### **Sales and Marketing**

The sales and marketing team works directly with KPB's technical, manufacturing and product development teams to offer solutions and meet new customer demands and product requirements. KPB markets and sells its products with the help of a national sales force.

#### **Competition**

##### ***Roanoke Rapids***

KPB is the leading manufacturer of unbleached kraft paper in North America. During 2004, the eight companies that accounted for approximately 80% of North American unbleached kraft paper production based on annual tonnage were: KPB (19%), Longview Fibre Company (12%), Smurfit-Stone Container Corporation (11%), Georgia-Pacific Corporation (10%), Delta Natural Kraft (9%), Tolko Industries Ltd. (7%), Canfor Corporation (6%) and Grupo Durango (6%). A number of other competitors comprise the remainder of North American unbleached kraft paper production.

Stone believes the key parameters on which North American unbleached kraft suppliers compete are supply reliability, delivered price and product quality. KPB has longstanding relationships with many of its customers and historically has entered into contracts with initial terms of at least two years. KPB's management believes that this is based on its reputation for surety of supply, roll-to-roll consistency, product runnability and high tensile strength.

### ***Ride Rite® Converting***

KPB's management believes that the two companies that account for the majority of the North American inflatable dunnage bag market are Ride Rite® Converting and Shippers Paper, a division of Illinois Tool Works. Based on feedback from suppliers and customers, KPB believes that IP's and Shippers Paper's market share is 50% and 40%, respectively.

### **Environmental Regulation**

KPB's 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 KPB's 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.

There are four components of the EPA's Cluster Rule, with which the Roanoke Rapids mill must comply. MACT I-Phase 1 and MACT II are complete and the mill is fully compliant with these standards. KPB uses a software system called the Proficy Environmental System for process monitoring, reporting and recordkeeping.

Boiler MACT compliance (particulate standards) will be achieved with existing emission control equipment, boiler fuel analysis and reporting, regulatory risk-out option for manganese. Compliance will be managed through the Proficy Environmental System. The compliance date is September 13, 2007.

KPB expects to achieve compliance with MACT-1 Phase 2 through the Innovations Project, an EPA and State of North Carolina approved project resulting in superior environmental technology and emission control equivalent to or better than the federal minimum requirement. The Roanoke Rapids mill will complete installation of hoods on the B- and C-Washer lines in early 2007 to incinerate the collected gasses in the power boiler, complete "environmentally beneficial projects" as agreed with community leaders and regulators, and manage compliance through the Proficy Environmental System. The compliance date is April 17, 2007.

The Roanoke Rapids mill is permitted to operate its A-Washer line without hoods (uncontrolled emissions) as needed (up to 30,000 air dried pulp tons/year) to support the mill's production capability.

The Roanoke Rapids mill is currently permitted to produce 480,000 EPT (equivalent paper tons) annually. After the April 17, 2007 compliance deadline, the mill will be permitted to produce 450,000 EPT annually. Upon completion of the Boiler MACT and MACT I-Phase 2 projects, KPB will be fully compliant with the Cluster Rules. The remaining cost of achieving compliance as described above is estimated to be approximately \$1.7 million. KPB is not aware of any future regulatory actions that will require significant capital expenditures.

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. KPB's management believes that its operations are in compliance in all material respects with all environmental regulations and is not aware of any pending regulatory agency compliance actions.

### **Legal Proceedings**

KPB is involved in litigation from time to time in the ordinary course of business. KPB's management currently is not aware of any pending or threatened litigation that would be likely to have a material adverse effect on the operations of Roanoke Rapids and Ride Rite® Converting.

### **Employees**

There are approximately 680 employees at the Roanoke Rapids and Ride Rite® Converting facilities. As of September 30, 2006, there were approximately 390 hourly employees and approximately 100 salaried employees at Roanoke Rapids, and approximately 150 hourly employees and approximately 20 salaried employees at Ride

Rite® Converting. Ride Rite® Converting also employed approximately 20 temporary employees as of September 30, 2006. All employees employed on an hourly basis are unionized and represented by the United Steelworkers Union. Currently, there are collective bargaining agreements in place with Roanoke Rapids through January 31, 2007 and with Ride Rite® Converting through June 30, 2008. There have been no strikes, work stoppages or similar actions since January 1, 2003. KP B's management believes that it has a good relationship with its employees.

Certain corporate and administrative functions with respect to KP B's business are currently handled by employees located at IP's corporate headquarters in Memphis, Tennessee. Stone has no obligation to offer employment to any KP B employees who are unwilling to relocate from Memphis, TN. Further, Stone has no obligation to pay any relocation costs to those employees who do agree to relocate. However, Stone will evaluate each situation on a case-by-case basis and expects to deal with any such relocation in the ordinary course of business. The estimated cost of such relocations, if any, is expected to be less than \$100,000. After the closing of the transaction, Stone intends to transfer these corporate and administrative functions to the Roanoke Rapids and Ride Rite® Converting facilities, or to Stone's corporate headquarters located in Northfield, Illinois.

Stone will seek to retain key management personnel by offering competitive compensation packages consisting of one or more of the following: salary, customary benefits, performance bonuses and appropriate equity incentives. To date, Stone has met with non-union KP B personnel and committed in the purchase agreement to provide them with certain specified benefits for at least twelve months after closing, if they remain with KapStone Kraft following the acquisition; however, Stone has not entered into any agreements with key management and does not expect to do so prior to the closing. The benefits, which include a 401(k) savings plan, health and welfare benefits and short and long-term incentive plans for non-union qualified employees are not anticipated to impose additional costs relative to prior periods.

## **Facilities**

### ***Roanoke Rapids***

The Roanoke Rapids facility is located on over 1,600 acres of land along the Roanoke River in Roanoke Rapids, North Carolina. The facility is an integrated pulp and paper mill, consisting of two papermaking machines, a single-line woodyard, a batch digester operation, three brown stock washer lines, one recovery boiler, one power boiler and a turbine generator. The facility is a 24-hour per day operation and typically operates 365 days per year, except for scheduled annual maintenance. The facility has approximately 670 acres dedicated to landfill. KP B'S management believes that the facility is in good operating condition and is suited for the purposes for which it is presently being used and provides significant ability for potential plant and landfill expansion.

### ***Ride Rite® Converting***

Ride Rite® Converting is located in Fordyce, Arkansas, approximately 70 miles south of Little Rock. The facility consists of two buildings that house the main offices, production lines and warehousing space of over 154,000 square feet. Ride Rite® Converting is located on over 20 acres of land that is leased from the town of Fordyce. The current lease term ends in 2017, with options to renew for up to nine years. The facility includes two converting production lines that operate 24 hours a day, five days a week to process kraft paper, lightweight linerboard, extensible paper and poly bags into Ride Rite® Converting inflatable dunnage bags. KP B believes that the facilities are in good operating condition and are suited for the purposes for which they are presently being used.

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

*You should read the following discussion of the financial condition and results of operations of KPB in conjunction with KPB's historical combined financial statements and related notes contained elsewhere herein. Among other things, those historical combined financial statements include more detailed information regarding the basis of presentation for the following information. The following discussion describes KPB as it was operated as a division of IP and therefore may not necessarily be indicative of the conditions that would have existed, or the results of operations that would have resulted, had KPB been operated as an unaffiliated company.*

The following discussion reflects the restatements discussed in Note 9 to the unaudited condensed combined financial statements as of September 30, 2006 and for the three and nine months ended September 30, 2006 and 2005 and Note 15 to the combined financial statements as of and for the three years ended December 31, 2005.

**Business Overview**

***General***

KPB is a division of IP. KPB operates through two business segments: Roanoke Rapids, a production facility consisting of an integrated pulp and paper mill located in Roanoke Rapids, North Carolina, which produces kraft paper and lightweight linerboard; and Ride Rite® Converting, located in Fordyce, Arkansas, which produces Ride Rite® inflatable dunnage bags.

***Business of Roanoke Rapids***

Historically, Roanoke Rapids has produced a mix of both kraft paper and linerboard. Roanoke Rapids currently has annual production capacity of over 400,000 tons of unbleached kraft paper and lightweight linerboard. Roanoke Rapids offers a portfolio of paper grades, which are sold to customers who convert the paper into a wide range of products. These products include multiwall bags for agricultural products, pet food, cement and chemicals, grocery bags, and specialty conversion products such as wrapping paper products and rollwrap. The linerboard grades are primarily produced for manufacturing corrugated containers for packaging products.

During 2003 and 2004, Roanoke Rapids implemented a kraft paper conversion project. The intent of this conversion project was to increase facility production of kraft paper and, at the same time reduce overall facility production capacity in order to conform to newly implemented environmental regulations. The shift in product mix to primarily kraft paper reduced the pulp production demand of the mill and permitted the shutdown of a recovery boiler and avoided the capital expense of Cluster Rule compliance for this boiler. With the shutdown of this recovery boiler, a second recovery boiler was upgraded to support production capacity of approximately 440,000 annual tons. KPB believes that this conversion project allowed Roanoke Rapids to devote additional resources toward product development in the kraft paper industry and concentrate on facility efficiency.

***Business of Ride Rite® Converting***

Dunnage bags are constructed of an internal poly liner encased by multiple layers of high strength kraft paper or linerboard and are used to secure freight to minimize movement and potential damage of goods and products during transport. Ride Rite® Converting relies on Roanoke Rapids for approximately two-thirds of its supply of kraft paper. 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. In 2005, the Ride Rite® Converting segment sold approximately 9.2 million dunnage bags. Ride Rite® Converting products are sold to manufacturers and less-than-trailer-load distributors, as well as retail regional distribution centers.

## Results of Operations

KPB's management uses a variety of financial measurements to analyze KPB's performance. These measurements include (1) Operating Income, (2) Productivity (3) Selling, General & Administrative ("SG&A") expenses and (4) Average revenue per ton (for Roanoke Rapids) and average revenue per dunnage bag (for Ride Rite® Converting).

*Operating Income.* Operating income is used by KPB's management primarily as a measure of the segments' operating performance. KPB's management defines operating income as KPB's sales minus costs associated with these sales. Sales include sales of unbleached kraft paper products, linerboard and dunnage bags net of term allowances and discounts. For purposes of calculating operating profit, costs include the cost of raw materials, labor, maintenance, depreciation and amortization, distribution expenses, selling, general and administrative expenses, and taxes other than income tax.

*Productivity.* Productivity for Roanoke Rapids is measured by the average daily plant production in tons. Productivity for Ride Rite® Converting is measured by total bags produced in a given period.

*Selling, General and Administrative Expenses.* KPB's SG&A expenses include marketing costs, mill-level overhead, corporate overhead, employee salaries and benefits, pension and 401(k) plan expenses, professional fees and information technology expenses. Expenses related to corporate management, legal, accounting and tax, treasury, payroll and benefits administration, risk management, information technology and centralized transaction processing are allocated to KPB. These costs are allocated based on various allocation methods, which management believes are reasonable. These methods include direct consumption, percent of capital employed, and number of employees. The allocation method is consistent from year to year; however, as the factors change, the allocation amounts increase or decrease.

*Average Revenue Per Ton/Dunnage Bag.* Average revenue per ton/bag represents the revenue divided by the tons of unbleached kraft paper and linerboard sold or the units of dunnage bags sold, as applicable.

## Nine Months Ended September 30, 2006 Compared with Nine Months Ended September 30, 2005

*Summary.* Financial performance for KPB showed improvement for the first nine months of 2006 driven by improved market conditions that were the result of improved linerboard demand and balanced capacity for kraft paper products. During this period, kraft producers (including KPB) with the ability to produce more than one product type from one machine (e.g., kraft papers and linerboard) began shifting more production to linerboard. This production shift, coupled with an exit by a major kraft paper supplier in 2004 (due to conversion of a portion of its capacity for linerboard and the subsequent sale of the business that consumed its multiwall kraft paper), reduced the kraft paper production capacity in the marketplace. KPB saw revenue improvement as a result of previously implemented price increases facilitated by these market conditions. Kraft paper sales volumes remained flat while linerboard sales improved, resulting in an overall increase in tons sold. KPB believes that the majority of kraft paper producers increased their prices during the first half of 2006 in the face of stronger demand. The price increases did not result in a shift in mix or a decline in tonnage. KPB also believes that its customers were able to pass on these price increases to their customer base. Dunnage bag sales continued to find new markets, particularly for two-ply bags, resulting in increased sales year-over-year. Coal and caustic soda prices remained elevated as other input costs began to stabilize. Distribution expenses increased due to increased sales volume and freight rates.

The continued demand for linerboard is expected to normalize during the fourth quarter of 2006. Accordingly, KPB believes that pricing for its products will remain flat. However, manufacturing fuel costs have begun to stabilize and are expected to be less volatile than they have been in the recent past. Distribution expenses are expected to rise slightly in accordance with inflation based on stable fuel costs. KPB believes that it will continue to operate at favorable production levels, which it defines as operating at or over budgeted production for a given period.

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**Unit Sales.** The following table presents tons sold or units sold, as applicable, by reportable segment for the nine months ended September 30, 2006 and 2005:

Segment	Nine Months Ended September 30		Increase (Decrease)	
	2005	2006	Tons/Units	%
<b>Roanoke Rapids</b>				
Tons of unbleached kraft paper <sup>(1)</sup>	274,405	272,624	(1,781)	(0.6)%
Tons of linerboard	95	30,730	30,635	nm
Ride Rite® Converting inflatable dunnage bags	6,778,513	7,225,710	447,197	6.6%

(1) Excludes sales of 5,322 tons and 5,406 tons of unbleached kraft paper from Roanoke Rapids to Ride Rite® Converting during the nine months ended September 30, 2005 and 2006, respectively.

Sales of linerboard increased by 30,635 tons for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005. The linerboard market showed improved demand during the fourth quarter of 2005 and continued through the third quarter of 2006. Roanoke Rapids utilized its strong kraft paper inventory position at the beginning of 2006 to supply kraft paper customers. This increased available machine time permitted KPB to manufacture linerboard to meet the demand from IP's containerboard system. Sales of Ride Rite® Converting inflatable dunnage bags increased by 447,197 units for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005 due to the continued growth in the dunnage bag market. The growth has been primarily in the two-ply dunnage bag, supplying the less-than-trailer-load market.

**Net Sales.** The following table presents net sales by reportable segment for the nine months ended September 30, 2006 and 2005:

	Nine Months Ended September 30		Increase (Decrease)	
	2005	2006	Dollars	%
(in millions except per ton and per bag data and %)				
Roanoke Rapids <sup>(1)</sup>	\$ 136.1	\$ 161.6	\$ 25.5	18.7%
Ride Rite® Converting	26.2	27.5	1.3	5.0%
<b>Total net sales</b>	<b>\$ 162.3</b>	<b>\$ 189.2</b>	<b>\$ 26.8</b>	<b>16.5%</b>
Average revenue per ton	\$ 495.81	\$ 532.71	\$ 36.90	7.4%
Average revenue per dunnage bag <sup>(2)</sup>	\$ 3.87	\$ 3.81	\$ (0.06)	(1.5)%

(1) Excludes intercompany sales to Ride Rite® Converting.

(2) Average revenue data is computed based on non-rounded information.

KPB's total net sales increased by \$26.8 million, or 16.5%, to \$189.2 million for the nine months ended September 30, 2006 compared with \$162.3 million for the nine months ended September 30, 2005. Improved sales volumes from both facilities and price improvements for Roanoke Rapids products were the major factors in the improved net sales.

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Roanoke Rapids net sales increased by \$25.5 million, or 18.7%, to \$161.6 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005. Average revenue at Roanoke Rapids increased by \$36.90 per ton, or 7.4%, due to realization of a \$30 per ton price increase implemented in the fourth quarter of 2005, a \$25 per ton price increase implemented in the first quarter of 2006, and a third price increase implemented in the second quarter of 2006. Net revenue per ton, although increasing by 7.4%, was diluted by the increase in linerboard sales, a lower priced per-ton product.

Ride Rite® Converting net sales increased by \$1.3 million, or 5.0%, to \$27.5 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005 mainly due to increased sales of two-ply bags. Two-ply revenue per bag is lower than four to eight-ply revenue per bag. Net revenue per bag declined modestly due to a shift to a higher mix of two-ply bags.

Roanoke Rapids productivity improved by 8.7% and Ride Rite® Converting improved 25.3% for the nine months ended September 30, 2006 compared with the first nine months of 2005.



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**Costs and Expenses.** The following table presents costs and expenses by reportable segment for the nine months ended September 30, 2006 and 2005:

Segment	Nine Months Ended September 30,		Increase (Decrease)	
	2005	2006	Dollars	%
(in millions except %)				
<b>Roanoke Rapids</b>				
Cost of sales (exclusive of depreciation and amortization)	\$ 87.3	\$ 96.6	\$ 9.3	10.7%
Distribution expenses	13.8	15.8	2.0	14.5%
Depreciation and amortization	16.2	13.4	(2.9)	(17.9)%
Selling, general, and administrative expenses	14.4	13.9	(0.4)	(2.8)%
Taxes other than income	1.7	1.8	0.1	5.9%
<b>Ride Rite® Converting</b>				
Cost of sales (exclusive of depreciation and amortization)	\$ 17.6	\$ 18.6	\$ 1.0	5.7%
Distribution expenses	1.1	1.2	0.1	9.1%
Depreciation and amortization	0.2	0.2	0.0	0.0%
Selling, general, and administrative expenses	2.5	2.6	0.1	4.0%
Taxes other than income				0.0%
<b>Kraft Paper Business</b>				
Cost of sales (exclusive of depreciation and amortization)	\$ 104.9	\$ 115.3	\$ 10.4	9.9%
Distribution expenses	14.9	16.9	2.0	13.3%
Depreciation and amortization	16.5	13.6	(2.9)	(17.6)%
Selling, general, and administrative expenses	16.8	16.5	(0.3)	(1.8)%
Taxes other than income	1.7	1.8	0.1	5.8%

*Cost of Sales.* Total cost of sales increased by \$10.4 million, or 9.9%, to \$115.3 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005. Although both facilities realized improved year-over-year productivity gains, cost of sales increased due to increased sales and continued rising coal and caustic soda pricing.

Cost of sales for Roanoke Rapids increased by \$9.3 million, or 10.7%, to \$96.6 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005. Higher volumes of materials consumed, higher raw material pricing, increased wages due to normal merit increases and inflationary increases in benefit costs were all factors in the increase. These overall increases were partially offset by an increase in the production of linerboard, which is less expensive to manufacture than kraft paper, and productivity improvements.

Cost of sales for Ride Rite® Converting increased by \$1.0 million, or 5.7%, to \$18.6 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005, primarily due to increased unit sales. This overall increase was net of the cost savings that were the result of producing a greater percentage of two-ply bags, which are less expensive to manufacture than higher ply bags.

*Distribution Expenses.* Distribution expenses for Roanoke Rapids increased by \$2.0 million, or 14.5%, to \$15.8 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005, due to increased sales volumes, increased truck shipments, which are more expensive than rail shipments, and increased freight rates. Distribution expenses for Ride Rite® Converting increased \$0.1 million as a result of higher unit sales.

*Depreciation and Amortization.* Total depreciation and amortization decreased by \$2.9 million, or 17.6%, to \$13.6 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005. Depreciation and amortization for Roanoke Rapids decreased by \$2.9 million, or 17.7%, to \$13.4 million as a result of accelerating the depreciation expense for a recovery boiler idled in April 2005.

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*Selling, General and Administrative Expenses.* Total SG&A expenses decreased by \$0.3 million, or 1.8%, to \$16.5 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005. SG&A expenses for Roanoke Rapids decreased by \$0.4 million, or 2.8%, to \$13.9 million for the nine months ended September 30, 2006 compared with the nine months ended September 30, 2005. The decrease at Roanoke was the result of the favorable resolution of a previously disputed expense resulting in a \$0.2 million benefit in 2006. Inflationary cost increases and increased corporate allocations were offset by cost reduction initiatives. SG&A expenses for Ride Rite® Converting increased \$0.1 million, or 4.0% due to increased facility administration expenses.

*Taxes Other Than Income Tax.* Taxes other than income tax for Roanoke Rapids increased \$0.1 million, while taxes remained unchanged for Ride Rite® Converting. Taxes other than income tax include personal and real estate property taxes, sales and use taxes, and business license fees. Overall assessed valuations remained relatively unchanged year-over-year, resulting in a little change in the expense.

*Operating Income.* The following table presents operating income by reportable segment for the nine months ended September 30, 2006 and 2005:

Segment	Nine Months Ended September 30,		Increase (Decrease)	
	2005	2006	Dollars	%
Roanoke Rapids	\$ 2.7	\$ 20.2	\$ 17.5	644.4%
Ride Rite® Converting	\$ 4.8	\$ 5.0	\$ 0.2	4.2%
<b>Total operating income</b>	<b>\$ 7.5</b>	<b>\$ 25.1</b>	<b>\$ 17.6</b>	<b>234.6%</b>

Total operating income was \$25.1 million for the nine months ended September 30, 2006, compared with \$7.5 million for the nine months ended September 30, 2005, an increase of \$17.6 million. A non-recurring accelerated depreciation recorded in 2005 accounted for \$3.0 million of the improved earnings performance.

Operating income for Roanoke Rapids increased by \$17.5 million due primarily to \$25.5 million of increased sales and \$3.0 million of lower depreciation expense, partially offset by \$9.3 million of increases in cost of sales and \$2.0 million of increased distribution expenses. Operating income for Ride Rite® Converting increased by \$0.2 million primarily due to increased sales, partially offset by increases in cost of sales.

### Year Ended December 31, 2005 Compared with Year Ended December 31, 2004

*Summary.* During the year ended December 31, 2005, Roanoke Rapids facility began realizing the benefits of the kraft conversion project completed during the year ended December 31, 2004. The facility outperformed the previous year by generating incremental sales volume of over 37,000 tons of unbleached kraft paper. Throughout 2005, KPB's management focused on product mix to improve profitability. The business also benefited from the full effect of two price increases in 2004 and an additional third quarter cost recovery price increase based on escalating costs and inflation. "Cost recovery" in the context of a price increase in the paper industry is not a customary part of most contracts, including those for Roanoke Rapids. The industry, however, has had some recent success in justifying a price increase based on increases in the costs of major components (pulp, energy, etc.) that are in excess of the general rate of inflation. The cost recovery increase resulted in an estimated annual revenue increase of \$12.0 million; however, due to the timing of the price increase, only \$1.0 million of incremental revenue was received for the year ended December 31, 2005. Net sales increased due to higher average revenue per ton as well as higher sales volume due to an increase in operating days compared with the same period in 2004. The kraft paper conversion project required major operating equipment, including the paper machines, to be out of service in order to perform the necessary capital improvements, resulting in an approximate loss of 30 operating days. There was no capital expenditures related to downtime in 2005. Net sales for Ride Rite® Converting improved on higher sales volumes for the year ended December 31, 2005.

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During the year ended December 31, 2005, KPB faced rising energy and chemical costs as well as other paper manufacturers. At the same time, KPB offset the increases through productivity improvements and cost reduction projects.

**Unit Sales.** The following table presents tons sold or units sold, as applicable, by reportable segment for the years ended December 31, 2005 and 2004:

Segment	Year Ended December 31,		Increase (Decrease)	
	2004	2005	Tons/Units	%
<b>Roanoke Rapids</b>				
Tons of unbleached kraft paper <sup>(1)</sup>	331,230	368,621	37,391	11.3%
Tons of linerboard	22,126	15,108	(7,018)	(31.7)%
Ride Rite® Converting inflatable dunnage bags	7,776,000	9,197,000	1,421,000	18.3%

(1) Excludes sales of 7,108 tons and 8,039 of unbleached kraft paper from Roanoke Rapids to Ride Rite® Converting during the year ended December 31, 2004 and 2005, respectively.

Sales of unbleached kraft paper increased by 37,391 tons for the year ended December 31, 2005 compared with the year ended December 31, 2004 due to productivity improvements and increased operating days. Sales of linerboard decreased by 7,018 tons due to the planned conversion to the kraft paper platform and an overall economic slowdown in 2005 compared to 2004. The reduction in linerboard production at Roanoke Rapids during this time period represented the final transition of 42# linerboard production to other linerboard machines within IP. Sales of Ride Rite® Converting inflatable dunnage bags increased by 1,421,000 units for the year ended December 31, 2005 compared with the year ended December 31, 2004 due to continued growth in the dunnage bag market driven by higher demand in the less-than-trailer-load market.

**Net Sales.** The following table presents net sales by reportable segment for the years ended December 31, 2005 and 2004:

Segment	Year Ended December 31,		Increase (Decrease)	
	2004	2005	Dollars	%
(in millions except per ton and per bag data and %)				
Roanoke Rapids <sup>(1)</sup>	\$ 157.3	\$ 186.6	\$ 29.2	18.6%
Ride Rite® Converting	30.9	35.4	4.5	14.6%
<b>Total net sales</b>	<b>\$ 188.3</b>	<b>\$ 222.0</b>	<b>\$ 33.7</b>	<b>17.9%</b>
Average revenue per ton	\$ 445.16	\$ 486.26	\$ 41.10	9.2%
Average revenue per dunnage bag <sup>(2)</sup>	\$ 3.98	\$ 3.85	\$ (0.13)	(3.3)%

(1) Excludes intercompany sales to Ride Rite® Converting.

(2) Average revenue data is computed using non-rounded information.

KPB's total net sales for the year ended December 31, 2005 increased by \$33.7 million, or 17.9%, to \$222.0 million compared to the year ended December 31, 2004. Roanoke Rapids' net sales increased by \$29.2 million, or 18.6%, to \$186.2 million for the year ended December 31, 2005 compared with the year ended December 31, 2004 due to increased sales volume as well as increased average revenue per ton. Average revenue per ton increased due to full realization of 2004 price increases and partial realization of a third quarter increase in 2005. Ride Rite® Converting net sales increased by \$4.5 million, or 14.6%, to \$35.4 million for the year ended December 31, 2005 compared with the year ended December 31, 2004 primarily due to continued growth in the dunnage bag market. Net revenue per bag was diluted by a higher mix of two-ply

bag sales, a lower priced product.

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**Costs and Expenses.** The following table presents costs and expenses by reportable segment for the years ended December 31, 2005 and 2004:

Segment	Year Ended December 31,		Increase (Decrease)	
	2004	2005	Dollars	%
(in millions except %)				
<b>Roanoke Rapids</b>				
Cost of sales (exclusive of depreciation and amortization)	\$ 116.4	\$ 124.7	\$ 8.3	7.2%
Distribution expenses	16.1	18.4	2.4	15.3%
Depreciation and amortization	16.1	21.0	4.9	30.4%
Selling, general, and administrative expenses	17.1	17.3	0.2	1.2%
Taxes other than income tax	2.1	2.3	0.2	9.5%
<b>Ride Rite® Converting</b>				
Cost of sales (exclusive of depreciation and amortization)	\$ 20.5	\$ 23.7	\$ 3.2	15.6%
Distribution expenses	1.4	1.5	0.1	10.4%
Depreciation and amortization	0.3	0.3	0.0	0.0%
Selling, general, and administrative expenses	3.0	3.2	0.2	5.3%
Taxes other than income tax	0.1	0.1	0.0	0.0%
<b>Kraft Papers Business</b>				
Cost of sales (exclusive of depreciation and amortization)	\$ 136.9	\$ 148.4	\$ 11.5	8.4%
Distribution expenses	17.4	20.0	2.6	14.9%
Depreciation and amortization	16.4	21.3	4.9	29.9%
Selling, general, and administrative expenses	20.1	20.4	0.3	1.5%
Taxes other than income tax	2.2	2.4	0.2	9.1%

*Cost of sales.* Total cost of sales increased by \$11.5 million, or 8.4%, to \$148.4 million for the year ended December 31, 2005 compared with the year ended December 31, 2004 as a result of increased sales volume. Cost of sales for Roanoke Rapids increased by \$8.3 million, or 7.2%, to \$124.7 million for the year ended December 31, 2005 compared with the year ended December 31, 2004 due to a 19.2% increase in sales volume and prices for raw materials, particularly for caustic soda and coal. The price of caustic soda, a main component of the pulping process, increased by 195.0%, or \$3.0 million. The price for coal increased by \$1.9 million, or 37.0%. Roanoke Rapids partially offset the cost increases by successfully implementing capital and non-capital initiatives to increase mill productivity as measured by overall equipment efficiency. These initiatives have resulted in a 6% improvement in overall equipment efficiency by reducing bottle necks on or in the paper machine area and through speed improvements on the paper machines, reducing off-spec product, and reducing planned/unplanned machine downtime. Initiatives were prioritized based on profit potential and ease of implementation. 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. Several productivity improvement projects were completed that increased machine speed and availability. Cost reduction projects resulted in better fiber utilization and reduced energy consumption and maintenance.

Cost of sales for Ride Rite® Converting increased by \$3.2 million, or 15.6%, to \$23.7 million for the year ended December 31, 2005 compared with the year ended December 31, 2004 due to higher sales volume and higher raw material costs, particularly film and paper costs.

*Distribution Expenses.* Total distribution expenses increased by \$2.6 million, or 14.9%, to \$20.0 million for the year ended December 31, 2005 as compared with the year ended December 31, 2004. Distribution expenses for Roanoke Rapids increased by \$2.4 million, or 15.3%, to \$18.4 million for the year ended December 31, 2005 as compared with the year ended December 31, 2004 due to increased sales and higher transportation costs, partially due to higher fuel costs. Distribution expenses for Ride Rite® Converting increased by \$0.1 million, or 10.4%, to

\$1.5 million for the year ended December 31, 2005 as compared with the year ended December 31, 2004 due to increased sales volume and higher fuel costs.

*Depreciation and Amortization.* Total depreciation and amortization increased by \$4.9 million, or 29.9%, to \$21.3 million for the year ended December 31, 2005 compared with the year ended December 31, 2004. Depreciation and amortization for Roanoke Rapids increased by \$4.9 million, or 30.4%, to \$21.0 million for the year ended December 31, 2005 compared with the year ended December 31, 2004 due to the accelerated depreciation for a recovery boiler idled in April 2005, which accounted for approximately \$3.0 million of the increase in depreciation. Also, depreciation for Roanoke Rapids increased for the year ended December 31, 2005 as a result of an increase in depreciable assets from capital expenditures of \$18 million incurred in the year ended December 31, 2004 under the kraft paper conversion project. Depreciation and amortization for Ride Rite® Converting remained flat.

*Selling, General and Administrative Expenses.* Total SG&A expenses increased by \$0.3 million, or 1.5%, to \$20.4 million for the year ended December 31, 2005 compared with the year ended December 31, 2004. SG&A expenses for Roanoke Rapids increased slightly to \$17.3 million for the year ended December 31, 2005. SG&A expenses for Ride Rite® Converting increased \$0.2 million, or 5.3%, to \$3.2 million for the year ended December 31, 2005, primarily due to an increase in sales volume.

*Taxes Other Than Income Tax.* Taxes other than income tax include personal and real estate property taxes, sales and use taxes, and business license fees. Taxes other than income tax for Roanoke Rapids increased by \$0.2 million, or 9.5%, to \$2.3 million for the year ended December 31, 2005 as a result of the sales and use taxes related to the acquisition of conversion project assets. Taxes other than income tax for Ride Rite® Converting remained flat at \$0.1 million.

*Operating Income.* The following table presents operating income (loss) by reportable segment for the years ended December 31, 2005 and 2004:

Segment	Year Ended December 31,		Increase (Decrease)	
	2004	2005	Dollars	%
(in millions except %)				
Roanoke Rapids	\$ (10.5)	\$ 2.9	\$ 13.4	127.6%
Ride Rite® Converting	5.8	6.6	0.8	13.8%
<b>Total operating income (loss)</b>	<b>\$ (4.7)</b>	<b>\$ 9.5</b>	<b>\$ 14.2</b>	<b>302.1%</b>

Total operating income was \$9.5 million for the year ended December 31, 2005, compared with an operating loss of \$4.7 million for the year ended December 31, 2004. Operating income for Roanoke Rapids increased by \$13.2 million primarily due to an increase in average revenue per ton and sales volume, offset in part by higher raw material costs. Operating income for Ride Rite® Converting increased by \$1.0 million primarily due to increased sales volume.

*Year Ended December 31, 2004 Compared with Year Ended December 31, 2003*

*Summary.* The decrease in net sales were driven by the kraft paper conversion project, which reduced production of paper at the Roanoke Rapids facility by 30 days. The loss in operating days was due to equipment downtime of the paper machines necessary to perform the work for the conversion. The intent of this conversion project was to increase facility production of kraft paper and reduce overall facility production capacity in order to conform to newly implemented environmental regulations. This shift in product mix to more kraft paper reduced the pulp production demand of the mill and allowed the mill to shut down the #6 recovery boiler and avoided the capital expense of Cluster Rule issued by the EPA compliance for this boiler. With the shutdown of the #6 recovery boiler, the #7 recovery boiler was upgraded to support up to approximately 440,000 annual tons. The resulting production mix, machine downtime during the conversion period and initial poor operating efficiency following the conversion

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project resulted in a reduced sales volumes of 127,000 tons for the year ended December 31, 2004, of which approximately 60,000 tons represented the planned production capacity reduction.

During the first quarter of 2004, KPB experienced the bottom of the industry cycle. Starting the second quarter of 2004, overall pricing and market demand improved. During the year ended December 31, 2004, KPB's management pursued new customers and grade mix improvement opportunities to enhance profitability. As a result, KPB entered into a long-term agreement with the largest multiwall converter in North America and by the end of 2004 was on 100,000 tons per year run rate with this customer. Improved market conditions allowed KPB's management to implement two price increases. As a result, by the year end 50# multiwall price (bellwether grade) averaged \$25 per ton above 2003 prices. Net sales for Ride Rite® Converting improved due to higher sales volume.

**Unit Sales.** The following table presents tons sold or units sold, as applicable, by reportable segment for the years ended December 31, 2004 and 2003:

Segment	Year Ended December 31,		Increase (Decrease)	
	2003	2004	Tons/Units	%
<b>Roanoke Rapids</b>				
Tons of unbleached kraft paper <sup>(1)</sup>	265,759	331,230	65,471	24.6%
Tons of linerboard	214,353	22,126	(192,227)	(89.7)%
Ride Rite® Converting inflatable dunnage bags	7,155,000	7,776,000	621,000	8.7%

(1)

Excludes sales of 7,015 tons and 7,108 tons of unbleached kraft paper from Roanoke Rapids to Ride Rite® Converting during the year ended December 31, 2003 and 2004, respectively.

Sales of unbleached kraft paper increased by 65,471 tons for the year ended December 31, 2004 compared with the year ended December 31, 2003 due to increased production of kraft paper and entering into a new long-term contract under which KPB would sell 100,000 tons of kraft paper annually. Sales of linerboard decreased by 192,227 tons for the year ended December 31, 2004 compared with the year ended December 31, 2003 due to planned reduction of linerboard at the Roanoke Rapids facility as a part of the kraft paper conversion project. Sales of Ride Rite® Converting inflatable dunnage bags increased by 621,000 units for the year ended December 31, 2004 compared with the year ended December 31, 2003 due to continued growth in the dunnage bag market.

**Net Sales.** The following table presents net sales by reportable segment for the years ended December 31, 2004 and 2003:

Segment	Year Ended December 31,		Increase (Decrease)	
	2003	2004	Dollars	%
(in millions except per ton and per bag data and %)				
Roanoke Rapids <sup>(1)</sup>	\$ 202.2	\$ 157.3	\$ (44.9)	(22.2)%
Ride Rite® Converting	29.0	30.9	1.9	6.7%
<b>Total net sales</b>	<b>\$ 231.2</b>	<b>\$ 188.3</b>	<b>\$ (42.9)</b>	<b>(18.6)%</b>
Average revenue per ton	\$ 421.15	\$ 445.16	\$ 24.01	5.7%
Average revenue per dunnage bag <sup>(2)</sup>	\$ 4.05	\$ 3.98	\$ (0.07)	(1.7)%

(1)

Excludes intercompany sales to Ride Rite® Converting.

(2)

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Average revenue data is computed based on non-rounded information.

KPB's total net sales for the year ended December 31, 2004 decreased by \$42.9 million, or 18.6%, to \$188.3 million compared with the year ended December 31, 2003. Roanoke Rapids net sales decreased by \$44.9 million, or 22.2%, to \$157.3 million for the year ended December 31, 2004 as compared with the year ended December 31,



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2003 due to the kraft paper conversion project and reduced annual production capacity, partially offset by increased average revenue per ton. Ride Rite® Converting net sales increased by \$1.9 million, or 6.7%, to \$30.9 million for the year ended December 31, 2004 as compared with the year ended December 31, 2003 primarily due to continued growth in the dunnage bag market.

**Costs and Expenses.** The following table presents costs and expenses by reportable segment for the years ended December 31, 2004 and 2003:

<b>Segment</b>	<b>Year Ended December 31,</b>	<b>Increase (Decrease)</b>
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