

KAPSTONE PAPER & PACKAGING CORP

Form 10-Q

July 30, 2014

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2014

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

For the transition period from _____ to _____

Commission File Number: 001-33494

KapStone Paper and Packaging Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware

20-2699372

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(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

KapStone Paper and Packaging Corporation

1101 Skokie Blvd., Suite 300

Northbrook, IL 60062

(Address of Principal Executive Offices including zip code)

Registrant's Telephone Number, including area code **(847) 239-8800**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

There were 95,924,136 shares of the Registrant's Common Stock, \$0.0001 par value, outstanding at July 25, 2014.

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KAPSTONE PAPER AND PACKAGING CORPORATION

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Table of Contents**PART 1. FINANCIAL INFORMATION****ITEM 1. - FINANCIAL STATEMENTS****KAPSTONE PAPER AND PACKAGING CORPORATION****Consolidated Balance Sheets****(In thousands, except share and per share amounts)**

| | June 30, 2014 (unaudited) | December 31, 2013 |
|---|--|------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 49,352 | \$ 12,967 |
| Trade accounts receivable, less allowance of \$285 in 2014 and \$682 in 2013 | 263,240 | 232,347 |
| Other receivables | 8,829 | 11,399 |
| Inventories | 225,020 | 217,382 |
| Prepaid expenses and other current assets | 9,404 | 6,405 |
| Total current assets | 555,845 | 480,500 |
| Plant, property and equipment, net | 1,395,987 | 1,389,609 |
| Other assets | 132,904 | 129,493 |
| Intangible assets, net | 116,911 | 123,745 |
| Goodwill | 533,851 | 528,515 |
| Total assets | \$ 2,735,498 | \$ 2,651,862 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 25,075 | \$ 4,950 |
| Other current borrowings | 2,898 | |
| Accounts payable | 161,173 | 159,127 |
| Accrued expenses | 49,436 | 45,885 |
| Accrued compensation costs | 46,896 | 54,871 |
| Accrued income taxes | 3,103 | |
| Deferred income taxes | 1,096 | 5,445 |
| Total current liabilities | 289,677 | 270,278 |
| Long-term debt, net of current portion | 1,172,073 | 1,192,413 |
| Pension and postretirement benefits | 66,168 | 69,611 |
| Deferred income taxes | 443,576 | 444,672 |
| Other liabilities | 8,513 | 8,808 |
| Total other liabilities | 1,690,330 | 1,715,504 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock \$0.0001 par value; 1,000,000 shares authorized; no shares issued and outstanding | | |
| Common stock \$0.0001 par value; 175,000,000 shares authorized; 95,924,136 shares issued and outstanding (excluding 40,000 treasury shares) at June 30, 2014 and 95,706,212 shares issued and outstanding (excluding 40,000 treasury shares) at December 31, 2013 | 10 | 10 |
| Additional paid-in-capital | 251,980 | 246,186 |
| Retained earnings | 495,907 | 412,349 |
| Accumulated other comprehensive income | 7,594 | 7,535 |
| Total stockholders equity | 755,491 | 666,080 |

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| | | | | |
|--|----|-----------|----|-----------|
| Total liabilities and stockholders' equity | \$ | 2,735,498 | \$ | 2,651,862 |
|--|----|-----------|----|-----------|

See notes to consolidated financial statements.

Table of Contents**KAPSTONE PAPER AND PACKAGING CORPORATION****Consolidated Statements of Comprehensive Income****(In thousands, except share and per share amounts)****(unaudited)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|------------------------------------|-------------|----------------------------------|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net sales | \$ 590,449 | \$ 326,321 | \$ 1,139,401 | \$ 646,134 |
| Cost of sales, excluding depreciation and amortization | 392,245 | 225,753 | 775,493 | 450,699 |
| Depreciation and amortization | 33,874 | 17,253 | 66,583 | 34,477 |
| Freight and distribution expenses | 44,924 | 27,849 | 85,656 | 55,769 |
| Selling, general, and administrative expenses | 34,093 | 21,072 | 68,238 | 40,200 |
| Other operating income | | 196 | | 398 |
| Operating income | 85,313 | 34,590 | 143,431 | 65,387 |
| Foreign exchange gain / (loss) | 125 | 89 | 101 | (222) |
| Interest expense, net | 7,971 | 2,636 | 17,200 | 5,237 |
| Income before provision for income taxes | 77,467 | 32,043 | 126,332 | 59,928 |
| Provision for income taxes | 26,008 | 11,052 | 42,774 | 20,478 |
| Net income | \$ 51,459 | \$ 20,991 | \$ 83,558 | \$ 39,450 |
| Other comprehensive income, net of tax | | | | |
| Pension and postretirement plan reclassification adjustments: | | | | |
| Amortization (accretion) of prior service costs | 30 | (10) | 62 | (21) |
| Amortization of net (gain) / loss | (1) | 48 | (3) | 96 |
| Other comprehensive income, net of tax | 29 | 38 | 59 | 75 |
| Total comprehensive income, net of tax | \$ 51,488 | \$ 21,029 | \$ 83,617 | \$ 39,525 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 95,892,033 | 95,140,852 | 95,806,181 | 95,072,436 |
| Diluted | 97,418,941 | 96,475,670 | 97,367,354 | 96,484,044 |
| Net income per share: | | | | |
| Basic | \$ 0.54 | \$ 0.22 | \$ 0.87 | \$ 0.41 |
| Diluted | \$ 0.53 | \$ 0.22 | \$ 0.86 | \$ 0.41 |

See notes to consolidated financial statements.

Table of Contents**KAPSTONE PAPER AND PACKAGING CORPORATION****Consolidated Statements of Cash Flows****(In thousands)****(unaudited)**

| | Six Months Ended June 30, | |
|---|----------------------------------|-------------|
| | 2014 | 2013 |
| Operating activities | | |
| Net income | \$ 83,558 | \$ 39,450 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 66,583 | 34,477 |
| Stock-based compensation expense | 4,229 | 3,299 |
| Pension and postretirement | (6,834) | 709 |
| Excess tax benefit from stock-based compensation | (2,612) | (1,730) |
| Amortization of debt issuance costs | 2,933 | 1,453 |
| Loss on disposal of fixed assets | 1,016 | 142 |
| Deferred income taxes | 2,179 | 13,426 |
| Changes in assets and liabilities: | | |
| Trade accounts receivable, net | (30,851) | (27,680) |
| Other receivables | 2,570 | 3,872 |
| Inventories | (9,664) | (554) |
| Prepaid expenses and other current assets | (2,999) | 2,447 |
| Other assets | (110) | (165) |
| Accounts payable | (638) | (8,168) |
| Accrued expenses and other liabilities | 5,144 | 7,429 |
| Accrued compensation costs | (7,975) | 453 |
| Accrued income taxes | 2,125 | 1,812 |
| Net cash provided by operating activities | 108,654 | 70,672 |
| Investing activities | | |
| Capital expenditures | (73,676) | (32,713) |
| Net cash used in investing activities | (73,676) | (32,713) |
| Financing activities | | |
| Proceeds from revolving credit facility | 97,900 | 91,400 |
| Repayments on revolving credit facility | (97,900) | (141,200) |
| Repayments on long-term debt | (2,350) | |
| Proceeds from other current borrowings | 6,300 | 3,731 |
| Repayments on other current borrowings | (3,402) | (2,028) |
| Payment of withholding taxes on stock awards | (1,641) | (860) |
| Proceeds from exercises of stock options | 389 | 1,014 |
| Proceeds from shares issued to ESPP | 205 | 170 |
| Loan amendment costs | (706) | |
| Excess tax benefit from stock-based compensation | 2,612 | 1,730 |
| Net cash provided by (used in) financing activities | 1,407 | (46,043) |
| Net increase (decrease) in cash and cash equivalents | 36,385 | (8,084) |
| Cash and cash equivalents-beginning of period | 12,967 | 16,488 |

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| | | | | |
|---|----|--------|----|-------|
| Cash and cash equivalents-end of period | \$ | 49,352 | \$ | 8,404 |
|---|----|--------|----|-------|

See notes to consolidated financial statements.

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**KAPSTONE PAPER AND PACKAGING CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(In thousands, except share and per share amounts)

(unaudited)

1. Financial Statements

The accompanying unaudited consolidated financial statements of KapStone Paper and Packaging Corporation (the Company, we, us, our or KapStone) have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2013.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09 Revenue from Contracts with Customers . The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The guidance in this update supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) Topic 605, Revenue Recognition , and most industry-specific guidance throughout the Industry Topics of the Codification. Additionally, this update supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition Construction-Type and Production-Type Contracts . For a public entity, the amendments are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The ASU allows for full or modified retrospective adoption. Early application is not permitted. The Company is currently evaluating the expected impact of adopting this standard.

In July 2013, the FASB issued ASU No. 2013-11 Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists . ASU No. 2013-11 amends the guidance within ASC Topic 740, Income Taxes , to require entities to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The Company adopted ASU No. 2013-11 beginning in the first quarter of 2014 with no impact on the consolidated financial statements.

3. Longview Acquisition

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On July 18, 2013, the Company acquired 100 percent of the stock of Longview Fibre Paper and Packaging, Inc., (Longview) for \$1.025 billion plus \$41.5 million of working capital adjustments. Longview is a leading manufacturer of high quality containerboard, kraft papers, and corrugated products. Longview's operations include a paper mill located in Longview, Washington equipped with five paper machines which have the capacity to produce 1.3 million tons of containerboard and kraft paper annually. Longview also owns seven converting facilities located in the Pacific Northwest.

The excess of the purchase price over the aggregate estimated fair value of net assets acquired was allocated to goodwill. The purchase price allocation is final.

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The following table summarizes the estimated fair value of the assets acquired and liabilities assumed by major category of assets and liabilities as of December 31, 2013, as well as adjustments (referred to as measurement period adjustments):

| | Amounts Recognized as of Acquisition Date (as Adjusted) (1) | Measurement Period Adjustments (2) | Amounts Recognized as of Acquisition Date (as Adjusted) |
|---|--|--|--|
| Deposit for redemption of senior notes | \$ 507,520 | | \$ 507,520 |
| Trade accounts receivable | 104,929 | 42 | 104,971 |
| Inventories | 106,805 | (2,026) | 104,779 |
| Prepaid expenses and other current assets | 2,554 | | 2,554 |
| Plant, property and equipment | 800,663 | (7,446) | 793,217 |
| Pension asset | 112,141 | | 112,141 |
| Other receivables and assets | 11,863 | | 11,863 |
| Intangible assets | 77,600 | | 77,600 |
| Accounts payable | (71,663) | | (71,663) |
| Accrued expenses | (17,630) | 80 | (17,550) |
| Accrued compensation costs | (19,385) | 61 | (19,324) |
| Debt | (507,520) | | (507,520) |
| Pension and post retirement benefits | (68,105) | | (68,105) |
| Deferred income taxes | (294,086) | 3,953 | (290,133) |
| Other noncurrent liabilities | (2,862) | | (2,862) |
| Goodwill | 302,935 | 5,336 | 308,271 |
| Total acquisition consideration | \$ 1,045,759 | | \$ 1,045,759 |

(1) As previously reported in the Notes to Consolidated Financial Statements included in our 2013 Form 10-K.

(2) The measurement period adjustments include the following:

- Property, plant, and equipment were adjusted downward by \$7.4 million to reflect the change in fair value estimates for certain acquired equipment.
- Inventories were adjusted downward to reflect better estimates for spare parts inventory.
- Deferred income taxes decreased primarily due to the change in property, plant, and equipment and inventories.

4. Annual Planned Maintenance Outage

Annual planned maintenance outage costs for the three months ended June 30, 2014 and 2013 totaled \$5.2 million and \$8.5 million, respectively, and are included in cost of sales. Outage costs for the three months ended June 30, 2014 included \$4.3 million primarily for downtime and maintenance costs incurred during a paper machine upgrade at Longview with a related 4,064 reduction in tons produced. Outage costs for the three months ended June 30, 2013 included \$5.0 million and a 9,432 reduction in tons produced for the tri-annual planned maintenance outage at

the Charleston, South Carolina mill.

Annual planned maintenance outage costs for the six months ended June 30, 2014 and 2013 totaled \$20.0 million and \$13.2 million, respectively.

Table of Contents**5. Inventories**

Inventories consist of the following at June 30, 2014 and December 31, 2013, respectively:

| | (unaudited) June 30, 2014 | December 31, 2013 |
|--------------------------------|---------------------------------|----------------------|
| Raw materials | \$ 90,092 | \$ 83,136 |
| Work in process | 4,305 | 3,293 |
| Finished goods | 57,948 | 58,336 |
| Replacement parts and supplies | 67,809 | 66,842 |
| Inventory at FIFO costs | 220,154 | 211,607 |
| LIFO inventory reserves | 4,866 | 5,775 |
| Inventories | \$ 225,020 | \$ 217,382 |

The cost for the Longview inventories is determined on a last-in, first-out method except for replacement parts and supplies inventories, which are valued using the average cost method. As of June 30, 2014, Longview's inventories included in the Consolidated Balance Sheets were \$110.3 million.

6. Short-term Borrowings and Long-term Debt***First Amendment to Amended and Restated Credit Agreement***

In April 2014, the Company entered into a First Amendment to the Amended and Restated Credit Agreement dated as of July 18, 2013 (the "First Amendment"). The First Amendment reduces the borrowing rates under our senior secured credit facility (the "Credit Facility") for both term loans under the Credit Facility and for any future borrowings under the \$400 million revolving credit facility (the "Revolver") portion of the Credit Facility. The interest rates are based on LIBOR rates plus margin determined from a pricing grid based on the Company's debt to EBITDA ratio as defined in our Amended and Restated Credit Agreement, as amended by the First Amendment (the "Credit Agreement"). Accordingly, the weighted average interest rate on borrowings under the Credit Facility as of June 30, 2014 is 2.0 percent, compared to 2.25 percent as of March 31, 2014. The First Amendment also reduced the unused commitment fees related to the Revolver by 5 to 10 basis points.

The Company incurred approximately \$0.7 million of loan amendment costs associated with the First Amendment, which is being amortized using the effective interest method.

Credit Facility

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As of June 30, 2014, the Company has current availability of \$395.0 million under the Revolver.

As of June 30, 2014, the Credit Facility had two term loans outstanding totaling \$1.221 billion with a weighted average interest rate of 2.0 percent.

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Debt Covenants

The Credit Agreement contains, among other provisions, covenants with which we must comply. The covenants limit our ability to, among other things, incur indebtedness, create additional liens on our assets, make investments, engage in mergers and acquisitions, pay dividends and sell any assets outside the normal course of business.

As of June 30, 2014, the Company was in compliance with all applicable covenants in the Credit Agreement.

Fair Value of Debt

As of June 30, 2014, the fair value of the Company's debt approximates the carrying value of \$1.2 billion as the variable interest rates re-price frequently at current market rates. The debt was valued using Level 2 inputs in the fair value hierarchy which are significant observable inputs including quoted prices for debt of similar terms and maturities.

Other Borrowing

In 2014 and 2013, the Company entered into short-term financing agreements of \$6.3 million and \$3.7 million, respectively, at an annual interest rate of 1.69 and 1.56 percent, respectively, for its annual property insurance premiums. The agreements require the Company to pay consecutive monthly payments through the term of each financing agreement ending on December 1st. As of June 30, 2014 and June 30, 2013, there was \$2.9 million and \$1.7 million, respectively, outstanding under these agreements which is included in Other current borrowings on the Consolidated Balance Sheets.

7. Income Taxes

The Company's effective income tax rate for the six months ended June 30, 2014 and 2013 was 33.9 percent and 34.2 percent, respectively. Our tax rate is affected by recurring items such as state income taxes. It is also affected by discrete items that may occur in any given period, but are not consistent from period to period. In addition to state income taxes, the domestic manufacturing deduction had the most significant impact on the difference between our statutory U.S. federal income tax rate of 35 percent and our effective tax rate for both years.

The Company is subject to examination by taxing authorities. The Company's federal tax years are open beginning with 2010. The Internal Revenue Service is currently examining the Company's income tax return for 2012. For acquired companies, U.S. Corrugated Acquisition Inc.'s federal tax years 2009 through 2011 are open and are currently under examination. The Internal Revenue Service recently concluded their examination of Longview's tax returns for 2011, 2012 and the period ending with our acquisition in July 2013. Accordingly, in the quarter ended June 30, 2014, the Company reversed a \$0.3 million reserve for an uncertain tax position. State income tax years are generally open beginning

with 2010.

8. Net Income per Share

Basic and diluted net income per share is calculated as follows (In thousands, except for share and per share data):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|------------|---------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | \$ 51,459 | \$ 20,991 | \$ 83,558 | \$ 39,450 |
| Weighted-average number of common shares for basic net income per share | 95,892,033 | 95,140,852 | 95,806,181 | 95,072,436 |
| Incremental effect of dilutive common stock equivalents: | | | | |
| Unexercised stock options | 1,186,789 | 959,708 | 1,199,319 | 945,914 |
| Unvested restricted stock awards | 340,119 | 375,110 | 361,854 | 465,694 |
| Weighted-average number of shares for diluted net income per share | 97,418,941 | 96,475,670 | 97,367,354 | 96,484,044 |
| Net income per share - basic | \$ 0.54 | \$ 0.22 | \$ 0.87 | \$ 0.41 |
| Net income per share - diluted | \$ 0.53 | \$ 0.22 | \$ 0.86 | \$ 0.41 |

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Approximately 78,000 shares and 10,000 of unexercised stock options were outstanding at June 30, 2014 and 2013, respectively, but were not included in the computation of diluted earnings per share because the options were anti-dilutive.

On December 11, 2013, the board of directors declared a two-for-one stock split in the form of a stock dividend on the Company's common stock. To implement the stock split, shares of common stock were distributed on January 7, 2014 to all shareholders of record as of the close of business on December 23, 2013. All shares and earnings per share amounts for the three and six month periods ended June 30, 2013 have been restated to reflect this change.

9. Pension Plan and Post-Retirement Benefits**Defined Benefit Plans**

Net pension (benefit) / cost recognized for the three and six months ended June 30, 2014 and 2013 for the Pension Plans are as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|----------|---------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Service cost for benefits earned during the quarter | \$ 2,449 | \$ 1,119 | \$ 4,898 | \$ 2,238 |
| Interest cost on projected benefit obligations | 7,180 | 297 | 14,360 | 594 |
| Expected return on plan assets | (11,030) | (306) | (22,061) | (614) |
| Amortization of net loss | | 72 | | 144 |
| Amortization of prior service cost | 100 | 32 | 201 | 65 |
| Net pension (benefit) / cost - Company plans | (1,301) | 1,214 | (2,602) | 2,427 |
| Net pension cost - multi -employer plan | 81 | 12 | 165 | 30 |
| Total net pension (benefit) / cost | \$ (1,220) | \$ 1,226 | \$ (2,437) | \$ 2,457 |

The year-over-year change in total net pension benefit is a result of two pension plans acquired as part of the Longview acquisition.

KapStone funds the Pension Plans according to IRS funding requirements. Based on those requirements, KapStone funded \$2.3 million for the six months ended June 30, 2014 and expects to fund an additional \$1.6 million to the Pension Plans in 2014.

Defined Contribution Plan

We offer a 401(k) Defined Contribution Plan (Contribution Plan) to eligible employees. The Company's monthly contributions are based on the matching of certain employee contributions or based on a union negotiated formula. For the three months ended June 30, 2014 and 2013, the Company recognized expense of \$4.0 million and \$2.9 million, respectively, for the Company contributions to these plans. For the six months ended June 30, 2014 and 2013, the Company recognized expense of \$8.2 million and \$5.8 million, respectively, for the Company contributions

to these plans.

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On May 15, 2014, stockholders of the Company approved the 2014 Incentive Plan (2014 Plan).

A maximum of 8,500,000 shares of our common stock will initially be available for all awards, subject to adjustment in the event of certain corporate transactions described in the 2014 Plan. Stock options, stock appreciation rights (SAR), restricted stock and restricted stock units may be granted under the 2014 Plan. To the extent the Company grants a stock option or SAR under the 2014 Plan, the number of shares of common stock that remain available for future grants will be reduced by an amount equal to the number of shares subject to such stock option or SAR. To the extent the Company grants restricted stock or a restricted stock unit (collectively, Stock Awards) under the 2014 Plan, the number of shares of common stock that remain available for future grants will be reduced by an amount equal to two times the number of shares subject to such Stock Award.

Under the 2014 Plan, awards may be granted to employees, officers and directors of, and consultants and advisors to, the Company.

In the quarter ended March 31, 2014, the compensation committee of the board of directors approved stock-based awards to executive officers, certain employees and directors. The 2014 awards included 441,415 stock option grants and 156,787 restricted stock units.

The Company accounts for stock-based awards in accordance with ASC 718, *Compensation Stock Compensation*, which requires that the cost resulting from all share-based payment transactions be recognized as compensation cost over the vesting period based on the fair value of the instrument on the date of grant.

Total stock-based compensation expense related to the stock option and restricted stock unit grants for the three and six months ended June 30, 2014 and 2013 is as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|--------|---------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Stock option compensation expense | \$ 674 | \$ 528 | \$ 2,198 | \$ 1,777 |
| Restricted stock unit compensation expense | 637 | 426 | 2,031 | 1,522 |
| Total stock-based compensation expense | \$ 1,311 | \$ 954 | \$ 4,229 | \$ 3,299 |

Total unrecognized stock-based compensation cost related to the stock option grants and restricted stock units as of June 30, 2014 and December 31, 2013 is as follows:

| | June 30, | December 31, |
|--|----------|--------------|
| | 2014 | 2013 |
| Unrecognized stock option compensation expense | \$ 4,495 | \$ 2,250 |

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| | | | | |
|---|----|-------|----|-------|
| Unrecognized restricted stock unit compensation expense | | 5,064 | | 2,535 |
| Total unrecognized stock-based compensation expense | \$ | 9,559 | \$ | 4,785 |

As of June 30, 2014, total unrecognized compensation cost related to non-vested stock options and restricted stock units is expected to be recognized over a weighted average period of 2.0 years and 2.3 years, respectively.

Table of ContentsStock Options

Stock option awards vest as follows: 50% after two years and the remaining 50% after three years or upon a grantee of such stock options attaining the age 65. The stock options awarded in 2014 have a contractual term of ten years and are subject to forfeiture should the recipient terminate his or her employment with the Company for certain reasons prior to vesting in his or her awards, or the occurrence of certain other events such as termination with cause. The exercise price of these stock options is based on the closing market price of our common stock on the date of grant (\$30.40 is the weighted average price for the 2014 awards described above) and compensation expense is recorded on an accelerated basis over the awards' vesting periods.

The weighted average fair value of the stock options granted in March 2014 and 2013 was \$10.36 and \$5.41, respectively. The fair value was calculated using the Black-Scholes option-pricing model based on the market price at the grant date and the weighted average assumptions specific to the underlying options. In the quarter ended March 31, 2014, the expected term used by the Company is based on the historical average life of stock option awards. The expected volatility assumption is based on the volatility of our common stock from the same time period as the expected term of the stock options. The risk-free interest rate was selected based upon yields of U.S. Treasury issues with a term similar to the expected life of the stock options. The assumptions utilized for calculating the fair value of stock options during the period are as follows:

| | Six Months Ended June 30, | |
|---|---------------------------|--------|
| | 2014 | 2013 |
| Stock Options Black-Scholes assumptions (weighted average): | | |
| Expected volatility | 39.93% | 50.19% |
| Expected life (years) | 4.30 | 4.00 |
| Risk-free interest rate | 1.34% | 0.57% |
| Expected Dividend yield | % | % |

The following table summarizes stock options amounts and activity:

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| | Options | | Weighted Average Exercise Price | | Weighted Average Remaining Life (Years) | | Intrinsic Value (dollars in thousands) |
|---------------------------------------|-----------|----|--|--|--|----|---|
| Outstanding at January 1, 2014 | 2,514,382 | \$ | 8.05 | | 7.4 | \$ | 49,977 |
| Granted | 441,415 | | 30.40 | | | | |
| Exercised | (87,384) | | 4.97 | | | | |
| Forfeited | (1,007) | | 30.41 | | | | |
| Outstanding at June 30, 2014 | 2,867,406 | \$ | 11.58 | | 7.4 | \$ | 61,792 |
| Exercisable at June 30, 2014 | 1,547,198 | \$ | 5.63 | | 6.1 | \$ | 42,546 |

For the three and six months ended June 30, 2014, cash proceeds from the exercise of stock options totaled \$0.2 million and \$0.4 million, respectively. For the three and six months ended June 30, 2013, cash proceeds from the exercise of stock options totaled \$0.6 million and \$1.0 million, respectively.

Restricted Stock

Restricted stock units are restricted as to transferability until they vest three years from the grant date or upon a grantee of such restricted stock units attaining the age 65. These restricted stock units are subject to forfeiture should applicable employees terminate their employment with the Company for certain reasons prior to vesting in their awards, or the occurrence of certain other events. The value of these restricted stock units is based on the closing market price of our common stock on the date of grant and compensation expense is recorded on a straight-line basis over the awards' vesting periods.

The following table summarizes unvested restricted stock units amounts and activity:

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| | Units | | Weighted Average Grant Date Fair Value |
|---------------------------------------|-----------|----|---|
| Outstanding at January 1, 2014 | 687,368 | \$ | 10.91 |
| Granted | 156,787 | | 30.42 |
| Vested | (225,786) | | 8.39 |
| Forfeited | (343) | | 30.40 |
| Outstanding at June 30, 2014 | 618,026 | \$ | 16.76 |

11. Commitments and Contingencies

We are subject to various legal proceedings arising from our operations. We establish reserves for claims and proceedings when it is probable that liabilities exist and reasonable estimates of loss can be made. While it is not possible to predict the outcome of these matters, based on our assessment of the facts and circumstances now known, we do not believe that these matters, individually or in the aggregate, will have a material adverse effect on our financial position. However, actual outcomes may be different from those expected and could have a material effect on our results of operations or cash flows in a particular period.

There have been no material changes in any of our legal proceedings since December 31, 2013.

12. Segment Information

The Company has one operating segment. The Company produces containerboard, corrugated products, and specialty paper which are sold to customers who convert our products into end-market finished products or internally to corrugating plants which produce a wide variety of products ranging from basic corrugated shipping containers to specialized packaging.

The Company's identification of one operating segment is based on financial information regularly evaluated by the chief operating decision maker in determining resource allocation and assessing performance, in accordance with Accounting Standards Codification 805, *Segment Reporting*.

Net sales for the three and six months ended June 30, 2014 and 2013 are as follows:

| Net sales by product line: | Three Months Ended June 30, | | Increase/ (Decrease) | Six Months Ended June 30, | | Increase/ (Decrease) |
|--------------------------------------|-----------------------------|------------|-------------------------|---------------------------|------------|-------------------------|
| | 2014 | 2013 | | 2014 | 2013 | |
| Containerboard / Corrugated products | \$ 373,223 | \$ 208,923 | \$ 164,300 | \$ 709,468 | \$ 403,902 | \$ 305,566 |
| Specialty paper | 193,077 | 96,409 | 96,668 | 382,086 | 199,805 | 182,281 |
| Other | 24,149 | 20,989 | 3,160 | 47,847 | 42,427 | 5,420 |
| Total | \$ 590,449 | \$ 326,321 | \$ 264,128 | \$ 1,139,401 | \$ 646,134 | \$ 493,267 |

In the three and six months ended June 30, 2014, the increase in net sales was driven primarily by the Longview acquisition which accounted for \$239.7 million and \$467.2 million, respectively.

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13. Voluntary Separation Plan

In February 2014, the Company offered a voluntary separation plan to a specific identified group of employees. The employees were given a limited timeframe to review the offer and to communicate their acceptance. As of June 30, 2014, 32 employees have accepted the offer and the Company has reserved \$4.8 million with respect to this separation plan. Payments charged against the reserve during the quarter ended June 30, 2014 totaled \$0.4 million.

Table of Contents**ITEM 2.**

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

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about us that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, could, would, expect, plan, anticipate, believe, estimate, the negative of such terms or other similar expressions. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those described in Part I Item 1A of our Form 10-K for the fiscal year ended December 31, 2013 and in our other Securities and Exchange Commission filings. The information contained in this Form 10-Q represents our best judgment at the date of this report based on information currently available. In providing forward-looking statements, KapStone does not intend, and does not undertake any duty or obligation, to update its statements as a result of new information, future events or otherwise.

The Company has one reportable segment as of June 30, 2014. The Company manufactures and sells containerboard, corrugated products, and specialty paper.

The following discussion should be read in conjunction with our Consolidated Financial Statements and related Notes thereto included elsewhere in this report.

Comparison of Results of Operations for the Three Months Ended June 30, 2014 and 2013

(In thousands)

| | Three Months Ended June 30, | | Increase/ (Decrease) |
|--|-----------------------------|------------|-------------------------|
| | 2014 | 2013 | |
| Net sales | \$ 590,449 | \$ 326,321 | \$ 264,128 |
| Cost of sales, excluding depreciation and amortization | 392,245 | 225,753 | 166,492 |
| Depreciation and amortization | 33,874 | 17,253 | 16,621 |
| Freight and distribution expenses | 44,924 | 27,849 | 17,075 |
| Selling, general, and administrative expenses | 34,093 | 21,072 | 13,021 |
| Other operating income | | 196 | (196) |
| Operating income | 85,313 | 34,590 | 50,723 |
| Foreign exchange gain | 125 | 89 | 36 |
| Interest expense, net | 7,971 | 2,636 | 5,335 |
| Income before provision for income taxes | 77,467 | 32,043 | 45,424 |
| Provision for income taxes | 26,008 | 11,052 | 14,956 |
| Net income | \$ 51,459 | \$ 20,991 | \$ 30,468 |

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Net sales for the quarter ended June 30, 2014 were \$590.4 million compared to \$326.3 million for the second quarter of 2013, an increase of \$264.1 million. The increase in net sales was driven primarily by the Longview acquisition which accounted for \$239.7 million of the increase. Excluding the Longview acquisition, net sales increased by \$24.4 million, or 7.5 percent, due to \$13.9 million of higher sales volume, \$9.6 million of higher average selling prices, and \$0.9 million of other factors. Average selling prices increased primarily due to the realization of 2013 containerboard and corrugated products price increases along with 2013 specialty paper price increases and the 2014 kraft paper price increase. Average mill selling price per ton for the quarter ended June 30, 2014 was \$685 compared to \$664 for the second quarter 2013.

In February 2014, the Company announced a \$50 per ton selling price increase for domestic kraft paper, which the Company expects to be fully implemented by the end of the third quarter of 2014.

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The following represents the Company's sales by product line:

| Product Line Revenue: | Net Sales | | Three Months Ended June 30, | | Tons Sold | | Increase/ | |
|-----------------------|------------|------------|-----------------------------|--------|-----------|---------|------------|-------|
| | 2014 | 2013 | Increase/ (Decrease) | % | 2014 | 2013 | (Decrease) | % |
| Containerboard / | | | | | | | | |
| Corrugated products | \$ 373,223 | \$ 208,923 | \$ 164,300 | 78.6% | 450,525 | 278,328 | 172,197 | 61.9% |
| Specialty paper | 193,077 | 96,409 | 96,668 | 100.3% | 269,224 | 139,522 | 129,702 | 93.0% |
| Other | 24,149 | 20,989 | 3,160 | 15.1% | | | | |
| Product sold | \$ 590,449 | \$ 326,321 | \$ 264,128 | 80.9% | 719,749 | 417,850 | 301,899 | 72.3% |

Tons of product sold for the quarter ended June 30, 2014 was 719,749 tons compared to 417,850 tons for the quarter ended June 30, 2013. Excluding the Longview acquisition, tons of products sold for the quarter ended June 30, 2014 increased by 15,715 tons or 3.8 percent as follows:

- Containerboard / Corrugated products sales volume decreased 0.4 percent. Containerboard sales decreased 4.0 percent reflecting volumes being redirected from outside sales to fulfill demand for internal converting. Corrugated product sales volume increased 5.9 percent.
- Specialty paper sales volume increased by 12.2 percent, primarily due to higher kraft paper shipments prior to the domestic kraft paper price increase.

Cost of sales, excluding depreciation and amortization expense, for the quarter ended June 30, 2014 was \$392.2 million compared to \$225.8 million for the second quarter of 2013, an increase of \$166.4 million. The increase in cost of sales was mainly due to the \$155.0 million impact of the Longview acquisition. Excluding the Longview acquisition, cost of sales increased by \$11.4 million, or 5.0 percent, mainly due to \$7.8 million of higher sales volume, \$6.8 million of inflation on labor, benefits and input costs, and \$4.5 million of voluntary severance plan charges, partially offset by lower planned maintenance outage costs of \$7.7 million. Planned maintenance outage costs, including Longview, of approximately \$5.2 million and \$8.5 million were included in cost of sales for the quarters ended June 30, 2014 and 2013, respectively.

Depreciation and amortization expense for the quarter ended June 30, 2014 totaled \$33.9 million compared to \$17.3 million for the quarter ended June 30, 2013. The increase of \$16.6 million was primarily due to the Longview acquisition and included \$1.3 million of amortization expense for identified intangibles associated with the Longview acquisition.

Freight and distribution expenses for the quarter ended June 30, 2014 totaled \$44.9 million compared to \$27.8 million for the quarter ended June 30, 2013. The increase of \$17.1 million was primarily due to \$14.6 million associated with the Longview acquisition. In addition, \$2.5 million of additional expenses were driven by the 3.8 percent sales volume increase.

Selling, general and administrative expenses for the quarter ended June 30, 2014 totaled \$34.1 million compared to \$21.1 million for the quarter ended June 30, 2013. The increase of \$13.0 million was primarily due to \$11.7 million from the Longview acquisition. Excluding the Longview

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acquisition, selling, general, and administrative expenses increased by \$1.3 million due to \$1.0 million of higher compensation related expenses, \$0.3 million of voluntary severance plan charges, \$0.4 million of IT related expenses, \$0.6 million of higher professional fees, and \$0.4 million of 2014 Longview integration related expenses, partially offset by \$1.4 million of 2013 Longview acquisition related expenses. For the quarter ended June 30, 2014, selling, general and administrative expenses as a percentage of net sales decreased to 5.8 percent from 6.5 percent in the quarter ended June 30, 2013.

Net interest expense for the quarters ended June 30, 2014 and 2013 was \$8.0 million and \$2.6 million, respectively. Interest expense reflects interest on the outstanding borrowings under the Credit Facility and amortization of debt issuance costs. Interest expense was \$5.4 million higher in the quarter ended June 30, 2014 due to higher term loan balances used to fund the Longview acquisition and an increase in interest rates.

Provision for income taxes for the quarters ended June 30, 2014 and 2013 was \$26.0 million and \$11.1 million, respectively, reflecting an effective tax rate of 33.6 percent for the quarter ended June 30, 2014

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compared to 34.5 percent for the similar period in 2013. The higher provision for income taxes in 2014 primarily reflects higher pre-tax income of \$45.4 million offset by \$0.7 million of favorable discrete tax adjustments.

Comparison of Results of Operations for the Six Months Ended June 30, 2014 and 2013

(In thousands)

| | Six Months Ended June 30, | | Increase/ (Decrease) |
|--|---------------------------|------------|-------------------------|
| | 2014 | 2013 | |
| Net sales | \$ 1,139,401 | \$ 646,134 | \$ 493,267 |
| Cost of sales, excluding depreciation and amortization | 775,493 | 450,699 | 324,794 |
| Depreciation and amortization | 66,583 | 34,477 | 32,106 |
| Freight and distribution expenses | 85,656 | 55,769 | 29,887 |
| Selling, general, and administrative expenses | 68,238 | 40,200 | 28,038 |
| Other operating income | | 398 | (398) |
| Operating income | 143,431 | 65,387 | 78,044 |
| Foreign exchange gain / (loss) | 101 | (222) | 323 |
| Interest expense, net | 17,200 | 5,237 | 11,963 |
| Income before provision for income taxes | 126,332 | 59,928 | 66,404 |
| Provision for income taxes | 42,774 | 20,478 | 22,296 |
| Net income | \$ 83,558 | \$ 39,450 | \$ 44,108 |

Net sales for the six months ended June 30, 2014 were \$1,139.4 million compared to \$646.1 million for the six months of 2013, an increase of \$493.3 million. The increase in net sales was driven primarily by the Longview acquisition which accounted for \$467.2 million of the increase. Excluding the Longview acquisition, net sales increased by \$26.1 million, or 4.0 percent, due to \$23.3 million of higher average selling prices in the first half of 2014 compared to the first half of 2013 and \$2.8 million of volume and mix changes. Average selling prices increased primarily due to the realization of 2013 containerboard and corrugated products price increases along with 2013 specialty paper price increases and the 2014 kraft paper price increase. Average mill selling price per ton for the six months ended June 30, 2014 was \$685 compared to \$658 for the prior year period.

The following represents the Company's sales by product line:

| Product Line Revenue: | Net Sales | | Six Months Ended June 30, | | Tons Sold | | Increase/ (Decrease) | |
|-----------------------|--------------|------------|---------------------------|-------|-----------|---------|-------------------------|-------|
| | 2014 | 2013 | Increase/ (Decrease) | % | 2014 | 2013 | Increase/ (Decrease) | % |
| Containerboard / | | | | | | | | |
| Corrugated products | \$ 709,468 | \$ 403,902 | \$ 305,566 | 75.7% | 856,442 | 546,342 | 310,100 | 56.8% |
| Specialty paper | 382,086 | 199,805 | 182,281 | 91.2% | 536,674 | 291,407 | 245,267 | 84.2% |
| Other | 47,847 | 42,427 | 5,420 | 12.8% | | | | |
| Product sold | \$ 1,139,401 | \$ 646,134 | \$ 493,267 | 76.3% | 1,393,116 | 837,749 | 555,367 | 66.3% |

Tons of product sold for the six months ended June 30, 2014 were 1,393,116 tons compared to 837,749 tons for the six months ended June 30, 2013. Excluding the Longview acquisition, tons of products sold for the six months ended June 30, 2014 decreased by 5,770 tons or 0.7 percent as follows:

- Containerboard / Corrugated products sales volume decreased 3.3 percent. Containerboard sales decreased 8.5 percent reflecting volumes being redirected from outside sales to fulfill demand for internal converting. Corrugated product sales volume increased 5.8 percent.

- Specialty paper sales volume increased by 4.3 percent, primarily due to higher kraft paper shipments prior to the domestic kraft paper price increase.

Cost of sales, excluding depreciation and amortization expense, for the six months ended June 30, 2014 was \$775.5 million compared to \$450.7 million for the six months of 2013, an increase of \$324.8 million. The increase in cost of sales was mainly due to the \$308.4 impact of the Longview acquisition.

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Excluding the Longview acquisition, cost of sales increased by \$16.4 million, or 3.6 percent, mainly due to \$9.5 million of inflation on labor, benefits and input costs, \$4.5 million of voluntary severance plan charges, \$2.7 million of weather related costs, and \$2.4 million of other cost changes, partially offset by \$2.7 million of lower planned maintenance outage costs. Planned maintenance outage costs of approximately \$20.0 million and \$13.2 million were included in cost of sales for the six months ended June 30, 2014 and 2013, respectively. The increase in maintenance outage costs from the prior year were primarily due to the Longview operations.

Depreciation and amortization expense for the six months ended June 30, 2014 totaled \$66.6 million compared to \$34.5 million for the six months ended June 30, 2013. The increase of \$32.1 million was primarily due to the Longview acquisition and included \$2.6 million of amortization expense for identified intangibles associated with the Longview acquisition.

Freight and distribution expenses for the six months ended June 30, 2014 totaled \$85.7 million compared to \$55.8 million for the six months ended June 30, 2013. The increase of \$29.9 million was primarily due to \$27.9 million from the Longview acquisition.

Selling, general and administrative expenses for the six months ended June 30, 2014 totaled \$68.3 million compared to \$40.2 million for the six months ended June 30, 2013. The increase of \$28.1 million was primarily due to \$22.9 million from the Longview acquisition. Excluding the Longview acquisition, selling, general, and administrative expenses increased by \$5.2 million due to \$3.8 million of higher compensation related expenses, \$0.8 million of IT related expenses, \$0.6 million of higher professional fees, \$0.5 million of 2014 Longview integration related expenses, \$0.3 million of voluntary severance plan charges, and \$0.1 million of bad debt expense, partially offset by \$1.4 million of 2013 Longview acquisition related expenses. For the six months ended June 30, 2014, selling, general and administrative expenses as a percentage of net sales decreased to 6.0 percent from 6.2 percent in the first six months of 2013.

Net interest expense for the six months ended June 30, 2014 and 2013 was \$17.2 million and \$5.2 million, respectively. Interest expense reflects interest on the outstanding borrowings under the Credit Facility and amortization of debt issuance costs. Interest expense was \$12.0 million higher in the first six months of 2014 due to higher term loan balances used to fund the Longview acquisition and an increase in interest rates.

Provision for income taxes for the six months ended June 30, 2014 and 2013 was \$42.8 million and \$20.5 million, respectively, reflecting an effective tax rate of 33.9 percent for the six months of 2014 compared to 34.2 percent for the similar period in 2013. The higher provision for income taxes in 2014 primarily reflects higher pre-tax income of \$66.4 million.

Liquidity and Capital Resources

Credit Facilities

In April 2014, the Company entered into the First Amendment, which reduced the borrowing rates for both term loans under the Credit Facility and for any future borrowings under the \$400 million Revolver. The interest rates are based on LIBOR rates plus margin determined from a pricing grid based on the Company's debt to EBITDA ratio as defined in the Credit Agreement. Accordingly, the average weighted interest rate on borrowings under the Credit Facility, as of June 30, 2014, is 2.0 percent, compared to 2.25 percent as of March 31, 2014. The First

Amendment also reduced the unused commitment fees related to the Revolver by 5 to 10 basis points.

The Company has \$395.0 million available under the Revolver at June 30, 2014. In addition, the Credit Facility also includes an accordion feature that allows the Company, subject to certain terms and conditions, to increase the commitments under the Revolver by up to \$300.0 million.

Voluntary and Mandatory Prepayments

For the six months of 2014, the Company made no voluntary prepayments on its term loans under the Credit Facility. No mandatory prepayments were required under the Credit Agreement.

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Other Borrowing

In January 2014, the Company entered into short-term financing agreement of \$6.3 million at an annual interest rate of 1.69 for its annual property insurance premiums. The agreement requires the Company to pay consecutive monthly payments through the term of the financing agreement ending on December 1st. As of June 30, 2014, there was \$2.9 million outstanding under the current agreement.

Debt Covenants

As of June 30, 2014, under the financial covenants of the Credit Agreement, the Company must comply on a quarterly basis with a maximum permitted leverage ratio. The leverage ratio is calculated by dividing the Company's debt by its rolling twelve month total earnings before interest expense, taxes, depreciation and amortization and allowable adjustments. The maximum permitted leverage ratio declines over the life of the Credit Agreement. On June 30, 2014, the maximum permitted leverage ratio was 4.50 to 1.00. On June 30, 2014, the Company was in compliance with a leverage ratio of 2.67 to 1.00.

The Credit Agreement also includes a financial covenant requiring a minimum fixed charge coverage ratio. This ratio is calculated by dividing the Company's trailing twelve month total earnings before interest expense, taxes, depreciation and amortization and allowable adjustments less cash payments for income taxes and capital expenditures by the sum of our cash interest and required principal payments during the twelve month period. From the closing date of the First Amendment through the quarter ending June 30, 2014, the fixed charge coverage ratio was required to be at least 1.25 to 1.00. On June 30, 2014, the Company was in compliance with the Credit Agreement with a fixed charge coverage ratio of 5.80 to 1.00.

As of June 30, 2014, KapStone was also in compliance with all other covenants in the Credit Agreement.

Income taxes

The Company's effective income tax rate, excluding discrete items for 2014, is projected to be 34.5 percent. The cash tax rate for 2014 is projected to be 35 percent.

Sources and Uses of Cash

| Three months ended June 30 (in thousands) | 2014 | 2013 | Incr / (Dcr) |
|---|------------|-----------|--------------|
| Operating activities | \$ 108,654 | \$ 70,672 | \$ 37,982 |
| Investing activities | (73,676) | (32,713) | (40,963) |
| Financing activities | 1,407 | (46,043) | 47,450 |

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| | | | | | | |
|---|----|--------|----|---------|----|--------|
| Total change in cash and cash equivalents | \$ | 36,385 | \$ | (8,084) | \$ | 44,469 |
|---|----|--------|----|---------|----|--------|

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Cash and cash equivalents increased by \$36.4 million from December 31, 2013, reflecting \$108.7 million of net cash provided by operating activities, \$73.7 million of net cash used in investing activities, and \$1.4 million of net cash provided by financing activities in the first six months of 2014.

Net cash provided by operating activities was \$108.7 million, comprised primarily of net income for the first six months of \$83.6 million and non-cash charges of \$67.5 million. Changes in operating assets and liabilities used \$42.4 million of cash. Net cash provided by operating activities increased by \$38.0 million in the six months ended June 30, 2014 compared to the six months ended June 30, 2013, mainly due to a \$44.1 million increase in net income, and higher non-cash charges of \$15.7 million, partially offset by \$21.8 million of cash used for working capital.

Net cash used in investing activities was \$73.7 million for capital expenditures. For the six months ended June 30, 2014, capital expenditures included \$25.7 million for our Longview operations acquired on July

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18, 2013 and \$5.5 million for the completion of the North Charleston, South Carolina paper mill No. 3 paper machine upgrade.

Net cash provided by financing activities was \$1.4 million and reflects \$2.9 million of net borrowings and repayments for our annual property insurance premiums and \$1.6 million of proceeds from share transactions, partially offset by \$2.4 million for payment on long-term debt and \$0.7 of loan amendment costs. Net cash provided by financing activities increased by \$47.5 million in the six months ended June 30, 2014, compared to the six months ended June 30, 2013, primarily due to repayments under the Revolver in the first half of 2013.

Future Cash Needs

We expect that cash generated from operating activities and, if needed, the ability to draw from our \$400.0 million Revolver and our \$300.0 million accordion provision under our Revolver, if available, will be sufficient to meet anticipated 2014 cash needs. Our remaining 2014 cash needs primarily consists of \$15.9 million to pay the remaining quarterly debt repayments and interest on our term loans, approximately \$50.0 million for capital expenditures for the balance of 2014, funding an additional \$1.6 million contribution to our pension plans and any additional working capital needs.

Off-Balance Sheet Arrangements

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

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ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the sensitivity of income to changes in interest rates, commodity prices, equity prices, and other market-driven rates or prices.

Under our Credit Agreement, at June 30, 2014 we have an outstanding Credit Facility consisting of two term loans totaling \$1.2 billion and the Revolver totaling \$400 million. Depending on the type of borrowing, the applicable interest rate under the Credit Facility is calculated at a per annum rate equal to (a) LIBOR plus an applicable margin or (b) the base rate that is calculated as (i) the greatest of (x) the prime rate, (y) the federal funds effective rate plus 0.50% or (z) a daily rate equal to one month LIBOR plus 1% plus (ii) an applicable margin. The unused portion of the Revolver will also be subject to an unused fee that will be calculated at a per annum rate (the Unused Fee Rate).

The applicable margin for borrowings under the Credit Facility and the Unused Fee Rate will be determined by reference to the pricing grid based on the Company's total leverage ratio. Under such pricing grid, the applicable margins for Term Loan A-1 and Revolver will range from 1.0% to 2.0% for Eurodollar loans and from 0.0% to 1.0% for base rate loans and the Unused Fee Rate will range from 0.25% to 0.40%. The applicable margins for Term Loan A-2 will range from 1.25% to 2.25% for Eurodollar loans and from 0.25% to 1.25% for base rate loans. At June 30, 2014 the weighted average interest rate of the term loans was 2.0%.

Changes in market rates may impact the base or LIBOR rate under our Credit Facility. For instance, if the bank's LIBOR rate was to increase or decrease by one percentage point (1.0%), our annual interest expense would change by approximately \$12.3 million based upon our expected future monthly term loan balances per our existing repayment schedule.

We are exposed to price fluctuations of certain commodities used in production. Key raw materials and energy used in the production process include roundwood and woodchips, old corrugated containers, fuel oil, electricity and caustic soda. We purchase these raw materials and energy at market prices, and do not use forward contracts or other financial instruments to hedge our exposure to price risk related to these commodities. We have three contracts to purchase coal at fixed prices with all expiring on December 31, 2014.

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

We are exposed to currency fluctuations as we invoice certain European customers in Euros. The Company did not use forward contracts to reduce the impact of currency fluctuations during the quarter ended June 30, 2014. No such contracts were outstanding at June 30, 2014.

ITEM 4.

CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our Chief Executive Officer and our Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as required by Rule 13a-15(b) under the Securities Exchange Act of 1934. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2014.

There were no changes in our internal control over financial reporting during the three months ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1.

LEGAL PROCEEDINGS

There have been no material changes in the legal proceedings described in our Form 10-K for the year ended December 31, 2013.

ITEM 1A.

RISK FACTORS

There have been no material changes from the Risk Factors described in our Form 10-K for the year ended December 31, 2013.

ITEM 2.

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3.

DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4.

MINE SAFETY DISCLOSURES

None.

ITEM 5.

OTHER INFORMATION

None.

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ITEM 6.

EXHIBITS

The following Exhibits are filed as part of this report.

| Exhibit No. | Description |
|--------------------|--|
| 10.8 | First Amendment to Amended and Restated Credit Agreement dated as of April 2, 2014, by and among KapStone Paper and Packaging Corporation, KapStone Kraft Paper Corporation, as Borrower, the subsidiaries of Borrower named therein, as Guarantors, the lenders named therein, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and Barclays Bank PLC and Wells Fargo Bank, National Association, as co-Syndication Agents. Incorporated by reference to the Registrant's Form 8-K filed on April 4, 2014. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase. |
| 101.PRE | XBRL Extension Presentation Linkbase. |

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SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KAPSTONE PAPER AND PACKAGING CORPORATION

July 30, 2014

By:

/s/ Andrea K. Tarbox

Andrea K. Tarbox

Vice President and Chief Financial Officer (duly
authorized officer and principal financial officer)