

POWER SOLUTIONS INTERNATIONAL, INC.  
Form 424B3  
March 23, 2012

**Filed Pursuant to Rule 424(b)(3) and Rule 424(c)**

**Registration File Nos. 333-176653 and 333-174543**

**Prospectus Supplement No. 7**

**(to Prospectus dated September 13, 2011)**

**POWER SOLUTIONS INTERNATIONAL, INC.**

**2,309,783 Shares of Common Stock**

This prospectus supplement no. 7 supplements the prospectus dated September 13, 2011, as supplemented by prospectus supplement no. 1 dated November 1, 2011 ( Supplement No. 1 ), prospectus supplement no. 2 dated November 4, 2011 ( Supplement No. 2 ), prospectus supplement no. 3 dated November 14, 2011 ( Supplement No. 3 ), prospectus supplement no. 4 dated November 23, 2011 ( Supplement No. 4 ), prospectus supplement no. 5 dated March 2, 2012 ( Supplement No. 5 ) and prospectus supplement no. 6 dated March 16, 2012 ( Supplement No. 6 ), which forms a part of each of our registration statements on Form S-1 (Registration File Nos. 333-176653 and 333-174543). This prospectus supplement is being filed to update and supplement the information included or incorporated by reference in the prospectus with the information contained in our current report on Form 8-K, filed with the Securities and Exchange Commission on March 23, 2012 (the Current Report ). Accordingly, we have attached the Current Report to this prospectus supplement.

The prospectus, Supplement No. 1, Supplement No. 2, Supplement No. 3, Supplement No. 4, Supplement No. 5, Supplement No. 6 and this prospectus supplement relate to the sale of up to 2,309,783 shares of Power Solutions International, Inc. common stock, par value \$0.001 per share, by the selling securityholders named in the Selling Securityholders section of the prospectus. We will not receive any proceeds from the sale of our shares by the selling securityholders.

Our common stock is quoted on the OTC Bulletin Board and the OTC Markets OTCQB tier under the symbol PSIX. On March 20, 2012, the last reported closing bid price of our common stock as reported on the OTC Bulletin Board was \$14.50 per share. These over-the-counter quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

**Investing in the securities involves a high degree of risk. You should read the prospectus, Supplement No. 1, Supplement No. 2, Supplement No. 3, Supplement No. 4, Supplement No. 5, Supplement No. 6 and this prospectus supplement carefully before you invest. See Risk Factors beginning on page 5 of the prospectus.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities offered hereby or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

**The date of this prospectus supplement is March 23, 2012**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 8-K**

**CURRENT REPORT**

**Pursuant to Section 13 or 15(d) of**

**The Securities Exchange Act of 1934**

**Date of Report (Date of Earliest Event Reported): March 20, 2012**

**POWER SOLUTIONS INTERNATIONAL, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction**

**of incorporation)**

**000-52213**  
**(Commission**

**File Number)**

**33-0963637**  
**(IRS Employer**

**Identification No.)**

Edgar Filing: POWER SOLUTIONS INTERNATIONAL, INC. - Form 424B3

**655 Wheat Lane, Wood Dale, IL**  
(Address of principal executive offices)

**Registrant's telephone number, including area code: (630) 350-9400**

**60191**  
(Zip Code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- ..  Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- ..  Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- ..  Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- ..  Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

**Item 1.01 Entry into a Material Definitive Agreement**

**Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant**

On March 20, 2012, Power Solutions International, Inc. (the Company) and its subsidiaries entered into an amendment (the Amendment) to its credit agreement, dated April 29, 2011 (the Credit Agreement), with BMO Harris Bank N.A (formerly known as Harris N.A.) (Harris), which increased the Company's total credit facility with Harris from \$35.0 million to \$50.0 million and extended the term of the credit facility through March 20, 2017. Under the terms of the Credit Agreement as amended by the Amendment (in contrast to the original Credit Agreement): (a) the revolving line of credit bears interest at Harris' prime rate plus an applicable margin ranging from 0% to 0.50%; or, at the Company's option, all or a portion of the revolving line of credit can be designated to bear interest at LIBOR plus an applicable margin ranging from 1.75% to 2.25%; (b) the unused line fee has been reduced 0.25%; (c) the Company's cash deposits in its line of credit account with Harris are no longer swept daily and applied against the outstanding balance of its line of credit; and (d) the Company is only required to report its compliance with the fixed charge coverage ratio for any month when its excess availability, as defined in the amended agreement, is less than the liquidity threshold, as defined in the Credit Agreement, as amended by the Amendment, for 60 consecutive days. The liquidity threshold is defined as the greater of (i) \$7,500,000 or (ii) 12.5% of the total credit facility of \$50.0 million, as may be reduced from time to time pursuant to the terms of the Credit Agreement, as amended by the Amendment.

The Amendment and related documents are attached to this Current Report on Form 8-K as Exhibit 10.1 and are incorporated herein by reference. The foregoing summary of the Amendment is qualified in its entirety by the complete text of the Amendment filed herewith.

**Item 9.01 Financial Statements and Exhibits**

(d) Exhibits.

Exhibit Number	Exhibit Description
10.1	Amendment No. 1, dated as of March 20, 2012, to Loan and Security Agreement, dated as of April 29, 2011, by and among BMO Harris Bank N.A., as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production, Inc., Power Global Solutions, Inc., PSI International, LLC and XISync LLC, and related documents.

Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been separately filed with the Securities and Exchange Commission.

**SIGNATURES**

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

Power Solutions International, Inc.

Date: March 23, 2012

/s/ Thomas J. Somodi

Name: Thomas J. Somodi

Title: Chief Operating Officer and Chief Financial Officer

**CONFIDENTIAL TREATMENT REDACTED COPY**

**\*\*CERTAIN INFORMATION IN THIS EXHIBIT HAS BEEN OMITTED AND HAS  
BEEN FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE  
COMMISSION PURSUANT TO A CONFIDENTIAL TREATMENT REQUEST  
UNDER 17 C.F.R. SECTIONS 24b-2, 200.80 (B)(4) AND 230.406**

**AMENDMENT NO. 1 TO LOAN AND SECURITY AGREEMENT**

This AMENDMENT NO. 1 TO LOAN AND SECURITY AGREEMENT (this Amendment ) is entered into as of March 20, 2012, by and among the Lenders identified on the signature pages hereof (such Lenders, together with their respective successors and permitted assigns, are referred to hereinafter each individually as a Lender and collectively as the Lenders ), BMO HARRIS BANK N.A. (formerly known as Harris N.A.), as administrative agent for the Lenders (in such capacity, Agent ), POWER SOLUTIONS INTERNATIONAL, INC., a Delaware corporation (Parent ), THE W GROUP, INC., a Delaware corporation (Holdings ), POWER SOLUTIONS, INC., an Illinois corporation (Power Solutions ), POWER GREAT LAKES, INC., an Illinois corporation (Great Lakes ), AUTO MANUFACTURING, INC., an Illinois corporation (Auto Manufacturing ), TORQUE POWER SOURCE PARTS, INC., an Illinois corporation (Torque ), POWER PROPERTIES, L.L.C., an Illinois limited liability company (Properties ), POWER PRODUCTION, INC., an Illinois corporation (Production ), POWER GLOBAL SOLUTIONS, INC., an Illinois corporation (Global ), PSI INTERNATIONAL, LLC, an Illinois limited liability company (PSI ) and XISYNC LLC, an Illinois limited liability company (XISYNC and together with Parent, Holdings, Power Solutions, Great Lakes, Auto Manufacturing, Torque, Properties, Production, Global and PSI, individually a Borrower and collectively Borrowers ).

WHEREAS, Borrowers, Agent, and the Lenders are parties to that certain Loan and Security Agreement dated as of April 29, 2011 (as amended, modified or supplemented from time to time, the Loan Agreement ); and

WHEREAS, Borrowers, Agent and the Lenders have agreed to amend the Loan Agreement in certain respects (including to increase the Revolving Credit Maximum Amount and Total Credit Facility thereunder from \$35,000,000 to \$50,000,000 and to extend the Term of the Loan Agreement to the date that is 5 years from the date hereof) subject to the terms and conditions set forth herein.

NOW THEREFORE, in consideration of the premises and mutual agreements herein contained, the parties hereto agree as follows:

1. Defined Terms. Unless otherwise defined herein, capitalized terms used herein shall have the meanings ascribed to such terms in the Loan Agreement.

2. Amendments to Credit Agreement. Subject to the satisfaction of the conditions set forth in Section 6 below and in reliance upon the representations and warranties set forth in Section 7 below, the Credit Agreement is hereby amended as follows:

(a) Section 1.1 of the Loan Agreement is amended by deleting the defined term Applicable Inventory Advance Rate therefrom in its entirety.

(b) Section 1.1 of the Loan Agreement is amended by adding the defined term Excess Availability thereto in its appropriate alphabetical order as follows:

Excess Availability as of any date of determination, the amount equal to Availability minus the aggregate amount of all then outstanding and unpaid trade payables and obligations of Borrowers which are more than sixty (60) days past due as of the end of the immediately preceding month or, at Agent's option, as of a more recent date based on such reports as Agent may from time to time specify.

(c) Section 1.1 of the Loan Agreement is amended by adding the defined term First Amendment Closing Date thereto in its appropriate alphabetical order as follows:

First Amendment Closing Date March 20, 2012.

(d) Section 1.1 of the Loan Agreement is amended by adding the defined term Insufficient Liquidity Period thereto in its appropriate alphabetical order as follows:

Insufficient Liquidity Period any period beginning on any date upon which Excess Availability on such date is less than the Liquidity Threshold and continuing until the date upon which Excess Availability has exceeded the Liquidity Threshold for 60 consecutive days.

(e) Section 1.1 of the Loan Agreement is amended by adding the defined term Liquidity Threshold thereto in its appropriate alphabetical order as follows:

Liquidity Threshold the greater of (i) \$7,500,000, and (ii) 12.5% of the Total Credit Facility.

(f) Section 1.1 of the Loan Agreement is amended by amending and restating the definition of the term Applicable Margin set forth therein in its entirety as follows:

Applicable Margin from the First Amendment Closing Date to, but not including, the first Adjustment Date (as hereinafter defined) the percentages set forth below with respect to each Base Rate Revolving Loan, each LIBOR Revolving Loan and the Unused Line Fee:

Base Rate Revolving Loans	0.00%
LIBOR Revolving Loans	1.75%

The percentages set forth above will be adjusted on the first day of the month following delivery by Borrowers to Agent of the financial statements required to be delivered pursuant to subsection 9.1.3(ii) of the Agreement for each March 31, June 30, September 30 and December 31 during the Term, commencing with the month ending September 30, 2012 (each such date an Adjustment Date ), effective prospectively, by reference to the applicable Financial Measurement (as defined below) for the four quarters most recently ending in accordance with the following:

Financial Measurement	Base Rate Revolving Loans	LIBOR Revolving Loans
Greater than 1.50 to 1.0	0.00%	1.75%
Less than or equal to 1.50 to 1.0 but greater than or equal to 1.25 to 1.0	0.25%	2.00%
Less than 1.25 to 1.0	0.50%	2.25%

provided that, (i) if Parents audited financial statements for any fiscal year delivered pursuant to subsection 9.1.3(i) of the Agreement reflect a Financial Measurement that yields a higher Applicable Margin than that yielded by the monthly financial statements previously delivered pursuant to subsection 9.1.3(ii) of the Agreement for the last month of such fiscal year, the Applicable Margin shall be readjusted retroactively for the period that was incorrectly calculated and (ii) if Borrowers fail to deliver the financial statements required to be delivered pursuant to subsection 9.1.3(i) or subsection 9.1.3(ii) of the Agreement on or before the due date thereof, the interest rate shall automatically adjust to the highest interest rate set forth above, effective prospectively from such due date until the delivery of such financial statements. Upon delivery of such financial statements, the Applicable Margin shall be readjusted as of the date of delivery of such financial statements pursuant hereto and shall be the effective Applicable Margin until the next Adjustment Date For purposes hereof, Financial Measurement shall mean the Fixed Charge Coverage Ratio.

(g) Section 1.1 of the Loan Agreement is amended by amending and restating clause (b) of the definition of the term Borrowing Base set forth therein as follows:

(b) the lesser of (i) 65% of the value of Eligible Inventory at such date and (ii) 100% of the NOLV of Eligible Inventory at such date.

(h) Section 1.1 of the Loan Agreement is amended by amending and restating the definition of the term Dominion Account set forth therein in its entirety as follows:



**Dominion Account** a special bank account or accounts of Agent established by Borrowers or any one of them pursuant to subsection 7.2.4 of the Agreement at Bank, and over which Agent shall have sole and exclusive access and control for withdrawal purposes during any Insufficient Liquidity Period and during any time that an Event of Default has occurred and is continuing.

(i) Section 1.1 of the Loan Agreement is amended by amending and restating the definition of the term **Revolving Credit Maximum Amount** set forth therein in its entirety as follows:

**Revolving Credit Maximum Amount** \$50,000,000, as such amount may be reduced from time to time pursuant to the terms of the Agreement.

(j) Section 1.1 of the Loan Agreement is amended by amending and restating the definition of the term **Total Credit Facility** set forth therein in its entirety as follows:

**Total Credit Facility** \$50,000,000, as reduced from time to time pursuant to the terms of this Agreement.

(k) The preamble to Section 2 of the Loan Agreement is amended by replacing the reference to \$35,000,000 set forth therein with a reference to \$50,000,000 .

(l) Section 2.1.3 of the Loan Agreement is hereby amended by replacing each reference to \$1,750,000 set forth therein with a reference to \$2,500,000 .

(m) Section 2.1.4 of the Loan Agreement is hereby amended by replacing the reference to \$3,500,000 set forth therein with a reference to \$5,000,000 .

(n) Section 2.1.5 of the Loan Agreement is hereby amended by replacing each reference to \$1,750,000 set forth therein with a reference to \$2,500,000 .

(o) Section 3.5 of the Loan Agreement is amended and restated in its entirety as follows:

3.5. **Unused Line Fee.**

Borrowers shall pay to Agent, for the ratable benefit of Lenders, a fee (the **Unused Line Fee** ) equal to the 0.25% per annum multiplied by the average daily amount by which **Revolving Credit Maximum Amount** exceeds the sum of (i) the outstanding principal balance of the **Revolving Credit Loans plus** (ii) the **LC Amount**. The **Unused Line Fee** shall be payable monthly in arrears on the first day of each month hereafter.

(p) Section 5.1 of the Loan Agreement is amended and restated in its entirety as follows:

5.1. **Term of Agreement.**

Subject to the right of Lenders to cease making Loans to Borrowers during the continuance of any Default or Event of Default, this Agreement shall be in effect for a period of five years from the First Amendment Closing Date, through and including March 20, 2017 (the Term), unless terminated as provided in Section 5.2 hereof.

(q) Section 7.2.4 of the Loan Agreement is amended and restated in its entirety as follows:

7.2.4. Maintenance of Dominion Account. Borrowers shall maintain a Dominion Account or Accounts pursuant to lockbox and blocked account arrangements acceptable to Agent with Bank. Borrowers shall issue to Bank an irrevocable letter of instruction directing Bank to deposit all payments or other remittances received in the lockbox and blocked accounts to the Dominion Account for application on account of the Obligations as provided in subsection 4.2.1 during any Insufficient Liquidity Period and during the continuance of any Event of Default. All funds deposited in any Dominion Account during any Insufficient Liquidity Period and during the continuance of any Event of Default shall immediately become the property of Agent, for the ratable benefit of Lenders, and Borrowers shall obtain the agreement by such banks in favor of Agent to waive any recoupment, setoff rights, and any security interest in, or against, the funds so deposited.

(r) Section 7.2.5 of the Loan Agreement is amended and restated in its entirety as follows:

7.2.5 Collection of Accounts; Proceeds of Collateral. Each Borrower agrees that all invoices rendered and other requests made by any Borrower for payment in respect of Accounts shall contain a written statement directing payment in respect of such Accounts to be paid to a lockbox established pursuant to subsection 7.2.4. To expedite collection, each Borrower shall endeavor in the first instance to make collection of its Accounts for Agent. All remittances received by any Borrower on account of Accounts during any Insufficient Liquidity Period and during the continuance of any Event of Default, together with the proceeds of any other Collateral, shall be held as Agent's property, for its benefit and the benefit of Lenders, by such Borrower as trustee of an express trust for Agent's benefit and such Borrower shall immediately deposit same in kind in the Dominion Account. Agent retains the right at all times after the occurrence and during the continuance of a Default or an Event of Default to notify Account Debtors that Borrowers' Accounts have been assigned to Agent and to collect Borrowers' Accounts directly in its own name, or in the name of Agent's agent, and to charge the collection costs and expenses, including attorneys' fees, to Borrowers.

(s) Section 8.1.4 of the Loan Agreement is amended by replacing each reference to as of the date hereof set forth therein with a reference to as of the First Amendment Closing Date .

(t) Section 8.1.13 of the Loan Agreement is amended by replacing the reference to as of the date hereof set forth therein with a reference to as of the First Amendment Closing Date .

(u) Section 8.1.25 of the Loan Agreement is amended by replacing the reference to as of the date hereof with a reference to as of the First Amendment Closing Date .

(v) Section 9.1.3(ii) of the Loan Agreement is amended by deleting the phrase not later than 30 days after the end of each month hereafter therein and inserting the phrase not later than 30 days after the end of each month hereafter (except for the months ending March 31, June 30, September 30 and December 31) and not later than 45 days after the end of the months ending March 31, June 30, September 30 and December 31 in its place.

(w) Section 9.1.4 of the Loan Agreement is amended and restated in its entirety as follows:

9.1.4. **Borrowing Base Certificates.** On or before the 3rd day of each week during an Insufficient Liquidity Period from and after the date hereof, and on or before the 20th day of each calendar month at all times that an Insufficient Liquidity Period is not in existence from and after the date hereof, Borrowers shall deliver to Agent, in form acceptable to Agent, a Borrowing Base Certificate as of the last day of the immediately preceding week (in the case of a weekly Borrowing Base Certificate) or the last day of the immediately preceding month (in the case of a monthly Borrowing Base Certificate), with such supporting materials as Agent shall reasonably request. If Borrowers deem it advisable, or Agent shall request, Borrowers shall execute and deliver to Agent Borrowing Base Certificates more frequently than weekly or monthly, as applicable. On or before the 20<sup>th</sup> day of each calendar month from and after the date hereof, Borrowers shall deliver to Agent, in the form reasonably acceptable to Agent, (i) reconciliations of Borrowers Accounts as shown on the month-end Borrowing Base Certificate for the immediately preceding month to Borrowers accounts receivable agings, to Borrowers general ledger and to Borrowers most recent financial statements and (ii) reconciliations of Borrowers Inventory as shown on Borrowers perpetual inventory, to Borrowers general ledger and to Borrowers financial statements, all with supporting materials as Agent shall reasonably request.

(x) Section 9.3 of the Loan Agreement is amended and restated in its entirety as follows:

9.3 **Specific Financial Covenants.**

During the Term, and thereafter for so long as there are any Obligations outstanding, Borrowers covenant that, unless otherwise consented to by Majority Lenders, in writing, they shall comply with all of the financial

covenants set forth in Exhibit 9.3 hereto; provided, however, that the Fixed Charge Coverage Ratio covenant set forth in Exhibit 9.3 shall be tested only for the most recently ended month for which Agent has received financial statements pursuant to Section 9.1.3 prior to the commencement of an Insufficient Liquidity Period and each month ending thereafter until such Insufficient Liquidity Period has ended and no additional Insufficient Liquidity Period has commenced. If GAAP changes from the basis used in preparing the audited financial statements delivered to Agent by Borrowers on or before the Closing Date, Borrowers will provide Agent with certificates demonstrating compliance with such financial covenants and will include, at the election of Borrowers or upon the request of Agent, calculations setting forth the adjustments necessary to demonstrate how Borrowers are also in compliance with such financial covenants based upon GAAP as in effect on the Closing Date.

(y) Each reference to Harris N.A. in the Loan Agreement is replaced with a reference to BMO Harris Bank N.A. (formerly known as Harris N.A.) .

(z) The following Exhibits to the Loan Agreement are amended and restated in their entirety in the form attached as Annex 1 to this Amendment: Exhibit 7.1.1 (Business Locations), Exhibit 8.1.1 (Jurisdictions of Qualification), Exhibit 8.1.4 (Capital Structure), Exhibit 8.1.5 (Names; Organization), Exhibit 8.1.13 (Surety Obligations), Exhibit 8.1.14 (Tax Identification Numbers), Exhibit 8.1.16 (Patents, Trademarks, Copyrights and Licenses), Exhibit 8.1.22 (Capitalized and Operating Leases).

3. Continuing Effect. Except as expressly set forth in Section 2 of this Amendment, nothing in this Amendment shall constitute a modification or alteration of the terms, conditions or covenants of the Loan Agreement or any other Loan Document, or a waiver of any other terms or provisions thereof, and the Loan Agreement and the other Loan Documents shall remain unchanged and shall continue in full force and effect.

4. Reaffirmation and Confirmation. Each Borrower hereby ratifies, affirms, acknowledges and agrees that the Loan Agreement and the other Loan Documents to which it is a party represent the valid, enforceable and collectible obligations of such Borrower, and further acknowledges that there are no existing claims or defenses, personal or otherwise, with respect to the Loan Agreement or any other Loan Document. Each Borrower hereby agrees that this Amendment in no way acts as a release or relinquishment of the Liens granted to the Agent under the Loan Documents and rights securing payments of the Obligations. The Liens and rights securing payment of the Obligations are hereby ratified and confirmed by each Obligor in all respects.

5. Amendment Fee. In order to induce Agent to enter into this Amendment, Borrowers hereby jointly and severally agree to pay an amendment fee to Agent for its own account on the date hereof in the amount of \$75,000 (the Amendment Fee ), which Amendment Fee shall be fully earned, non-refundable and due and payable on the date hereof. Borrowers hereby authorize Agent to charge the Amendment Fee to Borrowers as a Revolving Credit Loan on the date of this Amendment.

6. Conditions to Effectiveness. This Amendment shall become effective as of the date hereof and upon the satisfaction of the following conditions precedent:

(a) Each party hereto shall have executed and delivered this Amendment to Agent;

(b) No Default or Event of Default shall have occurred and be continuing as of the date of the effectiveness of this Amendment; and

(c) Agent shall have received each of the documents referenced on the closing checklist attached as Annex 2 to this Amendment (other than such documents expressly referenced as post-closing covenants in Section 8 below), in each case in form and substance satisfactory to Agent.

7. Representations and Warranties. In order to induce Agent and the Lenders to enter into this Amendment, each Borrower hereby represents and warrants to Agent and Lenders that:

(a) Both before and after giving effect to this Amendment, all representations and warranties contained in the Loan Agreement and the other Loan Documents are true and correct on and as of the date of this Amendment, in each case as if then made, other than representations and warranties that expressly relate solely to an earlier date (in which case such representations and warranties were true and correct on and as of such earlier date);

(b) Both before and after giving effect to this Amendment, no Default or Event of Default has occurred and is continuing;

(c) this Amendment has been approved by all necessary corporate or other relevant action and do not or will not require any consent or approval of the shareholders, partners or members, as the case may be, of Parent or any other Borrower, except for those obtained and in full force and effect, (ii) contravene Parent's or any other Borrower's charter, articles or certificate of incorporation, partnership agreement, articles or certificate of formation, by-laws, limited liability agreement, operating agreement or other organizational documents (as the case may be); (iii) violate, or cause Parent or any other Borrower or any of to be in default under, any provision of any law, rule, regulation, order, writ, judgment, injunction, decree, determination or award in effect having applicability to such Borrower; (iv) result in a breach of or constitute a default under any agreement, lease or instrument to which any Borrower or any of its Subsidiaries is a party or by which it or its Properties may be bound or affected; or (v) result in, or require, the creation or imposition of any Lien upon or with respect to any of the Properties now owned or hereafter acquired by any Borrower or any of its Subsidiaries; and

(d) This Amendment, the Loan Agreement and other Loan Documents to which it is a party, as modified hereby, constitute legal, valid and binding obligations of such Obligor and are enforceable against such Obligor in accordance with their respective terms.

8. Post-Closing Covenants. In order to induce Agent and the Lenders to enter into this Amendment, the Borrowers hereby covenant and agree that:

(a) Within 60 days following the date hereof (or such later date as permitted by Agent in its sole discretion, which extension may be effectuated by Agent delivering a written extension to Administrative Borrower (which writing may be in the form of electronic mail)), Borrowers shall deliver to Agent (i) evidence that the First Amendment to Real Property Mortgage of even date herewith between Properties and Agent with respect to the real property owned by Properties located at 655 Wheat Lane, Wood Dale, Illinois 60191 (the Wheat Lane Property ) has been recorded in the applicable jurisdiction, and (ii) a date down endorsement to the existing mortgagee title insurance policy in favor of Agent with respect to the mortgage of the Wheat Lane Property in favor of Agent, which date down endorsement shall be in form and substance satisfactory to Agent; and

(b) Within 90 days following the date hereof (or such later date as permitted by Agent in its sole discretion, which extension may be effectuated by Agent delivering a written extension to Administrative Borrower (which writing may be in the form of electronic mail)), Borrowers shall deliver evidence that UCC financing statements 16595994 and 16759082 filed by Associated Material Handling against Great Lakes with the Secretary of State of Illinois have been amended to limit the collateral description set forth therein in a manner acceptable to Agent.

The failure by Borrowers to satisfy any of the foregoing requirements within the time periods specified above shall constitute an Event of Default under the Loan Agreement.

9. Miscellaneous.

(a) Expenses. The Borrowers agree to pay on demand all costs and expenses of Agent (including the reasonable fees and expenses of outside counsel for Agent) in connection with the preparation, negotiation, execution, delivery and administration of this Amendment and all other instruments or documents provided for herein or delivered or to be delivered hereunder or in connection herewith. All obligations provided herein shall survive any termination of this Amendment and the Loan Agreement.

(b) Governing Law. This Amendment shall be a contract made under and governed by the internal laws of the State of Illinois.

(c) Counterparts. This Amendment may be executed in any number of counterparts, and by the parties hereto on the same or separate counterparts, and each such counterpart, when executed and delivered, shall be deemed to be an original, but all such counterparts shall together constitute but one and the same Amendment. A counterpart of this Amendment delivered via facsimile, .pdf or other electronic transmission shall be equally effective as the delivery of a manually executed counterpart of this Amendment.

10. Release.

(a) In consideration of the agreements of Agent and Lenders contained herein and for other good and valuable consideration, the receipt and sufficiency of which is

hereby acknowledged, each Borrower, on behalf of itself and its successors, assigns, and other legal representatives, hereby absolutely, unconditionally and irrevocably releases, remises and forever discharges Agent and the Lenders, and their successors and assigns, and their present and former shareholders, affiliates, subsidiaries, divisions, predecessors, directors, officers, attorneys, employees, agents and other representatives (Agent, each Lender and all such other Persons being hereinafter referred to collectively as the Releasees and individually as a Releasee ), of and from all actions, causes of action, suits, controversies and damages and any and all other claims, counterclaims, defenses, rights of set-off, demands and liabilities whatsoever (individually, a Claim and collectively, Claims ) of every name and nature, known or unknown, suspected or unsuspected, both at law and in equity, which such Borrower or any of its respective successors, assigns, or other legal representatives may now or hereafter own, hold, have or claim to have against the Releasees or any of them for, upon, or by reason of any action or inaction of any Releasee which has occurred or arises at any time on or prior to the day and date of this Amendment, including, without limitation, for or on account of, or in relation to, or in any way in connection with any of the Loan Agreement or any of the other Loan Documents or transactions thereunder or related thereto.

(b) Each Borrower understands, acknowledges and agrees that the release set forth above may be pleaded as a full and complete defense and may be used as a basis for an injunction against any action, suit or other proceeding which may be instituted, prosecuted or attempted in breach of the provisions of such release.

(c) Each Borrower agrees that no fact, event, circumstance, evidence or transaction which could now be asserted or which may hereafter be discovered shall affect in any manner the final, absolute and unconditional nature of the release set forth above.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed by their respective officers thereunto duly authorized and delivered as of the date first above written.

**BORROWERS:**

**POWER SOLUTIONS INTERNATIONAL, INC.,**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**THE W GROUP, INC.**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**POWER SOLUTIONS, INC.**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**POWER GREAT LAKES, INC.**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**AUTO MANUFACTURING, INC.**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

Signature Page to Amendment No. 1 to Loan and Security Agreement



**TORQUE POWER SOURCE PARTS, INC.**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**POWER PROPERTIES, L.L.C.**

**BY: THE W GROUP, INC., its Sole Managing Member**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**POWER PRODUCTION, INC.**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**POWER GLOBAL SOLUTIONS, INC.**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

**PSI INTERNATIONAL, LLC**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: Manager

**XISYNC LLC**

**BY: THE W GROUP, INC., its Sole Managing Member**

By: /s/ Gary Winemaster  
Name: Gary Winemaster  
Title: President and Chief Executive Officer

Signature Page to Amendment No. 1 to Loan and Security Agreement

**BMO HARRIS BANK N.A.**

(formerly known as HARRIS N.A.),

as Agent and sole existing Lender

By: /s/ William Kennedy

Name: William Kennedy

Title: Vice President

Signature Page to Amendment No. 1 to Loan and Security Agreement

Annex I

**Certain Amended and Restated Exhibits**

**EXHIBIT 7.1.1**

**BUSINESS LOCATIONS**

1. Each Borrower currently has the following business locations, and no others:

Chief Executive Office: 655 Wheat Lane (owned by Properties)  
Wood Dale, Du Page County, Illinois 60191

Other Locations: 170-176 Mittel Drive (leased by Great Lakes)  
Wood Dale, Du Page County, Illinois 60191

1455 Michael Drive (leased by Great Lakes)

Wood Dale, Du Page County, Illinois 60191

780 Arthur Avenue (leased by Great Lakes)

Elk Grove Village, Cook County, Illinois 60007

801 AEC Drive (leased by Power Great Lakes)

Wood Dale, Du Page County, Illinois 60191

201 Mittel Drive (leased by Power Great Lakes)

Wood Dale, Du Page, Illinois 60191

2. Each Borrower maintains its books and records relating to Accounts and General Intangibles at:  
655 Wheat Lane (owned by Properties)

Wood Dale, Du Page County, Illinois 60191

3. Each Borrower has had no office, place of business or agent for process located in any county other than as set forth above, except:  
950 Arthur Avenue (formerly leased by Great Lakes)

Elk Grove Village, Cook County, Illinois 60007

(not a current location)

4. Each Subsidiary currently has the following business locations, and no others:

Chief Executive Office: Not Applicable.

Other Locations: Not Applicable.

5. Each Subsidiary maintains its books and records relating to Accounts and General Intangibles at:

Not Applicable.

6. Each Subsidiary has had no office, place of business or agent for process located in any county other than as set forth above, except: Not Applicable.

7. The following bailees, warehouseman, similar parties and consignees hold Inventory of any Borrower or any one of its Subsidiaries:

Name and Address of Party	Nature of Relationship	Amount of Inventory <sup>1</sup>	Owner of Inventory
**	Warehouse	\$614,793	Power Solutions
**	Warehouse	\$1,561,579	Power Great Lakes
**	Processor	\$2,238	Power Solutions
**	Processor	\$1,010,895	Power Solutions
**	Processor	\$41,853.67	Power Solutions
**	Processor	\$45,055.79	Power Solutions
**	Processor	\$2,945.38	Power Production
**	Consignment	\$4,170.46	Power Solutions
**	Consignment	\$7,832.71	Power Solutions
**	Consignment	\$10,867.11	Power Solutions
**	Consignment	\$2,794.38	Power Solutions
**	Consignment	\$3,616.04	Power Solutions
**	Consignment	\$3,529.24	Power Solutions
**	Consignment	\$2,972.77	Power Solutions
**	Consignment	\$4,231.79	Power Solutions
**	Consignment	\$11,645.88	Power Solutions
**	Consignment	\$3,535.17	Power Solutions

<sup>1</sup> All values as of December 31, 2011, except with respect to inventory held by \*\*, which value is as of February 28, 2012.

Name and Address of Party	Nature of Relationship	Amount of Inventory <sup>1</sup>	Owner of Inventory
**	Consignment	\$862.58	Power Solutions
**	Consignment	\$10,875.29	Power Solutions
**	Consignment	\$2,972.77	Power Solutions
**	Consignment	\$2,714.97	Power Solutions
**	Consignment	\$2,260.39	Power Solutions

**EXHIBIT 8.1.1**

**JURISDICTIONS IN WHICH ANY BORROWER  
AND ITS SUBSIDIARIES  
ARE AUTHORIZED TO DO BUSINESS**

Name of Entity	Jurisdiction
Parent	Delaware
Holdings	Delaware and Illinois
Power Solutions	Illinois
Great Lakes	Illinois
Auto Manufacturing	Illinois
Torque	Illinois
Properties	Illinois
Production	Illinois
Global	Illinois
PSI	Illinois
XISYNC	Illinois

Exhibit 8.1.1-1

## EXHIBIT 8.1.4

## CAPITAL STRUCTURE

1. The classes and the number of authorized and issued Securities of Parent and the record owner of such Securities on the Closing Date are as follows:

	Common Stock	Warrant Shares	T
er	4,545,500	0	4
er	2,883,651	0	2
	0		

div>

In connection with our long-term growth strategy, we recently built a new TAD paper machine and installed four converting lines at our facility in Shelby, North Carolina and upgraded our TAD manufacturing capabilities at our Las Vegas, Nevada facility. As these are recently completed projects, we are still in the process of optimizing the operation of the new and upgraded equipment, the quality of the TAD products being produced at these facilities, the converting and distribution of our TAD and existing tissue products and the sales mix of our new TAD product offerings with existing product lines. We are also working with existing customers as well as new customers to develop marketing and sales programs in connection with the new TAD products. These ongoing efforts entail numerous risks, including potential mechanical and other operational problems in the start-up phase of operations of this complex manufacturing equipment, difficulties in integrating the new TAD products with existing products, difficulties in integrating the new operations and personnel with our other tissue operations and market acceptance of the new TAD products. Any of these risks, if realized, could have a material adverse effect on our business, financial condition, results of operations and liquidity. In addition, such events could also divert management's attention from other business concerns.

Additionally, over the past few years, several new or refurbished TAD paper machines have been completed or announced by our competitors, including private label competitors, that will result in a substantial increase in the supply of TAD tissue in the North American market. This increase in supply of TAD products, as well as the effects of that increased supply in displacing existing conventional tissue product sales, could have a material adverse effect on the price of TAD tissue products and on the market demand for conventional tissue products, which will continue to represent a majority of our total production for the foreseeable future.

The loss of, or a significant reduction in, orders from, or changes in prices in regards to, any of our large customers could adversely affect our operating results and financial condition.

In 2012, our Consumer Products segment derived approximately 32% of its net sales and we derived approximately 19% of our total net sales from three customers. If we lose any of these customers or if the terms of our relationship with them becomes less favorable to us, our net sales would decline, which would harm our business, results of operations and financial condition. We have experienced increased price and promotion competition for our consumer products customers, which can decrease our gross margins and adversely affect our financial condition. Some of our customers have the capability to produce the parent rolls or products themselves that they purchase from us. Our Pulp and Paperboard segment sells its products to a large number of customers, although certain customers have historically purchased a significant amount of our pulp or paperboard products.

We do not have long-term contracts with any of our customers, including our largest customers, that ensure a continuing level of business from them. In addition, our agreements with our customers are not exclusive and generally do not contain minimum volume purchase commitments. Our relationship with



our large customers will depend on our ability to continue to meet their needs for quality products and services at competitive prices. If we lose one or more of these customers or if we experience a significant decline in the level of purchases by any of them, we may not be able to quickly replace the lost business volume and our operating results and business could be harmed. In addition, our focus on these large accounts could affect our ability to serve our smaller accounts, particularly when product supply is tight and we are not able to fully satisfy orders for these smaller accounts.

We have increased our dependence on external sources of wood pulp, which subjects our business and results of operations to potentially significant fluctuations in the price of market pulp.

In 2010, our Consumer Products segment sourced approximately 65% of its annual pulp supply from our Pulp and Paperboard segment, while the Cellu Tissue operations we acquired historically relied entirely on external suppliers for wood pulp. Consequently, due to the integration of the Cellu Tissue operations at the end of 2010, our Consumer Products segment sourced approximately 71% of its pulp requirements externally during 2012. The increased dependence on external sources of wood pulp increases our exposure to fluctuations in prices for wood pulp, which in turn could have a material adverse effect on our financial results, operations and cash flows.

Pulp prices can, and have, changed significantly from one period to the next. For example, our external pulp costs decreased 17% from 2011 to 2012. The volatility of pulp prices can adversely affect our earnings if we are unable to pass cost increases on to our customers or if the timing of any price increases for our products significantly trails the increases in pulp prices. We have not hedged these risks.

table of contents

Changes in the cost and availability of wood fiber used in production of our products may adversely affect our results of operations and cash flow.

Wood fiber is the principal raw material used to create wood pulp, which in turn is used to manufacture our pulp and paperboard products and consumer products. In 2012, our wood fiber costs were 10.1% of our cost of sales. Much of the wood fiber we use in our pulp manufacturing process in Lewiston, Idaho, is the by-product of sawmill operations. As a result, the price of these residual wood fibers is affected by operating levels in the lumber industry. The significant reduction in home building over the past four years resulted in the closure or curtailment of operations at many sawmills. The price of wood fiber is expected to remain volatile until the housing market recovers and sawmill operations increase.

Additionally, the supply and price of wood fiber can be negatively affected by weather and other events. The effects on market prices for wood fiber resulting from various governmental programs involving tax credits or payments related to biomass and other renewable energy projects are uncertain and could result in a reduction in the supply of wood fiber available for our pulp and paperboard manufacturing operations. If we and our pulp suppliers are unable to obtain wood fiber at favorable prices or at all, our costs will increase and financial results, operations and cash flows may be materially adversely affected. The cost of chemicals and energy needed for our manufacturing processes significantly affects our business.

We use a variety of chemicals in our manufacturing processes, including latex and polyethylene, many of which are petroleum-based chemicals. In 2012, our chemical costs were 11.5% of our cost of sales. Prices for these chemicals have been and are expected to remain volatile. In addition, chemical suppliers that use petroleum-based products in the manufacture of their chemicals may, due to supply shortages and cost increases, ration the amount of chemicals available to us, and therefore we may not be able to obtain at favorable prices the chemicals we need to operate our business, if we are able to obtain them at all. Our manufacturing operations utilize large amounts of electricity and natural gas and our energy requirements, particularly natural gas, will increase significantly as a result of operations at our North Carolina facility. In 2012, our energy costs were 6.8% of our cost of sales. Energy prices have fluctuated widely over the past decade, which in turn affects our cost of sales. We purchase on the open market a substantial portion of the natural gas necessary to produce our products, and, as a result, the price and other terms of those purchases are subject to change based on factors such as worldwide supply and demand, geopolitical events, government regulation, and natural disasters. Our energy costs in future periods will depend principally on our ability to produce a substantial portion of our electricity needs internally, on changes in market prices for natural gas and on reducing energy usage.

Any significant energy shortage or significant increase in our energy costs in circumstances where we cannot raise the price of our products could have a material adverse effect on our business, financial condition, results of operations and cash flows. Any disruption in the supply of energy could also affect our ability to meet customer demand in a timely manner and could harm our reputation.

Increases in our transportation costs or disruptions in our transportation services could have a material adverse effect on our business.

Our business, particularly our Consumer Products business, is dependent on transportation services to deliver our products to our customers and to deliver raw materials to us. In 2012, our transportation costs were 10.6% of our cost of sales. The costs of these transportation services are primarily determined by fuel prices, which have steadily increased since 2008 and are affected by geopolitical and economic events. We have not been in the past, and may not be in the future, able to pass along part or all of any fuel price increases to customers. If we are unable to increase our prices as a result of increased fuel costs charged to us by transportation providers, our gross margins may be materially adversely affected.

If any transportation providers fail to deliver raw materials to us in a timely manner, we may be unable to manufacture products on a timely basis. Shipments of products and raw materials may be delayed due to weather conditions, labor strikes or other events. Any failure of a third-party transportation provider to deliver raw materials or products in a timely manner could harm our reputation, negatively affect our

customer relationships and have a material adverse effect on our business, financial condition, results of operations and cash flows.

Larger competitors have operational and other advantages over our operations.

The markets for our products are highly competitive, and companies that have substantially greater financial resources compete with us in each market. Some of our competitors have advantages over us, including lower raw material and labor costs and better access to the inputs of our products.

10

---

table of contents

Our Consumer Products business faces competition from companies that produce the same type of products that we produce or that produce alternative products that customers may use instead of our products. Our Consumer Products business competes with the branded tissue products producers, such as Procter & Gamble, and branded label producers who manufacture branded and private label products, such as Georgia-Pacific and Kimberly-Clark. These companies are far larger than us, have much greater sales, marketing and research and development resources than we do, and enjoy significant cost advantages due to economies of scale. In addition, because of their size and resources, these companies may foresee market trends more accurately than we do and develop new technologies that render our products less attractive or obsolete.

Our ability to successfully compete in the pulp and paperboard industry is influenced by a number of factors, including manufacturing capacity, general economic conditions and the availability and demand for paperboard substitutes. Our Pulp and Paperboard business competes with International Paper, MeadWestvaco, Georgia-Pacific, RockTenn and international producers, most of whom are much larger than us. Any increase in manufacturing capacity by any of these or other producers could result in overcapacity in the pulp and paperboard industry, which could cause downward pressure on pricing. In addition, customers could choose to use types of paperboard that we do not produce or could rely on alternative materials, such as plastic, for their products. An increased supply of any of these products could cause us to lower our prices or lose sales to competitors, either of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The consolidation of paperboard converting businesses, including through the acquisition and integration of such converting business by larger competitors of ours, could result in a loss of customers and sales on the part of our Pulp and Paperboard business, which does not include paperboard converting facilities or capabilities. A loss of paperboard customers or sales as a result of consolidations and integrations could have a material adverse effect on our business, financial condition, results of operations and cash flows. Changes in demand for certain products could adversely affect our financial results.

Our ability to compete successfully depends on our ability to adjust to increases and decreases in demand. If we are unable to respond to increases in demand, we may need to limit deliveries of some orders for existing customers, which could harm our reputation and our long-term relationships with these customers. Currently, we are unable to meet all of the demand from existing and potential customers for bathroom tissue due to very high demand. Alternatively, if we experience a decrease in demand for certain products, we may incur significant costs in revising our manufacturing plan. If we are not able to respond to changes in demand for our products in a timely manner, our financial position, results of operations and cash flows may be adversely affected.

Competitors' branded products and private label TAD products could have an adverse effect on our financial results.

Our consumer products compete with well-known, branded products, as well as other private label products. Inherent risks in our competitive strategy include whether our products will receive direct and retail customer acceptance, new product offerings by competitors, the effects of consolidation within retailer and distribution channels, and price competition from companies that may have greater financial resources than we do. We have only recently completed new, or upgraded existing, TAD facilities that allow us to produce TAD bathroom tissue. If we are unable to offer our existing customers, or new customers, tissue products comparable to branded products or private label competitive TAD products, and in sufficient quantities, we may lose business or we may not be able to grow our existing business and be forced to sell lower-margin products, all of which could negatively affect our financial condition and results of operations.

Our qualification to retain, or ability to utilize, tax credits associated with alternative fuels or cellulosic biofuels and the tax treatment associated with receipt of such credits are uncertain.

In 2009, we received refundable federal tax credit payments in connection with our use of "black liquor," a by-product of the pulp manufacturing process, in an alternative fuel mixture to produce energy at our pulp

mills. The amount of the refundable tax credit was equal to \$0.50 per gallon of alternative fuel mixture used. This tax credit expired on December 31, 2009. In 2009, we recorded pre-tax income of \$170.6 million related to the Alternative Fuel Mixture Tax Credit, or AFMTC. We have not recorded any pre-tax income since 2009 relating to the AFMTC.

There is relatively little guidance regarding the AFMTC and the law governing the issue is complex. Accordingly, there remains uncertainty as to our qualification to receive the tax credit in 2009, as well as to whether we will be entitled to retain the amounts we received upon further review by the Internal Revenue Service, or IRS. In addition, while it is our position that payments received or credits taken in relation to the AFMTC should not be subject to corporate income tax, there can be no assurance as to whether or not the amounts we have received will be subject to taxation. As of December 31, 2012 we have recorded accrued taxes on uncertain tax positions related to the AFMTC of \$68.3 million. In 2012, the IRS began conducting an audit of our 2008 to 2011 tax years, which is further discussed in Note 8, "Income Taxes," in the notes to the consolidated financial statements.

table of contents

We are also registered with the IRS as a cellulosic biofuel producer, which enables us to claim the \$1.01 per gallon Cellulosic Biofuel Producer Credit, or CBPC, in regards to black liquor produced and used as a fuel by us at our pulp mills in 2009. We have changed, and may in the future make additional changes in, our position as to some or all of the credits we claimed under the AFMTC on our 2009 federal income tax form, provided we believe we will have sufficient future federal taxable earnings to enable us to carry forward the credits potentially available under the CBPC. There can be no assurance that we will be able to fully utilize the CBPC. Congress has identified the elimination or modification of the CBPC in connection with black liquor as a possible revenue source. Such legislative action could limit or eliminate our ability to convert AFMTC gallons to CBPC gallons and/or CBPC gallons to AFMTC gallons and, accordingly, limit or eliminate our ability to claim carry forward credits.

We are subject to significant environmental regulation and environmental compliance expenditures, which could increase our costs and subject us to liabilities.

We are subject to various federal, state and foreign environmental laws and regulations concerning, among other things, water discharges, air emissions, hazardous material and waste management and environmental cleanup. Environmental laws and regulations continue to evolve and we may become subject to increasingly stringent environmental standards in the future, particularly under air quality and water quality laws and standards related to climate change issues, such as reporting of greenhouse gas emissions. Increased regulatory activity at the state, federal and international level is possible regarding climate change as well as other emerging environmental issues associated with our manufacturing sites. Compliance with regulations that implement new public policy in these areas might require significant expenditures on our part.

We are required to comply with environmental laws and the terms and conditions of multiple environmental permits. In particular, the pulp and paper industry in the United States is subject to several performance based rules associated with effluent and air emissions as a result of certain of its manufacturing processes. Federal, state and local laws and regulations require us to routinely obtain authorizations from and comply with the evolving standards of the appropriate governmental authorities, which have considerable discretion over the terms of permits. Failure to comply with environmental laws and permit requirements could result in civil or criminal fines or penalties or enforcement actions, including regulatory or judicial orders enjoining or curtailing our operations or requiring us to take corrective measures, install pollution control equipment, or take other remedial actions, such as product recalls or labeling changes. We also may be required to make additional expenditures, which could be significant, relating to environmental matters on an ongoing basis.

In 2012, we were notified that the U.S. Environmental Protection Agency, or EPA, submitted a civil referral to the U.S. Department of Justice, or DOJ, alleging violations of the Clean Air Act stemming from an EPA investigation at our Lewiston, Idaho pulp facility. Prior to the filing of any formal action, we and the DOJ agreed to discuss the resolution of the allegations, and the parties entered into an agreement to toll the statute of limitations. The tolling agreement expires on March 29, 2013, unless further extended by the parties. Discussions with the DOJ and EPA are ongoing. However, this matter could result in civil penalties or enforcement actions, including regulatory or judicial orders enjoining or curtailing our operations or requiring us to take corrective measures, install pollution control equipment, or take other remedial actions.

We own properties, conduct or have conducted operations at properties, and have assumed indemnity obligations in connection with our spin-off in 2008 from Potlatch, for properties or operations where hazardous materials have been or were used for many years, including during periods before careful management of these materials was required or generally believed to be necessary. Consequently, we will continue to be subject to risks under environmental laws that impose liability for historical releases of hazardous substances. There can be no assurance that future environmental permits will be granted or that we will be able to maintain and renew existing permits, and the failure to do so could have a material adverse effect on our results of operations, financial condition and cash flows.

We incur significant expenses to maintain our manufacturing equipment and any interruption in the operations of our facilities may harm our operating performance.

We regularly incur significant expenses to maintain our manufacturing equipment and facilities. The machines and equipment that we use to produce our products are complex, have many parts and some are run on a continuous basis. We must perform routine maintenance on our equipment and will have to periodically replace a variety of parts such as motors, pumps, pipes and electrical parts. In addition, our pulp and paperboard facilities require periodic shutdowns to perform major maintenance. These scheduled shutdowns of facilities result in decreased sales and increased costs in the periods in which a shutdown occurs.

12

---

table of contents

Unexpected production disruptions could cause us to shut down or curtail operations at any of our facilities. For example, in 2011 we curtailed operations at our Cypress Bend, Arkansas, pulp and paperboard facility as the result of an electrical malfunction and curtailed operations at our Wiggins, Mississippi, consumer products facility as the result of a fire. Disruptions could occur due to any number of circumstances, including prolonged power outages, mechanical or process failures, shortages of raw materials, natural catastrophes, disruptions in the availability of transportation, labor disputes, terrorism, changes in or non-compliance with environmental or safety laws and the lack of availability of services from any of our facilities' key sole suppliers. Any facility shutdowns may be followed by prolonged startup periods, regardless of the reason for the shutdown. Those startup periods could range from several days to several weeks, depending on the reason for the shutdown and other factors. Any prolonged disruption in operations at any of our facilities could cause significant lost production, which would have a material adverse effect on our business, financial condition, results of operations and cash flows. We rely on information technology in critical areas of our operations, and a disruption relating to such technology could harm our financial condition.

We use information technology, or IT, systems in various aspects of our operations, including enterprise resource planning, management of inventories and customer sales. Some of these systems have been in place for long periods of time. Additionally, with the acquisition of Cellu Tissue, we have different legacy IT systems which we are continuing to integrate. If one of these systems was to fail, or if we decide to change these systems or hire outside parties to provide these systems, we may suffer disruptions, which could have a material adverse effect on our results of operations and financial condition. In addition, we may underestimate the costs and expenses of developing and implementing new systems.

United States and global economic conditions could have adverse effects on the demand for our products and financial results.

U.S. and global economic conditions have negatively affected and may continue to negatively affect our business and financial results. For example, the away-from-home consumer paper products market has experienced a decline because of the slowdown in the travel and restaurant industries as a result of the ongoing economic downturn. Recessed economic conditions affect our business in a number of ways, including causing: (i) increased pressure for price concessions from customers; (ii) declines in domestic and global demand for paperboard; (iii) shifts in customer purchases that affect the mix of our product sales; (iv) decreased or low housing starts, which increase production costs due to lower wood fiber supplies; and (v) financial distress or insolvency for certain customers which could affect our sales volumes or our ability to collect accounts receivable on a timely basis from those customers.

Our company-sponsored pension plans and one of our multiemployer pension plans are currently underfunded, and over time we will be required to make cash payments to the plans, reducing cash available for our business.

We have company-sponsored pension plans covering certain of our salaried and hourly employees. The significant decline in the securities markets beginning in 2008 and resulting substantial decline in the value of equity and fixed income investments held by these plans, coupled with a low interest rate environment resulting in higher liability valuations, have caused these plans to be underfunded so that the projected benefit obligation exceeds the aggregate fair value of plan assets. At December 31, 2012, our company sponsored pension plans were underfunded in the aggregate by approximately \$78.7 million. As a result of underfunding, we are required to make contributions to our qualified pension plans. In 2012, we contributed \$20.6 million to these pension plans. We may be required to make increased annual contributions to our pension plans in future years, which would reduce the cash available for business and other needs.

We also contribute to two multiemployer pension plans. The amount of our annual contributions to each of these plans is negotiated with the plan and the bargaining unit representing our employees covered by the plan. In 2012 we contributed approximately \$6 million to these plans and in future years we may be required to make increased annual contributions, which would reduce the cash available for business and



other needs. In addition, in the event of a partial or complete withdrawal by us from any multiemployer plan that is underfunded, we would be liable for a proportionate share of such multiemployer plan's unfunded vested benefits, referred to as a withdrawal liability. A withdrawal liability is considered a contingent liability. Based on the limited information available from the plan administrator of one of our multiemployer plans, which we cannot independently validate, we believe that our portion of the contingent liability in the case of a full withdrawal from or termination of that plan would likely be material to our financial position and results of operations. In the event that any other contributing employer withdraws from any multiemployer plan that is underfunded, and such employer cannot satisfy its obligations under the multiemployer plan at the time of withdrawal, then we, along with the other remaining contributing employers, would be liable for our proportionate share of such plan's unfunded vested benefits which could result in an increase to our required annual contributions.

table of contents

Our pension and health care costs are subject to numerous factors which could cause these costs to change.

In addition to our pension plans, we provide retiree health care benefits to certain of our current and former U.S. salaried and hourly employees. Our retiree health care costs vary with changes in health care costs generally, which have significantly exceeded general economic inflation rates for many years. Our pension costs are dependent upon numerous factors resulting from actual plan experience and assumptions about future investment returns. Pension plan assets are primarily made up of equity and fixed income investments. Fluctuations in actual equity market returns as well as changes in general interest rates may result in increased pension costs in future periods. Likewise, changes in assumptions regarding current discount rates and expected rates of return on plan assets could also increase pension costs. Significant changes in any of these factors may adversely impact our cash flows, financial condition and results of operations.

Cyclical industry conditions have in the past affected and may continue to adversely affect the operating results and cash flow of our Pulp and Paperboard business.

Our Pulp and Paperboard business is particularly affected by cyclical market conditions. We may be unable to sustain pricing in the face of weaker demand, and weaker demand may in turn cause us to take production downtime. In addition to lost revenue from lower shipment volumes, production downtime causes unabsorbed fixed manufacturing costs due to lower production levels. Our results of operations and cash flows may be materially adversely affected in a period of prolonged and significant market weakness. We are not able to predict market conditions or our ability to sustain pricing and production levels during periods of weak demand.

We rely on a limited number of third-party suppliers for certain raw materials required for the production of our products.

Our dependence on a limited number of third-party suppliers, and the challenges we may face in obtaining adequate supplies of raw materials, involve several risks, including limited control over pricing, availability, quality, and delivery schedules. We cannot be certain that our current suppliers will continue to provide us with the quantities of these raw materials that we require or will continue to satisfy our anticipated specifications and quality requirements. Any supply interruption in limited raw materials could materially harm our ability to manufacture our products until a new source of supply, if any, could be identified and qualified. Although we believe there are other suppliers of these raw materials, we may be unable to find a sufficient alternative supply channel in a reasonable time or on commercially reasonable terms. Any performance failure on the part of our suppliers could interrupt production of our products, which would have a material adverse effect on our business.

Our business and financial performance may be harmed by future labor disruptions.

As of December 31, 2012, 52% of our full-time employees are represented by unions under collective bargaining agreements. As these agreements expire, we may not be able to negotiate extensions or replacement agreements on terms acceptable to us. We currently have no collective bargaining agreements under negotiation. Any failure to reach an agreement with one of the unions may result in strikes, lockouts or other labor actions. Any such labor actions, including work slowdowns in the future or stoppages, could have a material adverse effect on our operations and financial results.

Additional expansion of our business through construction of new facilities or acquisitions may not proceed as anticipated.

In addition to the acquisition of Cellu Tissue and construction of our North Carolina facility, in the future we may build other converting and papermaking facilities, pursue acquisitions of existing facilities, or both. We may be unable to identify future suitable building locations or acquisition targets. In addition, we may be unable to achieve anticipated benefits or cost savings from construction projects or acquisitions in the timeframe we anticipate, or at all. Any inability by us to integrate and manage any new or acquired facilities or businesses in a timely and efficient manner, any inability to achieve anticipated cost savings or other anticipated benefits from these projects or acquisitions in the time frame we

anticipate or any unanticipated required increases in promotional or capital spending could adversely affect our business, financial condition, results of operations or liquidity. Large construction projects or acquisitions can result in a decrease in our cash and short-term investments, an increase in our indebtedness, or both, and also may limit our ability to access additional capital when needed and divert management's attention from other business concerns.

14

---

table of contents

The indentures for our outstanding notes that we issued in 2010 and 2013, and the credit agreement governing our senior secured revolving credit facility, contain various covenants that limit our discretion in the operation of our business.

The indentures governing our outstanding notes that we issued in 2010 and 2013, and the credit agreement governing our senior secured revolving credit facility, contain various provisions that limit our discretion in the operation of our business by restricting our ability to:

- undergo a change in control;
- sell assets;
- pay dividends and make other distributions;
- make investments and other restricted payments;
- redeem or repurchase our capital stock;
- incur additional debt and issue preferred stock;
- create liens;
- consolidate, merge, or sell substantially all of our assets;
- enter into certain transactions with our affiliates;
- engage in new lines of business; and
- enter into sale and lease-back transactions.

These restrictions on our ability to operate our business in our discretion could seriously harm our business by, among other things, limiting our ability to take advantage of financing, merger and acquisition and other corporate opportunities. In addition, our senior secured revolving credit facility requires, among other things, that we maintain a minimum fixed charge coverage ratio of at least 1.0-to-1.0 when availability falls below \$50 million or an event of default exists. Events beyond our control could affect our ability to meet this financial test, and we cannot assure you that we will meet it. Our failure to comply with the covenants contained in our senior secured revolving credit facility or the indentures governing our outstanding notes, including as a result of events beyond our control, could result in an event of default that could cause repayment of the debt to be accelerated.

If we are not able to comply with the covenants and other requirements contained in the indentures governing our outstanding notes, our senior secured revolving credit facility or our other debt instruments, an event of default under the relevant debt instrument could occur. If an event of default does occur, it could trigger a default under our other debt instruments, prohibit us from accessing additional borrowings, and permit the holders of the defaulted debt to declare amounts outstanding with respect to that debt to be immediately due and payable. Our assets and cash flow may not be sufficient to fully repay borrowings under our outstanding debt instruments. In addition, we may not be able to refinance or restructure the payments on the applicable debt. Even if we were able to secure additional financing, it may not be available on favorable terms.

To service our indebtedness, we must generate significant cash flows. Our ability to generate cash depends on many factors beyond our control.

Our ability to make payments on and to refinance our indebtedness, including our outstanding notes, and to fund planned capital expenditures, will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us under our senior secured revolving credit facility in an amount sufficient to enable us to pay our indebtedness, including the notes, or to fund our other liquidity needs. We cannot assure you that we will be able to refinance any of our indebtedness, including our senior secured revolving credit facility and our existing notes, on commercially reasonable terms or at all.

table of contents

Certain provisions of our certificate of incorporation and bylaws and Delaware law may make it difficult for stockholders to change the composition of our Board of Directors and may discourage hostile takeover attempts that some of our stockholders may consider to be beneficial.

Certain provisions of our certificate of incorporation and bylaws and Delaware law may have the effect of delaying or preventing changes in control if our Board of Directors determines that such changes in control are not in the best interests of the company and our stockholders. The provisions in our certificate of incorporation and bylaws include, among other things, the following:

- a classified Board of Directors with three-year staggered terms;
- the ability of our Board of Directors to issue shares of preferred stock and to determine the price and other terms, including preferences and voting rights, of those shares without stockholder approval;
- stockholder action can only be taken at a special or regular meeting and not by written consent;
- advance notice procedures for nominating candidates to our Board of Directors or presenting matters at stockholder meetings;
- removal of directors only for cause;
- allowing only our Board of Directors to fill vacancies on our Board of Directors; and
- supermajority voting requirements to amend our bylaws and certain provisions of our certificate of incorporation.

While these provisions have the effect of encouraging persons seeking to acquire control of the company to negotiate with our Board of Directors, they could enable the Board of Directors to hinder or frustrate a transaction that some, or a majority, of the stockholders might believe to be in their best interests and, in that case, may prevent or discourage attempts to remove and replace incumbent directors. We are also subject to Delaware laws that could have similar effects. One of these laws prohibits us from engaging in a business combination with a significant stockholder unless specific conditions are met.

ITEM 1B.

Unresolved Staff Comments

None.

table of contents

## ITEM 2.

## Properties

## FACILITIES

We own and operate facilities located throughout the United States and one in Canada. The following table lists each of our facilities and its location, use, capacity and production:

	USE	LEASED OR OWNED	CAPACITY	PRODUCTION <sup>1</sup>
<b>CONSUMER PRODUCTS</b>				
Tissue manufacturing facilities:				
East Hartford, Connecticut	Tissue	Owned	36,000 tons	34,000 tons
Gouverneur, New York	Tissue	Owned	39,000 tons	39,000 tons
Ladysmith, Wisconsin	Tissue	Owned	56,000 tons	53,000 tons
Las Vegas, Nevada	TAD tissue	Owned/Leased	38,000 tons	38,000 tons
Lewiston, Idaho	Tissue	Owned	190,000 tons	190,000 tons
Menominee, Michigan	Machine-glazed tissue	Owned	36,000 tons	34,000 tons
Neenah, Wisconsin	Tissue	Owned	84,000 tons	84,000 tons
Shelby, North Carolina <sup>3</sup>	TAD tissue	Owned/Leased	70,000 tons	2,000 tons
St. Catharines, Ontario	TAD tissue	Owned	26,000 tons	26,000 tons
	Machine-glazed tissue		23,000 tons	23,000 tons
Wiggins, Mississippi	Tissue	Owned	29,000 tons	29,000 tons
	Machine-glazed tissue		33,000 tons	33,000 tons
			660,000 tons	585,000 tons
Tissue converting facilities:				
Central Islip, New York <sup>2</sup>	Tissue converting	Leased	38,000 tons	26,000 tons
Elwood, Illinois <sup>2</sup>	Tissue converting	Leased	68,000 tons	63,000 tons
Las Vegas, Nevada	Tissue converting	Owned/Leased	57,000 tons	49,000 tons
Lewiston, Idaho	Tissue converting	Owned	95,000 tons	80,000 tons
Menominee, Michigan	Machine-glazed tissue converting	Owned	27,000 tons	6,000 tons
Neenah, Wisconsin	Tissue converting	Owned	99,000 tons	57,000 tons
Oklahoma City, Oklahoma <sup>2</sup>	Tissue converting	Leased	14,000 tons	11,000 tons
Shelby, North Carolina <sup>3</sup>	Tissue converting	Owned/Leased	41,000 tons	23,000 tons
Thomaston, Georgia <sup>2</sup>	Tissue converting	Leased	38,000 tons	18,000 tons
			477,000 tons	333,000 tons
<b>PULP AND PAPERBOARD</b>				
Pulp Mills:				
	Pulp	Owned	316,000 tons	309,000 tons

Cypress Bend, Arkansas						
Lewiston, Idaho	Pulp	Owned	540,000	tons	533,000	tons
			856,000	tons	842,000	tons
Bleached Paperboard Mills:						
Cypress Bend, Arkansas	Paperboard	Owned	348,000	tons	338,000	tons
Lewiston, Idaho	Paperboard	Owned	445,000	tons	433,000	tons
			793,000	tons	771,000	tons
CORPORATE						
Alpharetta, Georgia	Operations and administration	Owned/Leased		N/A		N/A
Spokane, Washington	Corporate headquarters	Leased		N/A		N/A

<sup>1</sup> Production amounts are approximations for full year 2012.

<sup>2</sup> The buildings located at these facilities are leased by Clearwater Paper or a subsidiary, and the operating equipment located within the building is owned by Clearwater Paper or a subsidiary.

<sup>3</sup> In December 2012, our new TAD tissue machine in North Carolina began producing tissue. In addition to two converting lines installed in 2011 at our North Carolina location, two more tissue converting lines at that site became operational during the fourth quarter of 2012.

table of contents

ITEM 3.

Legal Proceedings

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

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

ITEM 4.

Mine Safety Disclosures

Not applicable



table of contents

## Part II

## ITEM 5.

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

**MARKET FOR OUR COMMON STOCK**

Our common stock is traded on the New York Stock Exchange. The following table sets forth, for each period indicated, the high and low sales prices of our common stock during our two most recent years. Prices have been retroactively adjusted to reflect our two-for-one stock split effected in the form of a stock dividend, effective August 26, 2011.

	Common Stock Price	
	High	Low
Year Ended December 31, 2012:		
Fourth Quarter	\$42.79	\$37.33
Third Quarter	41.98	33.37
Second Quarter	34.79	29.84
First Quarter	40.19	32.51
Year Ended December 31, 2011:		
Fourth Quarter	\$37.54	\$31.50
Third Quarter	38.86	32.83
Second Quarter	41.15	30.44
First Quarter	41.74	36.82

**HOLDERS**

On February 11, 2013, the last reported sale price for our common stock on the New York Stock Exchange was \$46.12 per share. As of February 11, 2013, there were approximately 1,050 registered holders of our common stock.

**DIVIDENDS**

We have not paid any cash dividends and do not anticipate paying a cash dividend in 2013. We will continue to review whether payment of a cash dividend on our common stock in the future best serves the company and our stockholders. The declaration and amount of any dividends, however, will be determined by our Board of Directors and will depend on our earnings, our compliance with the terms of our notes and revolving credit facility that contain certain restrictions on our ability to pay dividends, and any other factors that our Board of Directors believes are relevant.

**SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS**

Please see Part III, Item 12 of this report for information relating to our equity compensation plans.

**ISSUER PURCHASES OF EQUITY SECURITIES**

On July 28, 2011, we announced that our Board of Directors had authorized the repurchase of up to \$30 million of our common stock. Under the stock repurchase program, we were authorized to repurchase shares in the open market or as otherwise determined by management, subject to market conditions, business opportunities and other factors. During 2012, we repurchased 520,170 shares of outstanding common stock at a total cost of \$18.7 million, representing an average price of \$35.85 per share. We completed this repurchase program in the fourth quarter of 2012. The total number of shares repurchased under this program was 853,470 at an aggregate cost of \$30 million and an average price of \$35.15 per share.

On January 21, 2013, in an event subsequent to the close of our 2012 fiscal year, and in conjunction with the sale of \$275 million aggregate principal amount of senior notes, we announced that our Board of Directors approved a new stock repurchase program authorizing the repurchase of \$100 million of our common stock. We intend to complete this share repurchase program during 2013 through open market purchases, negotiated transactions or other means.



table of contents

The following table provides information about share repurchases that we made during the three months ended December 31, 2012 (in thousands, except share and per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
October 1, 2012 to October 31, 2012	31,400	\$39.63	31,400	\$ 8,051
November 1, 2012 to November 30, 2012	199,988	\$40.26	199,988	\$ —
December 1, 2012 to December 31, 2012	—	\$—	—	\$ —
Total	231,388	\$40.18	231,388	

## ITEM 6.

## Selected Financial Data

Prior to our spin-off from Potlatch Corporation, or Potlatch, on December 16, 2008, we were a wholly-owned subsidiary of Potlatch. On December 16, 2008, Potlatch distributed 100% of the issued and outstanding shares of our common stock to the holders of Potlatch common stock.

During the period from December 16, 2008 through December 31, 2012, we operated as and were accounted for as a separate public company. Our results of operations and financial condition reflected in the table below cover the period from January 1, 2008 until the spin-off and related transactions. The historical financial and other data for this period prior to the spin-off was prepared on a combined basis from Potlatch's consolidated financial statements using the historical results of operations and basis of the assets and liabilities of Potlatch's consumer products and pulp and paperboard businesses and its wood products operation at Lewiston, Idaho, and give effect to allocations of expenses from Potlatch. All other data has been derived from our audited financial statements. Our historical financial and other data is not necessarily indicative of our future performance nor do they necessarily reflect what our financial position and results of operations would have been had we operated as a separate, stand-alone entity prior to December 16, 2008. In addition, all amounts below for 2010 reflect the acquisition of Cellu Tissue on December 27, 2010, including four days of Cellu Tissue's operating results and incurrence of acquisition related expenses. Amounts for 2011 forward, are reflective of the sale of our Lewiston, Idaho sawmill in November 2011.

Earnings per share and common shares outstanding data have been retroactively adjusted to reflect our two-for-one stock split that was effected in the form of a stock dividend distributed on August 26, 2011 to shareholders of record on August 12, 2011.

(In thousands, except earnings per share amounts)	2012	2011	2010	2009	2008
Net sales	\$1,874,304	\$1,927,973	\$1,372,965	\$1,250,069	\$1,255,309
Income from operations	145,387	115,445	98,767	297,440	28,484
Net earnings <sup>1</sup>	64,131	39,674	73,800	182,464	9,743
Working capital <sup>2</sup>	293,733	390,839	394,346	452,583	14,022
Note payable to Potlatch	—	—	—	—	100,000
Long-term debt, net of current portion	523,933	523,694	538,314	148,285	—
Stockholders' equity	540,894	484,904	468,349	363,736	180,989
Capital expenditures <sup>3</sup>	207,115	137,743	47,033	19,328	21,306

Property, plant and equipment, net	877,377	735,566	654,456	364,024	389,867
Total assets	1,633,456	1,571,318	1,545,336	947,463	683,266
Basic net earnings per common share	\$2.75	\$1.73	\$3.22	\$8.03	\$0.43
Basic average common shares outstanding	23,299	22,914	22,947	22,721	22,710
Diluted net earnings per common share	\$2.72	\$1.66	\$3.12	\$7.75	\$0.43
Diluted average common shares outstanding	23,614	23,952	23,670	23,540	22,710

<sup>1</sup> Income from operations for the year ended December 31, 2009, included \$170.6 million associated with the Alternative Fuel Mixture Tax Credit.

<sup>2</sup> Working capital is defined as our current assets less our current liabilities as presented on our Consolidated Balance Sheets.

<sup>3</sup> Capital expenditures in 2012, 2011 and 2010 primarily include expenditures related to our through-air-dried tissue expansion project at our Shelby, North Carolina, and Las Vegas, Nevada, manufacturing and converting facilities.

table of contents

ITEM 7.

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

The following discussion and analysis should be read in conjunction with our audited consolidated financial statements and notes thereto that appear elsewhere in this report. This discussion contains forward-looking statements reflecting our current expectations that involve risks and uncertainties. Actual results may differ materially from those discussed in these forward-looking statements due to a number of factors, including those set forth in the section entitled "Risk Factors" and elsewhere in this report. Unless the context otherwise requires or unless otherwise indicates, references in this report to "Clearwater Paper Corporation," "we," "our," "the company" and "us" refer to Clearwater Paper Corporation and its subsidiaries. On December 27, 2010, we acquired Cellu Tissue Holdings, Inc., or Cellu Tissue. The results discussed below include Cellu Tissue operating results for the period December 28, 2010 forward.

OVERVIEW

2012 Highlights

Consumer Products Expansion

In December 2012, we announced the start-up of our new through-air-dried, or TAD, paper machine and the completion of two additional converting lines that became operational in the fourth quarter of 2012. The completion of the TAD paper machine and a total of four converting lines in Shelby, North Carolina, along with another converting line we expect to install in 2013, is expected to increase our ultra and premium offerings to existing and new customers. Also in the fourth quarter, we completed upgrades to our TAD tissue manufacturing facility in Las Vegas, Nevada.

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

We estimate the TAD project will cost approximately \$270 million, excluding capitalized interest. As of December 31, 2012, we have incurred a total of \$253.8 million in TAD project costs, of which \$144.5 million was incurred in 2012. We expect the remaining balance of approximately \$16 million to be spent in 2013. In addition, we capitalized a total of \$16.8 million of interest related to the TAD project, of which \$12.6 million was capitalized in 2012.

In August 2011, First Quality Tissue SE, LLC, or First Quality, filed a lawsuit against Metso Paper, the company we contracted with to supply the TAD paper machine to our North Carolina facility, seeking to enjoin Metso Paper from delivering the TAD paper machine based on First Quality's agreement with Metso Paper. On June 20, 2012, the United States District Court for the District of South Carolina ruled in favor of Clearwater Paper and Metso Paper and denied First Quality's claim to enjoin Metso Paper from delivering the TAD paper machine to us.

Integration of Cellu Tissue Holdings, Inc.

On December 27, 2010, we acquired Cellu Tissue, which included nine tissue manufacturing facilities located in the Southern, Midwestern and Eastern United States and one facility in Eastern Canada. These facilities have allowed us to better serve existing private label grocery customers by creating a broad manufacturing footprint geographically and have enabled us to expand into new private label and other tissue channels. We recognized \$10.4 million and \$31.0 million of net cost savings from synergies relating to the acquisition during the three and twelve months ended December 31, 2012, respectively, and expect to achieve \$35 to \$40 million annually in net cost savings from synergies beginning in 2013.

Capital Allocation

On July 28, 2011, we announced that our Board of Directors had authorized the repurchase of up to \$30 million of our common stock. Under the stock repurchase program, we were authorized to repurchase shares in the open market or as otherwise determined by management, subject to market conditions, business opportunities and other factors. During 2012, we repurchased 520,170 shares of outstanding

common stock at a total cost of \$18.7 million, representing an average price of \$35.85 per share. We completed this repurchase program in the fourth quarter of 2012. The total number of shares repurchased under this program was 853,470 at an aggregate cost of \$30 million and an average price of \$35.15 per share.

21

---

table of contents

On February 22, 2013, in an event subsequent to the close of our 2012 fiscal year, and in conjunction with the issuance of \$275 million of 4.5% aggregate principal senior notes due 2023, which we refer to as the 2013 Notes, we redeemed \$150 million in aggregate principal amount of 10.625% senior notes issued in 2009. In addition, through the same subsequent event, we announced that our Board of Directors approved a new common stock repurchase program authorizing the repurchase of \$100 million of our common stock, to be funded by a portion of the proceeds from the 2013 Notes. We intend to complete this share repurchase program during 2013 through open market purchases, negotiated transactions or other means.

Business

We are a leading producer of private label tissue and premium bleached paperboard products. Our products are primarily wood pulp-based and predominately manufactured in the U.S.

Our business is organized into two reporting segments:

Our Consumer Products segment manufactures and sells a complete line of at-home tissue products in each tissue category, including bathroom tissue, paper towels, napkins and facial tissue. We also manufacture away-from-home tissue, or AFH, machine-glazed tissue and parent rolls for external sales. Our integrated manufacturing and converting operations and geographic footprint enable us to deliver a broad range of cost-competitive products with brand equivalent quality to our consumer products customers. In 2012, our Consumer Products segment had net sales of \$1.1 billion, representing approximately 61% of our total net sales.

Our Pulp and Paperboard segment manufactures and markets bleached paperboard for the high-end segment of the packaging industry and is a leading producer of solid bleach sulfate paperboard. This segment also produces hardwood and softwood pulp, which is primarily used as the basis for our paperboard products, and slush pulp, which it supplies to our Consumer Products segment. In 2012, our Pulp and Paperboard segment had net sales of \$739.7 million, representing approximately 39% of our total net sales.

Developments and Trends in our Business

Net Sales

Prices for our consumer tissue products are affected by competitive conditions and the prices of branded tissue products. Tissue has historically been one of the strongest segments of the paper and forest products industry due to its steady demand growth and the absence of severe supply imbalances that occur in a number of other paper segments. Our Consumer Products segment competes based on product quality, customer service and price. We deliver customer-focused business solutions by assisting in managing product assortment, category management, and pricing and promotion optimization.

Demand and pricing for our pulp and paperboard products are largely determined by macro-economic conditions around the world. Paperboard prices softened modestly in 2012 compared to 2011.

Our pulp and paperboard business experiences cyclical market conditions and, as a result, historical prices for our products and sales volumes have been volatile. Product pricing is significantly affected by the relationship between supply and demand for our products. Product supply in the industry is influenced primarily by fluctuations in available manufacturing production, which tends to increase during periods when prices remain strong. In addition, currency exchange rates affect U.S. supplies of paperboard, as non-U.S. manufacturers are attracted to the U.S. market when the dollar is relatively strong. Our paperboard business, through exports denominated in U.S. dollars, has benefited significantly from general weakness in the U.S. dollar over the past few years.

The markets for our products are highly competitive and companies that have substantially greater financial resources than we do compete with us in each of our markets. In addition, our businesses are capital intensive, which leads to high fixed costs, large capital outlays and generally results in continued production as long as prices are sufficient to cover variable costs. These conditions have contributed to substantial price competition, particularly during periods of reduced demand. Some of our competitors have lower production costs and greater buying power and, as a result, may be less adversely affected

than we are by price decreases.

Net sales consist of sales of consumer tissue and pulp and paperboard, net of discounts, returns and allowances and any sales taxes collected.

22

---



table of contents

## Operating Costs

Prices for our principal operating cost items are variable and directly affect our results of operations. For example, as economic conditions improve, we normally would expect at least some upward pressure on these operating costs. Competitive market conditions can limit our ability to pass cost increases through to our customers.

(Dollars in thousands)	Year Ended December 31,		2011		2010				
	2012	Percentage of	Cost	Percentage of	Cost	Percentage of	Cost	Percentage of	
	Cost	Cost of	Cost	Cost of	Cost	Cost of	Cost	Cost of	
		Sales		Sales		Sales		Sales	
Purchased pulp	\$242,921	15.1	%	\$291,595	17.1	%	\$175,519	15.0	%
Chemicals	183,606	11.5		174,660	10.3		132,263	11.3	
Transportation <sup>1</sup>	171,114	10.6		185,329	10.9		136,731	11.6	
Chips, sawdust and logs	162,904	10.1		196,017	11.5		128,934	11.0	
Energy	109,592	6.8		130,179	7.6		91,977	7.8	
Maintenance and repairs <sup>2</sup>	98,217	6.1		99,775	5.9		82,368	7.0	
Packaging supplies	86,282	5.4		94,926	5.6		45,263	3.9	
Depreciation and amortization	79,333	4.9		76,933	4.5		47,728	4.0	
	\$1,133,969	70.5	%	\$1,249,414	73.4	%	\$840,783	71.6	%

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

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

**Purchased pulp.** We purchase a significant amount of the pulp from external suppliers to supply our consumer products, and, to a lesser extent, our pulp and paperboard manufacturing facilities. For 2012, total purchased pulp costs were 15.1% of our cost of sales, representing a decrease of 2.0 percentage points compared to 2011. This decrease in purchased pulp costs was primarily due to lower average external pulp prices in 2012, which were at record highs in 2011, and our continued focus on using our internally produced pulp at our consumer products facilities. In 2013 we expect to continue using our lower cost internally produced pulp at our consumer products facilities to help defray our pulp costs.

**Chemicals.** We consume a substantial amount of chemicals in the production of pulp and paperboard. The chemicals we generally use include polyethylene, caustic, starch, sodium chlorate, latex and specialty paper process chemicals. A large portion of the chemicals used in our manufacturing processes, particularly in the pulp-making process, are petroleum-based and are impacted by petroleum prices. Chemical costs for 2012 increased \$8.9 million, or 1.2 percentage points, over 2011 costs, primarily as a result of increased production volumes and, to a lesser degree, higher starch and caustic pricing.

**Transportation.** Fuel prices significantly impact transportation costs for delivery of raw materials to our manufacturing facilities, internal inventory transfers and delivery of our finished products to customers. Changing fuel prices particularly affect our margins for consumer products because we supply customers throughout the U.S. and transport significant numbers of unconverted parent rolls from our tissue mills to our geographically dispersed tissue converting facilities. Our transportation costs for 2012, compared to 2011, decreased as less fuel was needed because of continuing optimization of shipping to and from our expanded converting facilities resulting from the Cellu Tissue acquisition. Because of our expanded size, we were also able to continue negotiating better fuel rates and surcharges. In addition, as a result of the sale of our Lewiston, Idaho sawmill in November 2011, overall transportation costs were lower for 2012 compared to 2011.

**Chips, sawdust and logs.** We purchase chips, sawdust and logs used to manufacture pulp. Overall costs for chips, sawdust and logs for 2012 decreased compared to 2011, both in dollars and as a percentage of cost of sales, primarily due to the sale of our Lewiston, Idaho sawmill in November 2011. Excluding the effects of our former sawmill, the cost of chips, sawdust and logs decreased slightly when compared to

the prior year period primarily due to lower hardwood usage, which was attributable to the use of a higher proportion of lower-priced sawdust, and lower overall pricing at our Lewiston, Idaho, pulp and paperboard mill. In 2013, as a result of our acquisition of a wood chipping facility at the end of 2012, we expect to be less exposed to market costs for chips, sawdust and logs.

23

---

table of contents

Energy. We use energy in the form of electricity, hog fuel, steam and natural gas to operate our mills. Energy prices have fluctuated widely over the past decade. We have taken steps, and intend to continue to take steps, to reduce our exposure to volatile energy prices through conservation. In addition, cogeneration facilities that produce steam and electricity at our East Hartford, Connecticut, Lewiston, Idaho and Menominee, Michigan manufacturing sites help to lower our energy costs. However, TAD tissue production involves greater natural gas usage than conventional tissue manufacturing and, as a result, we expect our natural gas requirements will increase due to the start up of our North Carolina TAD paper machine. To help mitigate our exposure to changes in natural gas prices, from time to time we have used firm-price contracts to supply a portion of our natural gas requirements. As of December 31, 2012, these contracts covered approximately 4% of our expected natural gas requirements for our manufacturing facilities for 2013. Energy costs for 2012 were lower than those in 2011 due to lower usage as a result of the sale of our Lewiston, Idaho, sawmill and lower natural gas and electricity prices. Our energy costs in future periods will continue to depend principally on our ability to produce a substantial portion of our electricity needs internally, on changes in market prices for natural gas and on our ability to reduce our energy usage.

Maintenance and repairs. We incur significant costs to maintain our manufacturing equipment. We perform routine maintenance on our machines and periodically replace a variety of parts such as motors, pumps, pipes and electrical parts. Maintenance and repair costs, including major maintenance and repairs, are expensed as incurred.

Major equipment maintenance and repairs in our Pulp and Paperboard segment also require maintenance shutdowns annually at our Idaho facility, historically, and approximately every 18 months at our Arkansas facility, which increases costs and may reduce net sales in the quarters in which the major maintenance shutdowns occur. We have optimized the major maintenance process at our Idaho facility and expect that facility to also be on an 18 month schedule going forward. In the first quarter of 2012, we had 17 combined days of scheduled machine downtime for the two paperboard machines at our Idaho pulp and paperboard mill and incurred approximately \$15.5 million in major maintenance costs, excluding labor, compared to major maintenance costs of \$11.4 million and \$3.1 million, respectively, at the same mill in the first and third quarters of 2011. There was no major maintenance in the second and third quarters of 2012. As a result of a decision to defer a portion of our expected major maintenance costs at our Arkansas facility of \$4.3 million originally planned for the fourth quarter of 2012 we spent \$2.0 million in the fourth quarter of 2012, and expect to incur the remainder in the first quarter of 2013. In 2013, we expect to spend a total of approximately \$14 million for planned major maintenance, which consists of an estimated \$3 million at our Arkansas facility during the first quarter and an estimated \$11 million at our Idaho facility, which is largely expected to be incurred during the third quarter.

In addition to ongoing maintenance and repair costs, we make capital expenditures to increase our operating capacity and efficiency, to improve safety at our facilities and to comply with environmental laws. Excluding \$144.5 million of expenditures for our TAD project, we spent \$50.0 million on capital expenditures during 2012, compared to \$47.3 million in 2011. Capital expenditures for 2013 are expected to be approximately \$91 million, which includes an estimated \$16 million associated with the completion of our TAD project.

Packaging supplies. As a significant producer of private label consumer tissue products, we package to order for retail chains, wholesalers and cooperative buying organizations. In connection with sales to these customers, we incur expenses related to the unique packaging of our products for direct retail sale to consumers. For the year ended December 31, 2012, packaging costs were lower than those in 2011 primarily due to procurement synergies resulting from the Cellu Tissue acquisition.

Depreciation and amortization. We record depreciation expense associated with our plant and equipment and amortization expense associated with our definite-lived intangible assets. Depreciation and amortization expense for 2012 was higher than 2011 due primarily to additional depreciation associated with our TAD project. We anticipate a further increase in 2013 due primarily to a full year of depreciation

associated with our North Carolina TAD paper machine, which started up in December 2012.

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

Selling, general and administrative expenses

Selling, general and administrative expenses primarily consist of compensation and associated costs for sales and administrative personnel, as well as commission expenses related to sales of our products. Our total selling, general and administrative costs were \$121.0 million in 2012 compared to \$110.0 million in 2011, with the increase primarily a result of higher wage and benefits expense, partially associated with the completion of our North Carolina facility, as well as increased incentive compensation expense, expense related to the First Quality/Metso Paper litigation and additional expenses associated with the integration of Cellu Tissue and achieving net cost saving synergies.

24

---

table of contents

Interest expense

Interest expense in 2012 was mostly comprised of interest on our \$375 million aggregate principal amount 7.125% senior notes due 2018 issued in October 2010, which we refer to as the 2010 Notes, and our \$150 million aggregate principal amount 10.625% senior notes due 2016 issued in June 2009, which we refer to as the 2009 Notes.

Interest expense also includes amortization of deferred finance costs associated with all of our notes and our revolving credit facility. Interest expense in 2012 was partially offset by our capitalization of interest for our TAD project. Interest expense before reductions for capitalized interest in 2012 decreased slightly compared to 2011 primarily as a result of the third quarter 2011 redemption of our industrial revenue bonds.

In January 2013, we issued the 2013 Notes. A portion of the proceeds from the 2013 Notes were used to redeem the 2009 Notes in February 2013. As a result of the issuance of the 2013 Notes at an interest rate significantly lower than the 2009 Notes, our interest expense is expected to decrease by approximately \$3.6 million on an annual basis. However, this favorable change in interest expense associated with our notes will be more than offset by a decrease in capitalized interest, as no capitalized interest is expected in 2013 compared to \$12.6 million recorded in 2012.

Income taxes

Income taxes are based on reported earnings and tax rates in jurisdictions in which our operations occur and offices are located, adjusted for available credits, changes in valuation allowances and differences in reported earnings and taxable income using current law and enacted tax rates. The annual rates, including discrete items, for the years ended December 31, 2012, 2011 and 2010 were 42.5%, 44.1% and 3.1%, respectively. The reasons for the change in the tax rate from 2012 compared to 2011 was primarily due to four items. The first was a decrease in the rate attributable to state tax credits. The second was a decrease due to a remeasurement of state deferred tax assets and liabilities using anticipated future tax rates that will be in effect when the underlying assets and liabilities reverse. The third was a reduction of the valuation allowance relating to foreign tax credits. Lastly, the decision in the first quarter of 2012 to convert certain gallons of alternative fuel originally claimed in 2009 under the Alternative Fuel Mixture Tax Credit, or AFMTC, which had been converted by us in 2010 to the Cellulosic Biofuel Producer Credit, or CBPC, back to gallons under the AFMTC and associated uncertain tax position. The low annual rate in 2010 was primarily due to benefits from the CBPC and reductions in our provision for uncertain tax positions relating to the AFMTC.

The estimated annual effective tax rate for 2013 is expected to be approximately 40%.

table of contents

## RESULTS OF OPERATIONS

Our financial and other data are not necessarily indicative of our future performance. The results discussed below include Cellu Tissue operating results from December 28, 2010 forward.

Our business is organized into two reporting segments: Consumer Products and Pulp and Paperboard. Intersegment costs for pulp transferred from our Pulp and Paperboard segment to our Consumer Products segment are recorded at cost, and thus no intersegment sales or cost of sales for these transfers are included in our segments' results.

## YEAR ENDED DECEMBER 31, 2012 COMPARED TO YEAR ENDED DECEMBER 31, 2011

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

(Dollars in thousands)	Years Ended December 31,					
	2012		2011			
Net sales	\$1,874,304	100.0	%	\$1,927,973	100.0	%
Costs and expenses:						
Cost of sales	(1,607,872	) 85.8		(1,702,530	) 88.3	
Selling, general and administrative expenses	(121,045	) 6.5		(109,998	) 5.7	
Total operating costs and expenses	(1,728,917	) 92.2		(1,812,528	) 94.0	
Income from operations	145,387	7.8		115,445	6.0	
Interest expense, net	(33,796	) 1.8		(44,809	) 2.3	
Other, net	—	—		284	—	
Earnings before income taxes	111,591	6.0		70,920	3.7	
Income tax provision	(47,460	) 2.5		(31,246	) 1.6	
Net earnings	\$64,131	3.4		\$39,674	2.1	

Net sales—Net sales for 2012 decreased by \$53.7 million, or 2.8%, compared to 2011, due to the sale of our Lewiston, Idaho sawmill in November 2011, which accounted for \$80.3 million of net sales in 2011.

Excluding the impact of net sales from the sawmill in 2011, overall net sales were higher in 2012 due to increased shipments and higher net selling prices for our consumer products as well as increased paperboard shipments. These favorable comparisons were partially offset by lower external pulp shipments, due to increased internal usage of pulp we produce, and lower pulp and paperboard net selling prices. These items are discussed further below under “Discussion of Business Segments.”

Cost of sales—Cost of sales decreased 2.5 percentage points in 2012 to 85.8% of net sales, compared to 88.3% of net sales in 2011. The favorable change in cost of sales was due primarily to lower costs for purchased pulp, chips, sawdust and logs, energy, and transportation, partially offset by higher chemical costs.

Selling, general and administrative expenses—Selling, general and administrative expenses increased \$11.0 million, or 10.0%, during 2012 compared to 2011. The increase was primarily a result of higher wage and benefits expense, increased incentive compensation expense, expense related to the First Quality/Metso Paper litigation and additional expenses associated with the integration of Cellu Tissue and achieving net cost saving synergies.

table of contents

## DISCUSSION OF BUSINESS SEGMENTS

## Consumer Products

(Dollars in thousands - except per-ton amounts)	Years Ended December 31,	
	2012	2011
Net sales	\$1,134,556	\$1,092,133
Operating income	93,347	42,806
Percent of net sales	8.2	% 3.9
Tissue shipments (short tons)	531,327	515,519
Tissue sales price (per short ton)	\$2,135	\$2,119

Net sales for our Consumer Products segment in 2012 increased \$42.4 million, or 3.9%, compared to 2011 due to increased shipments and higher average net selling prices. Shipments increased 3.1% due to increased case sales of retail tissue products, which were largely attributable to an increase in shipments from our North Carolina converting facility, and higher non-retail shipments in 2012. The increase in net selling prices was primarily due to a price increase for our retail tissue products implemented in the fourth quarter of 2011 and the first quarter of 2012, partially offset by lower non-retail pricing.

Operating income, which more than doubled during 2012 with an increase of \$50.5 million, outpaced the growth of net sales due to lower purchased pulp and energy costs, as well as lower overall transportation and packaging costs primarily attributable to net cost saving synergies from the integration of Cellu Tissue. These improvements were partially offset by increased staffing, training and startup costs associated with our North Carolina paper making and converting facilities, higher incentive compensation expense, increased commission expense and a loss on the sale of legacy Cellu Tissue foam manufacturing assets.

## Pulp and Paperboard

(Dollars in thousands - except per-ton amounts)	Years Ended December 31,	
	2012	2011
Net sales	\$739,748	\$835,840
Operating income	103,910	92,827
Percent of net sales	14.0	% 11.1
Shipments (short tons)		
Paperboard	760,919	743,845
Pulp	17,238	42,201
Sales price (per short ton)		
Paperboard	\$956	\$976
Pulp	520	694

Net sales for our Pulp and Paperboard segment were down \$96.1 million, or 11.5%, during 2012 compared to 2011. The decrease was primarily attributable to the sale of our Lewiston, Idaho sawmill in November 2011, which accounted for \$80.3 million of the segment's net sales in 2011. Paperboard net sales increased slightly in 2012 due to a 2.3% increase in shipments that was partially offset by a 2.0% decrease in net selling prices resulting primarily from market pressure. The higher overall paperboard net sales in 2012 were more than offset by a decrease in net sales of external pulp, which was largely the result of increased internal usage by our Consumer Products segment of pulp that we produced.

Operating income in 2012 increased by 11.9% compared to 2011, primarily due to lower costs of energy and purchased pulp, as well as benefits from the sale of our Lewiston, Idaho sawmill. These favorable comparisons were partially offset by higher chemical, wage and benefit and transportation costs compared to 2011. Operating income for 2012 was also negatively impacted by \$0.9 million related to deferred revenue as part of our tax planning strategy.





table of contents

## YEAR ENDED DECEMBER 31, 2011 COMPARED TO YEAR ENDED DECEMBER 31, 2010

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

(Dollars in thousands)	Years Ended December 31,		2010			
	2011		%			
Net sales	\$1,927,973	100.0	%	\$1,372,965	100.0	%
Costs and expenses:						
Cost of sales	(1,702,530	) 88.3		(1,173,804	) 85.5	
Selling, general and administrative expenses	(109,998	) 5.7		(100,394	) 7.3	
Total operating costs and expenses	(1,812,528	) 94.0		(1,274,198	) 92.8	
Income from operations	115,445	6.0		98,767	7.2	
Interest expense, net	(44,809	) 2.3		(22,571	) 1.6	
Debt retirement costs	284	—		—	—	
Earnings before income taxes	70,920	3.7		76,196	5.5	
Income tax provision	(31,246	) 1.6		(2,396	) 0.2	
Net earnings	\$39,674	2.1		\$73,800	5.4	

Net sales—We experienced significantly higher shipments in 2011 in our Consumer Products segment, due primarily to the acquired Cellu Tissue operations, resulting in an increase in total company net sales of \$555.0 million, a 40.4% increase compared to 2010. We also realized higher net selling prices for our paperboard in 2011 compared to 2010. These increases were partially offset by lower net selling prices year-over-year due to our broader mix of tissue products in 2011. These items are discussed further below under "Discussion of Business Segments."

Cost of sales—Cost of sales was 88.3% of net sales for 2011, compared to 85.5% for 2010. The \$528.7 million increase in 2011 was primarily due to higher overall costs related to the inclusion of Cellu Tissue's operations, as well as integration costs associated with those operations. Other factors that contributed to higher cost of sales in 2011 included wage and benefit costs associated with our North Carolina expansion, higher costs for packaging supplies and chemicals, higher transportation costs due to higher fuel prices and increased shipments, and retroactive pay related to labor contracts.

Selling, general and administrative expenses—Selling, general and administrative expenses decreased as a percentage of sales for 2011 compared to 2010 as a result of economies of scale relating to the significantly higher sales. The \$9.6 million increase in expense for 2011 compared to 2010 was primarily due to integration and startup costs related to Cellu Tissue and our North Carolina facilities.

table of contents

## DISCUSSION OF BUSINESS SEGMENTS

## Consumer Products

(Dollars in thousands - except per-ton amounts)	Years Ended December 31,	
	2011	2010
Net sales	\$1,092,133	\$570,047
Operating income	42,806	80,791
Percent of net sales	3.9	% 14.2
Tissue shipments (short tons)	515,519	218,653
Tissue sales price (per short ton)	\$2,119	\$2,607

The Consumer Products segment reported a \$522.1 million, or 91.6%, increase in net sales and a \$38.0 million decrease in operating income for 2011 compared to 2010. The increase in net sales was primarily due to the addition of sales from the Cellu Tissue operations, which contributed to a 135.8% increase in shipment volumes, partially offset by 18.7% lower net selling prices. The decrease in net selling prices is a result of the addition of Cellu Tissue products and the resulting change in the mix of tissue grades sold. The Cellu Tissue facilities produce a broad range of products and some tissue grades that sell at lower price points than the tissue products produced by the Consumer Products segment historically.

The decrease in operating income was primarily due to higher wage and benefit costs associated with the startup of our North Carolina facilities, relocation and severance costs associated with the acquisition of Cellu Tissue, and retroactive pay related to labor contracts. In addition, costs were higher for packaging supplies, transportation costs associated with higher fuel prices and additional shipments, depreciation and amortization resulting from the Cellu Tissue acquisition and repair and maintenance expenses associated with the Cellu Tissue facilities. Lower pulp costs, due to decreasing costs in the second half of 2011, partially offset the unfavorable comparisons.

## Pulp and Paperboard

(Dollars in thousands - except per-ton amounts)	Years Ended December 31,	
	2011	2010
Net sales	\$835,840	\$802,918
Operating income	92,827	64,869
Percent of net sales	11.1	% 8.1
Shipments (short tons)		
Paperboard	743,845	739,380
Pulp	42,201	60,748
Sales price (per short ton)		
Paperboard	\$976	\$915
Pulp	694	691

Net sales for the Pulp and Paperboard segment were \$32.9 million, or 4.1%, higher in 2011 compared to 2010. The increase in net sales over 2010 was largely due to an increase of 6.7% in paperboard prices and slightly higher paperboard shipments. These increases were partially offset by a 30.5% decrease in external pulp shipments due primarily to increased internal usage.

Operating income increased \$28.0 million in 2011 compared to the same period in 2010. The increase was largely attributable to higher net selling prices for paperboard and lower maintenance, purchased paper and wood fiber costs, all of which were partially offset by higher chemical costs.

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

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

EBITDA and Adjusted EBITDA do not reflect our cash expenditures for capital assets;

EBITDA and Adjusted EBITDA do not reflect changes in, or cash requirements for, our working capital requirements;

EBITDA and Adjusted EBITDA do not include cash pension payments;

EBITDA and Adjusted EBITDA exclude certain tax payments that may represent a reduction in cash available to us;

EBITDA and Adjusted EBITDA do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments on our debt;

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA and Adjusted EBITDA do not reflect cash requirements for such replacements; and

other companies, including other companies in our industry, may calculate these measures differently than we do, limiting their usefulness as a comparative measure.

We present EBITDA and Adjusted EBITDA because we believe they assist investors and analysts in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance. In addition, we use EBITDA and Adjusted EBITDA: (i) as factors in evaluating management's performance when determining incentive compensation, (ii) to evaluate the effectiveness of our business strategies and (iii) because our credit agreement and the indentures governing the 2009 Notes, 2010 Notes and 2013 Notes use measures similar to EBITDA to measure our compliance with certain covenants.

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

(In thousands)	Years Ended December 31,		
	2012	2011	2010
Net earnings	\$64,131	\$39,674	\$73,800
Interest expense, net of interest income	33,796	44,809	22,571
Income tax provision	47,460	31,246	2,396
Depreciation and amortization expense	79,333	76,933	47,728
EBITDA	\$224,720	\$192,662	\$146,495
Loss on sale of foam assets	1,014	—	—
Expense associated with Metso litigation	2,019	—	—
Lewiston, Idaho sawmill sale related adjustments <sup>1</sup>	—	2,883	—
Cellu Tissue acquisition related expenses	—	—	20,354
Adjusted EBITDA	\$227,753	\$195,545	\$166,849

<sup>1</sup> The total impact of the sawmill sale and related adjustments on the Pulp and Paperboard segment was \$15.4 million of expense. The net impact to the company was \$2.9 million of net expense in 2011 primarily due to offsetting LIFO inventory liquidation and other adjustments recorded at the corporate

level.

30

---

table of contents

## LIQUIDITY AND CAPITAL RESOURCES

The following table presents information regarding our cash flows for the years ended December 31, 2012, 2011 and 2010.

## Cash Flows Summary

(In thousands)	Years Ended December 31,		
	2012	2011	2010
Net cash provided by operating activities	\$ 198,693	\$ 68,395	\$ 185,591
Net cash used for investing activities	(177,004 )	(50,149 )	(227,938 )
Net cash (used for) provided by financing activities	(17,549 )	(29,096 )	58,451

Operating Activities—Net cash provided by operating activities for 2012 significantly increased compared to 2011 due primarily to cash generated from working capital, compared to cash used for working capital in 2011, as well as higher earnings, after adjusting for noncash items. These increases were partially offset by a \$15.8 million excess tax benefit from equity-based compensation arrangements in 2012, a \$10.8 million increase in taxes receivable in 2012 compared to a slight decrease in 2011, and an \$8.1 million increase in contributions to our qualified pension plans in 2012 compared to 2011.

For 2011, net cash provided by operating activities decreased \$117.2 million, or 63.1%, compared to 2010. The decrease was primarily attributable to the cash receipt of \$101.3 million during 2010 from the Federal Government primarily related to the AFMTC claimed in 2009. Working capital increased \$80.7 million in 2011 due to increased receivables and inventories from increased sales and our North Carolina expansion, as well as a reduction in our accounts payable. These changes were partially offset by higher earnings in 2011, after adjusting for noncash items.

Investing Activities—Cash flows used in investing activities increased \$126.9 million in 2012, compared to 2011. The increase was largely due to increased capital spending for plant and equipment in 2012, primarily associated with our TAD project, as well as a \$36.1 million reduction in the amount of cash provided from the conversion of short-term investments into cash in 2012 compared to 2011.

Net cash used for investing activities decreased by \$177.8 million in 2011 compared to 2010. This was largely due to our acquisition of Cellu Tissue in 2010 for \$247.0 million, offset by cash acquired of \$3.2 million. This was partially offset by an increase of \$88.0 million in capital expenditures in 2011, primarily related to the cash outlays associated with our new converting and manufacturing facilities in North Carolina and capital improvement projects at Cellu Tissue facilities.

Financing Activities—Net cash used for financing activities was \$17.5 million in 2012, compared with \$29.1 million in 2011. Cash used for financing activities in 2012 consisted of payments totaling \$13.2 million for minimum tax withholdings associated with settlement and distribution of equity-based awards and \$18.7 million for treasury stock purchases, partially offset by an excess tax benefit of \$15.8 million associated with the equity-based awards settled and distributed in 2012.

Net cash used for financing activities was \$29.1 million for 2011, compared to cash provided by financing activities of \$58.5 million in 2010. The use of cash in 2011 primarily consisted of \$11.3 million used to repurchase shares of our common stock pursuant to our \$30 million stock repurchase program and \$15.6 million used in the redemption of the remaining principal amount on our outstanding IRBs and associated costs. The cash provided by financing activities in 2010 was primarily attributable to financing related to the Cellu Tissue acquisition, as discussed below.

## Capital Resources

Due to the competitive and cyclical nature of the markets in which we operate, as well as an uncertain economic environment, there is uncertainty regarding the amount of cash flows we will generate during the next twelve months. However, we believe that our cash flows from operations, cash on hand, short-term investments and available borrowing capacity under our credit facility will be adequate to fund debt service requirements and provide cash required to support our ongoing operations, capital expenditures, and working capital needs for the next twelve months.

We may choose to refinance all or a portion of our indebtedness on or before maturity. We cannot be certain that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all. As of December 31, 2012, our short-term investments were not restricted and were largely invested in demand deposits.

At December 31, 2012, our financial position included debt of \$523.9 million, compared to the balance of \$523.7 million at December 31, 2011. Stockholders' equity at December 31, 2012 was \$540.9 million, compared to the December 31, 2011 balance of \$484.9 million. Our total debt to total capitalization, excluding accumulated other comprehensive loss, was 44.4% at December 31, 2012, compared to 46.6% at December 31, 2011.

table of contents

Subsequent to our year end, we issued the 2013 Notes, of which we received net proceeds of \$271.2 million, after deducting discounts and estimated offering expenses. We used approximately \$165.8 million of the net proceeds to redeem all of our outstanding 2009 Notes, and intend to use approximately \$100 million of the remaining net proceeds to purchase shares of the company's common stock pursuant to our \$100 million stock repurchase program authorized in January 2013.

## Debt Arrangements

## 2010 Notes

Our 2010 Notes mature on November 1, 2018, have an interest rate of 7.125% and were issued at their face value. The issuance of these notes generated net proceeds of \$367.5 million after deducting offering expenses. The net proceeds from the issuance of the 2010 Notes were used to finance in part our acquisition of Cellu Tissue, to refinance certain existing indebtedness of Cellu Tissue, and to pay fees and expenses incurred as part of the 2010 Note offering, acquisition of Cellu Tissue and related transactions. The 2010 Notes are guaranteed by certain of our existing and future direct and indirect domestic subsidiaries. The 2010 Notes are equal in right of payment with all other existing and future unsecured senior indebtedness and are senior in right of payment to any future subordinated indebtedness. The 2010 Notes are effectively subordinated to all of our existing and future secured indebtedness, including borrowings under our secured revolving credit facility, which is secured by certain of our accounts receivable, inventory and cash. The terms of the 2010 Notes limit our ability and the ability of any restricted subsidiaries to borrow money; pay dividends; redeem or repurchase capital stock; make investments; sell assets; create restrictions on the payment of dividends or other amounts to us from any restricted subsidiaries; enter into transactions with affiliates; enter into sale and lease back transactions; create liens; and consolidate, merge or sell all or substantially all of our assets.

Prior to November 1, 2013, we may redeem up to 35% of the 2010 Notes at a redemption price equal to 107.125% of the principal amount plus accrued and unpaid interest with the proceeds from one or more qualified equity offerings. We have the option to redeem all or a portion of the 2010 Notes at any time before November 1, 2014 at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest and a "make whole" premium. On or after November 1, 2014, we may redeem all or a portion of the 2010 Notes at specified redemption prices plus accrued and unpaid interest. In addition, we may be required to make an offer to purchase the 2010 Notes upon the sale of certain assets and upon a change of control.

Our 2013 expected debt service obligation related to the 2010 Notes, consisting of cash payments for interest, is \$26.7 million.

Redemption of \$150 million senior notes due 2016 and issuance of \$275 million senior notes due 2023  
In June 2009, we issued senior unsecured notes, which we refer to as the 2009 Notes, in the aggregate principal amount of \$150 million. The 2009 Notes, which were due on June 15, 2016 and had an interest rate of 10.625%, were issued at a price equal to 98.792% of their face value.

On February 22, 2013, in an event occurring subsequent to the close of our 2012 fiscal year end, we exercised our option to redeem all of the 2009 Notes at a redemption price equal to approximately \$166 million, which consisted of 100% of the principal amount, plus an approximate \$13 million "make whole" premium and accrued and unpaid interest of approximately \$3 million. Proceeds to fund the redemption of our 2009 Notes were made available through the sale of \$275 million aggregate principal amount senior notes on January 23, 2013, which we refer to as the 2013 Notes. The 2013 Notes mature on February 1, 2023, have an interest rate of 4.5% and were issued at their face value.

The 2013 Notes are guaranteed by our existing and future direct and indirect domestic subsidiaries, are equal in right of payment with all other existing and future unsecured senior indebtedness, and are senior in right of payment to any future subordinated indebtedness. The 2013 Notes are effectively subordinated to all of our existing and future secured indebtedness, including borrowings under our secured revolving credit facility, which is secured by certain of our accounts receivable, inventory and cash. The terms of the 2013 Notes limit our ability and the ability of any restricted subsidiaries to borrow money; pay

dividends; redeem or repurchase capital stock; make investments; sell assets; create restrictions on the payment of dividends or other amounts to us from any restricted subsidiaries; enter into transactions with affiliates; enter into sale and lease back transactions; create liens; and consolidate, merge or sell all or substantially all of our assets.

Prior to February 1, 2016, we may redeem up to 35% of the 2013 Notes at a redemption price equal to 104.5% of the principal amount plus accrued and unpaid interest with the proceeds from one or more qualified equity offerings. We have the option to redeem all or a portion of the 2013 Notes at any time before February 1, 2018 at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest and a “make whole” premium. On or after February 1, 2018 we may redeem all or a portion of the 2013 Notes at specified redemption prices plus accrued and unpaid interest. In addition, we may be required to make an offer to purchase the 2013 Notes upon the sale of certain assets and upon a change of control.

Semi-annual interest payments of \$6.2 million under the 2013 Notes are payable on February 1 and August 1 each year. In 2013, we will only make one such semi-annual payment of approximately \$6.5 million in August, which represents interest accrued from January 23 to August 1, 2013.



table of contents

CityForest Industrial Bonds

Prior to our acquisition of Cellu Tissue, Cellu Tissue CityForest LLC, or CityForest, a wholly-owned subsidiary of Cellu Tissue, was party to a loan agreement, dated as of March 1, 1998, with the City of Ladysmith, Wisconsin. Pursuant to this agreement, the City of Ladysmith loaned the proceeds of its Variable Rate Demand Solid Waste Disposal Facility Revenue Bonds, Series 1998, or IRBs, to CityForest to finance the construction by CityForest of a solid waste disposal facility. As a result of our acquisition of Cellu Tissue, we assumed the IRBs. During the third quarter of 2011, we redeemed the remaining \$15.2 million principal amount of outstanding IRBs.

Revolving Credit Facility

On November 26, 2008, we entered into a \$125 million senior secured revolving credit facility with certain financial institutions. The amount available to us under the revolving credit facility is based on the lesser of 85% of our eligible accounts receivable plus approximately 65% of our eligible inventory, or \$125 million. The term of our revolving credit facility ends on September 30, 2016.

As of December 31, 2012, there were no borrowings outstanding under the credit facility, but approximately \$5.9 million of the credit facility was being used to support outstanding standby letters of credit. Loans under the credit facility bear interest (i) for LIBOR loans, LIBOR plus between 1.75% and 2.25%, and (ii) for base rate loans, a per annum rate equal to the greatest of (a) the prime rate for such day; (b) the federal funds effective rate for such day, plus 0.50%; or (c) LIBOR for a 30-day interest period as determined on such day, plus 1.0%, plus between 0.25% and 0.75%. The percentage margin on all loans is based on our fixed charge coverage ratio for the most recent four quarters. As of December 31, 2012, we would have been permitted to draw approximately \$119.1 million under the credit facility at LIBOR plus 1.75% or base rate plus 0.25%.

A minimum fixed charge coverage ratio is the only financial maintenance covenant under our credit facility and is triggered when there are any commitments or obligations outstanding and availability falls below 12.5% or an event of default exists, at which time the minimum fixed charge coverage ratio must be at least 1.0-to-1.0. As of December 31, 2012, the fixed charge coverage ratio for the most recent four quarters was 3.6-to-1.0.

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

table of contents**CONTRACTUAL OBLIGATIONS**

The following table summarizes our contractual obligations as of December 31, 2012. Portions of the amounts shown are reflected in our financial statements and accompanying notes, as required by GAAP. See the footnotes following the table for information regarding the amounts presented and for references to relevant financial statement notes that include a detailed discussion of the item.

(In thousands)	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt <sup>1</sup>	\$525,000	\$—	\$—	\$150,000	\$375,000
Interest on long-term debt <sup>1</sup>	216,096	42,657	85,313	61,407	26,719
Capital leases <sup>2</sup>	49,465	2,330	4,795	4,979	37,361
Operating leases <sup>2</sup>	44,947	14,966	16,715	9,307	3,959
Purchase obligations <sup>3</sup>	534,053	314,926	211,827	7,300	—
Other obligations <sup>4,5</sup>	307,583	118,184	55,858	35,979	97,562
<b>Total</b>	<b>\$1,677,144</b>	<b>\$493,063</b>	<b>\$374,508</b>	<b>\$268,972</b>	<b>\$540,601</b>

Included above are the principal and interest payments that were due on our 2009 and 2010 Notes, which were outstanding as of December 31, 2012. Subsequent to December 31, 2012, we issued the \$275 million 2013 Notes, which mature in 2023. A portion of the funds from these notes were used in the redemption of our 2009 Notes. For more information regarding specific terms of our long-term debt, see the discussion under the heading “Debt Arrangements,” and Note 10, “Debt,” in the notes to the consolidated financial statements.

These amounts represent our minimum capital lease payments, including amounts representing interest, and our minimum operating lease payments. See Note 16, “Commitments and Contingencies,” in the notes to the consolidated financial statements.

Purchase obligations consist primarily of contracts for the purchase of raw materials (primarily pulp) from third parties, trade accounts payable as of December 31, 2012, contracts for outside wood chipping, contracts with railroads and contracts with natural gas and electricity providers.

Included in other obligations are accrued liabilities and accounts payable (other than trade accounts payable) as of December 31, 2012, liabilities associated with supplemental pension and deferred compensation arrangements, and estimated payments on qualified pension and postretirement employee benefit plans. Since pension contributions are determined by factors that are subject to change each year, estimated payments on qualified pension plans included above are only for years 1-5 and are based on current estimates of minimum required contributions.

Total excludes \$78.7 million of unrecognized tax benefits due to the uncertainty of timing of payment. See Note 8, “Income Taxes,” in the notes to the consolidated financial statements.

**OFF-BALANCE SHEET ARRANGEMENTS**

We have no off-balance sheet arrangements that have had, or are reasonably likely to have, a material current or future effect on our financial conditions or consolidated financial statements.

**ENVIRONMENTAL**

Our operating facilities are subject to rigorous federal and state environmental regulation governing air emissions, wastewater discharges, and solid and hazardous waste management. Our goal is continuous compliance with all environmental regulations and we regularly monitor our activities to ensure compliance with all pertinent rules and requirements. Compliance with environmental regulations is a significant factor in our business and requires periodic capital expenditures as well as additional operating costs as rules change.

Of our 15 manufacturing sites, two were audited for environmental compliance by outside auditors in 2012. No material issues were identified during these audits. In 2013, we will have eight outside audits conducted. Our goal is that each of our manufacturing facilities will undergo a detailed environmental

audit by an outside party at least once every three years.

Our tissue manufacturing and converting facility in Neenah, Wisconsin, received a drafted National Pollutant Discharge Elimination System discharge permit, or NPDES, with proposed interim limit on Total Maximum Daily Loads, or TMDL. When the new permit is issued, we expect the initial requirements to be well within the capabilities of the current waste water treatment system, although some upgrades may be required between 2015 and 2016. No compliance issues are expected and the level of capital upgrades is expected to be minor.

The new federal standard for hazardous air pollutants from boiler and process heaters were finalized by the U.S. Environmental Protection Agency, or EPA, in late 2012. Our sites at Lewiston, Idaho, Menominee, Michigan, and Cypress Bend, Arkansas, will be affected by this new rule, although the specific requirements are uncertain at this time. Any capital projects will be executed between 2014 and 2016. Preliminary total cost estimates for all required projects are expected to be between \$5 and \$10 million.

The EPA is also currently reviewing the risks associated with hazardous air pollutants from Kraft paper mills. Any changes to these rules would impact our Lewiston and Cypress Bend operations.

table of contents

Concern over climate change, including the impact of global warming, may lead to future regulations. We believe there are no U.S. or Canadian proposed rules that would have a material impact on our operations. In 2012 we received notification of alleged Clean Air Act violations at our Lewiston facility. We have entered into a tolling agreement and are negotiating with the U.S. Department of Justice and EPA to resolve these alleged violations. We expect these negotiations to continue through 2013.

Our facilities are currently in substantial compliance with applicable environmental laws and regulations. We cannot be certain, however, that situations that may give rise to material environmental liabilities will not be discovered or that the enactment of new environmental laws or regulations or changes in existing laws or regulations will not require significant expenditures by us.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

See Note 3, “Recently Adopted and Prospective Accounting Standards” to the consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for additional information regarding recently adopted and new accounting pronouncements.

Goodwill and intangibles. Our acquisitions are accounted for using the purchase method of accounting as prescribed by applicable accounting guidance. In accordance with the accounting guidance, we revalued the assets and liabilities acquired at their respective fair values on the acquisition date. Changes in assumptions and estimates during the allocation period affecting the acquisition date fair value of acquired assets and liabilities would result in changes to the recorded values, resulting in an offsetting change to the goodwill balance associated with the business acquired. Significant changes in assumptions and estimates subsequent to completing the allocation of purchase price to the assets and liabilities acquired, as well as differences in actual results versus estimates, could have a material impact on our earnings.

Goodwill from an acquisition represents the excess of the cost of a business acquired over the net of the amounts assigned to assets acquired, including identifiable intangible assets and liabilities assumed. As a result of our Cellu Tissue acquisition, we recorded \$229.5 million of goodwill on our Consolidated Balance Sheet as of December 31, 2010, which has not been subsequently adjusted through December 31, 2012. Goodwill is not amortized but tested for impairment annually and at any time when events suggest impairment may have occurred. When required, our goodwill impairment test will be performed by comparing the fair value of the Consumer Products reporting unit to its carrying value. We incorporate assumptions involving future growth rates, discount rates and tax rates in projecting the future cash flows. In the event the carrying value exceeds the fair value of the reporting unit, an impairment loss would be recognized to the extent the carrying amount of the reporting unit’s goodwill exceeds its implied fair value. Long-lived assets. A significant portion of our total assets are invested in our manufacturing facilities. Also, the cyclical patterns of our businesses cause cash flows to fluctuate by varying degrees from period to period. As a result, long-lived assets are a material component of our financial position with the potential for material change in valuation if assets are determined to be impaired. Accounting guidance requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable, as measured by its undiscounted estimated future cash flows.

We use our operational budgets to estimate future cash flows. Budgets are inherently uncertain estimates of future performance due to the fact that all inputs, including net sales, costs and capital spending, are subject to frequent change for many different reasons. Because of the number of variables involved, the

interrelationship between the variables and the long-term nature of the impairment measurement, sensitivity analysis of individual variables is not practical. Budget estimates are adjusted periodically to reflect changing business conditions, and operations are reviewed, as appropriate, for impairment using the most current data available.

We believe we have adequate support for the carrying value of all of our long-lived assets based on anticipated cash flows that will result from our estimates of future demand, pricing, and production costs, assuming certain levels of capital expenditures.

35

---

table of contents

Pension and postretirement employee benefits. The determination of pension plan expense and the requirements for funding our pension plans are based on a number of actuarial assumptions. Two critical assumptions are the discount rate applied to pension plan obligations and the rate of return on plan assets. For other postretirement employee benefit, or OPEB, plans, which provide certain health care and life insurance benefits to qualified retired employees, critical assumptions in determining OPEB expense are the discount rate applied to benefit obligations and the assumed health care cost trend rates used in the calculation of benefit obligations.

Note 12, "Savings, Pension and Other Postretirement Employee Benefit Plans," to our consolidated financial statements includes information for the three years ended December 31, 2012, 2011 and 2010, on the components of pension and OPEB expense and the underlying actuarial assumptions used to calculate periodic expense, as well as the funded status for our pension and OPEB plans as of December 31, 2012 and 2011.

The discount rate used in the determination of pension benefit obligations and pension expense is determined based on a review of long-term high-grade bonds and management's expectations. At December 31, 2012, we calculated obligations using a 4.15% discount rate. The discount rates used at December 31, 2011 and 2010 were 4.90% and 5.70%, respectively. To determine the expected long-term rate of return on pension assets, we employ a process that analyzes historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return. The long-term rates of return used for the years ended December 31, 2012, 2011 and 2010 were 8.00%, 8.00% and 8.50%, respectively.

Total periodic pension plan expense in 2012 was \$10.7 million. An increase in the discount rate or the rate of expected return on plan assets, all other assumptions remaining the same, would decrease pension plan expense, and conversely, a decrease in either of these measures would increase plan expense. As an indication of the sensitivity that pension expense has to the discount rate assumption, a 25 basis point change in the discount rate would affect annual plan expense by approximately \$0.6 million. A 25 basis point change in the assumption for expected return on plan assets would affect annual plan expense by approximately \$0.6 million. The actual rates of return on plan assets may vary significantly from the assumptions used because of unanticipated changes in financial markets.

Our company-sponsored pension plans were underfunded by \$78.7 million at December 31, 2012 and \$89.1 million at December 31, 2011. As a result of being underfunded, we are required to make contributions to our qualified pension plans. In 2012, we contributed \$20.6 million to these pension plans. We also contributed \$0.2 million to our non-qualified pension plan in 2012. Our cash contributions in 2013 are estimated to be approximately \$20 million.

For our OPEB plans, expense for 2012 was \$3.8 million. We do not anticipate funding our OPEB plans in 2013 except to pay benefit costs as incurred during the year by plan participants. The discount rate used to calculate OPEB obligations, which was determined using the same methodology we used for our pension plans, was 4.05%, 4.95% and 5.60% at December 31, 2012, 2011 and 2010, respectively. The assumed health care cost trend rates used to calculate OPEB obligations and expense were 7.00% and 7.50%, respectively, in 2012, with both grading to 4.70% over approximately 60 years.

As an indication of the sensitivity that OPEB expense has to the discount rate assumption, a 25 basis point change in the discount rate would affect plan expense by approximately \$0.4 million. A 1% change in the assumption for health care cost trend rates would have affected 2012 plan expense by approximately \$0.5 million to \$0.6 million and the total postretirement employee obligation by approximately \$10.7 million to \$12.5 million. The actual rates of health care cost increases may vary significantly from the assumption used because of unanticipated changes in health care costs.

Periodic pension and OPEB expenses are included in "Cost of sales" and "Selling, general and administrative expenses" in the Consolidated Statements of Operations. The expense is allocated to all business segments. In accordance with current accounting guidance governing defined benefit pension and other

postretirement plans, at December 31, 2012 and 2011, long-term assets are recorded for overfunded plans and liabilities are recorded for underfunded plans. The funded status of a benefit plan is measured as the difference between plan assets at fair value and the projected benefit obligation. For underfunded plans, the estimated liability to be payable in the next twelve months is recorded as a current liability, with the remaining portion recorded as a long-term liability.

Effective December 15, 2010, the salaried pension plan was closed to new entrants and after December 31, 2011, it was frozen and ceased accruing further benefits. In 2010, we recorded a loss of \$0.2 million related to the closing of the salaried pension plan. In addition, we recorded a \$14.2 million decrease in our pension liability.

Income taxes. The conclusion that deferred tax assets are realizable is subject to certain assessments, projections and judgments made by management. In assessing whether deferred tax assets are realizable, the standard we use is whether it is more likely than not that some or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. We consider the scheduled reversal of deferred tax liabilities (including the impact of available carry forward periods), projected taxable income, and amounts of taxable income we would have generated historically if we had been a stand-alone company in making this

table of contents

assessment. In order to fully realize the deferred tax asset, we will need to generate future taxable income before the expiration of the deferred tax assets governed by the tax code.

Based on existing deferred tax liabilities and projected taxable income over the periods for which the deferred tax assets are deductible, we believe that it is more likely than not that we will realize the benefits of these future deductible differences, excluding items for which we have already recorded a valuation allowance. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

We have tax jurisdictions located in many areas of the United States and Canada and are subject to audit in these jurisdictions. Tax audits by their nature are often complex and can require several years to resolve. In the preparation of our consolidated financial statements, management exercises judgment in estimating the potential exposure to unresolved tax matters and applies the guidance pursuant to uncertain tax positions which employs a more likely than not criteria approach for recording tax benefits related to uncertain tax positions. While actual results could vary, in management's judgment, we have adequate tax accruals with respect to the ultimate outcome of such unresolved tax matters.



table of contents

## ITEM 7A.

## Quantitative and Qualitative Disclosures About Market Risks

## Interest Rate Risk

Our exposure to market risks on financial instruments includes interest rate risk on our secured revolving credit facility. As of December 31, 2012, there were no borrowings outstanding under our revolving credit facility. The interest rates applied to borrowings under the credit facility are adjusted often and therefore react quickly to any movement in the general trend of market interest rates. For example, a one percentage point increase or decrease in interest rates, based on assumed outstanding credit facility borrowings of \$10.0 million, would have a \$0.1 million annual effect on interest expense. We currently do not attempt to mitigate the effects of short-term interest rate fluctuations on our credit facility borrowings through the use of derivative financial instruments.

## Commodity Risk

We are exposed to market risk for changes in natural gas commodity pricing, which we have, from time-to-time, partially mitigated through the use of firm price contracts for a portion of our natural gas requirements for our manufacturing facilities. As of December 31, 2012, we had firm-price contracts for natural gas covering approximately 4% of the expected average monthly requirements for 2013.

## Foreign Currency Risk

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

## Quantitative Information about Market Risks

(Dollars in thousands)	Expected Maturity Date						Total
	2013	2014	2015	2016	2017	Thereafter	
Long-term debt <sup>1</sup> :							
Fixed rate	\$—	\$—	\$—	\$150,000	\$—	\$375,000	\$525,000
Average interest rate	—	% —	% —	% 10.625	% —	% 7.125	% 8.125
Fair value at December 31, 2012							\$572,625

<sup>1</sup> On January 23, 2013, we exercised our option to redeemed all of the \$150 million 2009 Notes maturing in 2016. Proceeds to fund the redemption of our 2009 Notes were made available through the issuance of the 2013 Notes. See Item 7, under the heading "Debt Arrangements," for more information.

table of contents

## ITEM 8.

Financial Statements and Supplementary Data  
Index to Consolidated Financial Statements

	PAGE NUMBER
Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010	<u>40</u>
Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2011 and 2010	<u>41</u>
Consolidated Balance Sheets at December 31, 2012 and 2011	<u>42</u>
Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010	<u>43</u>
Consolidated Statements of Stockholders' Equity for the years ended December 31, 2012, 2011 and 2010	<u>44-45</u>
Notes to Consolidated Financial Statements	<u>46-77</u>
Reports of Independent Registered Public Accounting Firm	<u>78-79</u>

## Financial Statement Schedules:

All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

table of contents

## CLEARWATER PAPER CORPORATION

## Consolidated Statements of Operations

(Dollars in thousands – except per-share amounts)

	FOR THE YEARS ENDED DECEMBER 31,		
	2012	2011	2010
Net sales	\$1,874,304	\$1,927,973	\$1,372,965
Costs and expenses:			
Cost of sales	(1,607,872	) (1,702,530	) (1,173,804
Selling, general and administrative expenses	(121,045	) (109,998	) (100,394
Total operating costs and expenses	(1,728,917	) (1,812,528	) (1,274,198
Income from operations	145,387	115,445	98,767
Interest expense, net	(33,796	) (44,809	) (22,571
Other, net	—	284	—
Earnings before income taxes	111,591	70,920	76,196
Income tax provision	(47,460	) (31,246	) (2,396
Net earnings	\$64,131	\$39,674	\$73,800
Net earnings per common share:			
Basic	\$2.75	\$1.73	\$3.22
Diluted	2.72	1.66	3.12

All per common share amounts have been adjusted for the two-for-one stock split effected in the form of a stock dividend distributed on August 26, 2011.

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

table of contents

## CLEARWATER PAPER CORPORATION

## Consolidated Statements of Comprehensive Income

(In thousands)

	FOR THE YEARS ENDED DECEMBER 31,		
	2012	2011	2010
Net earnings	\$64,131	\$39,674	\$73,800
Other comprehensive (loss) income, net of tax:			
Defined benefit pension and other postretirement employee benefits:			
Net (loss) gain arising during the period, net of tax benefit (expense) of \$6,359, \$15,830, and \$(11,188)	(9,780	) (21,942	) 17,499
Prior service credit arising during the period, net of tax expense of \$(2,267), \$(1,163) and \$(71)	3,488	1,613	112
Amortization of actuarial loss included in net periodic cost, net of tax expense of \$(4,761), \$(3,513) and \$(4,194)	7,324	4,869	6,560
Amortization of prior service credit included in net periodic cost, net of tax benefit of \$806, \$252 and \$230	(1,240	) (350	) (360
Foreign currency translation adjustment	—	(874	) —
(Amortization) recognition of deferred taxes related to actuarial gain on other postretirement employee benefit obligations	(220	) (229	) 4,799
Other comprehensive (loss) income, net of tax	(428	) (16,913	) 28,610
Comprehensive income	\$63,703	\$22,761	\$102,410

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

table of contents

## CLEARWATER PAPER CORPORATION

## Consolidated Balance Sheets

(Dollars in thousands – except share data)

	AT DECEMBER 31,	
	2012	2011
<b>ASSETS</b>		
Current assets:		
Cash	\$12,579	\$8,439
Short-term investments	20,000	55,001
Restricted cash	—	769
Receivables, net	154,143	176,189
Taxes receivable	20,828	10,000
Inventories	231,466	244,071
Deferred tax assets	17,136	39,466
Prepaid expenses	12,314	11,396
Total current assets	468,466	545,331
Property, plant and equipment, net	877,377	735,566
Goodwill	229,533	229,533
Intangible assets, net	47,753	49,748
Other assets, net	10,327	11,140
<b>TOTAL ASSETS</b>	<b>\$1,633,456</b>	<b>\$1,571,318</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$165,596	\$144,631
Current liability for pensions and other postretirement employee benefits	9,137	9,861
Total current liabilities	174,733	154,492
Long-term debt	523,933	523,694
Liability for pensions and other postretirement employee benefits	204,163	215,932
Other long-term obligations	50,910	48,474
Accrued taxes	78,699	74,464
Deferred tax liabilities	60,124	69,358
Stockholders' equity:		
Preferred stock, par value \$0.0001 per share, 5,000,000 authorized shares, no shares issued	—	—
Common stock, par value \$0.0001 per share, 100,000,000 authorized shares, 23,840,683 and 23,101,710 shares issued	2	2
Additional paid-in capital	326,901	315,964
Retained earnings	359,684	295,553
Treasury stock, at cost, common shares—853,470 and 333,300 shares repurchased	(30,000)	(11,350)
Accumulated other comprehensive loss, net of tax	(115,693)	(115,265)
Total stockholders' equity	540,894	484,904
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$1,633,456</b>	<b>\$1,571,318</b>

All per common share amounts have been adjusted for the two-for-one stock split effected in the form of a stock dividend distributed on August 26, 2011.

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

42

---

table of contents

## CLEARWATER PAPER CORPORATION

## Consolidated Statements of Cash Flows

(In thousands)

	FOR THE YEARS ENDED		
	DECEMBER 31,		
	2012	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net earnings	\$64,131	\$39,674	\$73,800
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	79,333	76,933	47,728
Deferred tax expense	12,870	14,777	(14,991 )
Equity-based compensation expense	9,703	8,134	8,518
Employee benefit plans	9,366	16,897	15,011
Changes in working capital, net	61,281	(86,012 )	(5,304 )
Change in taxes receivable, net	(10,828 )	354	93,754
Excess tax benefits from equity-based payment arrangements	(15,837 )	(885 )	(855 )
Change in non-current accrued taxes	4,235	2,453	(4,271 )
Funding of qualified pension plans	(20,627 )	(12,498 )	(25,100 )
Change in restricted cash	769	4,160	(3,637 )
Other, net	4,297	4,408	938
Net cash provided by operating activities	198,693	68,395	185,591
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Change in short-term investments, net	35,001	71,094	61,926
Additions to plant and equipment	(203,776 )	(134,069 )	(46,086 )
Cash paid for acquisitions, net of cash acquired	(9,264 )	—	(243,778 )
Proceeds from sale of assets	1,035	12,826	—
Net cash used for investing activities	(177,004 )	(50,149 )	(227,938 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net proceeds from long-term debt	—	—	367,500
Repayment of Cellu Tissue debt	—	(15,595 )	(304,667 )
Purchase of treasury stock	(18,650 )	(11,350 )	—
Excess tax benefits from equity-based payment arrangements	15,837	885	855
Payment of tax withholdings on equity-based payment arrangements	(13,234 )	(2,400 )	(3,470 )
Other, net	(1,502 )	(636 )	(1,767 )
Net cash (used for) provided by financing activities	(17,549 )	(29,096 )	58,451
Effect of exchange rate changes	—	361	—
Increase (decrease) in cash	4,140	(10,489 )	16,104
Cash at beginning of period	8,439	18,928	2,824
Cash at end of period	\$12,579	\$8,439	\$18,928
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Cash paid for interest, net of amounts capitalized	\$30,086	\$43,595	\$15,938
Cash paid for income taxes	18,719	43,085	28,596
Cash received from income tax refunds	2,220	33,808	101,393
<b>SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING ACTIVITIES:</b>			
Increase in accrued plant and equipment	\$3,339	\$3,674	\$1,397

Property acquired under capital lease	—	12,687	11,404
---------------------------------------	---	--------	--------

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



table of contents

CLEARWATER PAPER CORPORATION  
 Consolidated Statements of Stockholders' Equity  
 (In thousands)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK		ACCUMULATED OTHER COMPREHENSIVE (LOSS) GAIN	TOTAL STOCKHOLDERS' EQUITY
	SHARES	AMOUNT			SHARES	AMOUNT		
Balance, December 31, 2009	22,732	\$ 2	\$ 308,617	\$ 182,079	—	\$—	\$ (126,962 )	\$ 363,736
Net earnings	—	—	—	73,800	—	—	—	73,800
Performance share and restricted stock unit awards	226	—	2,203	—	—	—	—	2,203
Pension and OPEB, net of tax of \$15,223	—	—	—	—	—	—	23,811	23,811
Recognition of deferred taxes related to actuarial gain on other postretirement employee benefit obligations	—	—	—	—	—	—	4,799	4,799
Balance, December 31, 2010	22,958	\$ 2	\$ 310,820	\$ 255,879	—	\$—	\$ (98,352 )	\$ 468,349
Net earnings	—	—	—	39,674	—	—	—	39,674
Performance share and restricted stock unit awards	144	—	5,144	—	—	—	—	5,144
Pension and OPEB, net of tax of \$(11,406)	—	—	—	—	—	—	(15,810 )	(15,810 )
Amortization of deferred taxes related to actuarial gain	—	—	—	—	—	—	(229 )	(229 )

on other postretirement employee benefit obligations									
Foreign currency translation adjustment	—	\$ —	\$ —	\$ —	—	\$ —	\$ (874	)	\$ (874
Purchase of treasury stock	—	\$ —	\$ —	\$ —	(333	)	\$ (11,350)	\$ —	\$ (11,350
Balance, December 31, 2011	23,102	\$ 2	\$ 315,964	\$ 295,553	(333	)	\$ (11,350)	\$ (115,265	)
									\$ 484,904

44

---

table of contents

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK		ACCUMULATED OTHER COMPREHENSIVE (LOSS) GAIN	TOTAL STOCKHOLDERS' EQUITY
	SHARES	AMOUNT			SHARES	AMOUNT		
Net earnings	—	—	—	64,131	—	—	—	64,131
Performance share and restricted stock unit awards	739	—	10,937	—	—	—	—	10,937
Pension and OPEB, net of tax of \$(137)	—	—	—	—	—	—	(208 )	(208 )
Amortization of deferred taxes related to actuarial gain on other postretirement employee benefit obligations	—	—	—	—	—	—	(220 )	(220 )
Purchase of treasury stock	—	—	—	—	(520 )	(18,650 )	—	(18,650 )
Balance, December 31, 2012	23,841	\$ 2	\$ 326,901	\$ 359,684	(853 )	\$(30,000)	\$ (115,693 )	\$ 540,894

All common stock share numbers have been adjusted for the two-for-one stock split effected in the form of a stock dividend distributed on August 26, 2011.

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

table of contents

**CLEARWATER PAPER CORPORATION**

Notes to Consolidated Financial Statements

NOTE 1 Nature of Operations and Basis of Presentation

On December 16, 2008, Potlatch Corporation, which we refer to in this report as Potlatch, distributed 100% of the issued and outstanding shares of our common stock to the holders of record of Potlatch common stock in a tax-free spin-off. Unless the context otherwise requires or unless otherwise indicates, references in this report to “Clearwater Paper Corporation,” “we,” “our,” “the company” and “us” refer: for all periods prior to the spin-off, to the consumer products and pulp and paperboard businesses separated from Potlatch in the spin-off; and

for all periods following the spin-off, to Clearwater Paper Corporation and its subsidiaries.

On December 27, 2010, we acquired Cellu Tissue Holdings, Inc., or Cellu Tissue, and consolidated the acquisition in our financial statements as of that date.

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

These consolidated financial statements include the financial condition and results of operations of Clearwater Paper Corporation and its wholly-owned subsidiaries. All intercompany transactions and balances between operations within the company have been eliminated.

NOTE 2 Summary of Significant Accounting Policies

**SIGNIFICANT ESTIMATES**

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S., which we refer to in this report as GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. Significant areas requiring the use of estimates and measurement of uncertainty include determination of net realizable value for deferred tax assets, uncertain income tax positions, assessment of impairment of long-lived assets and goodwill, assessment of environmental matters, allocation of purchase price and fair value estimates for business combinations, equity-based compensation and pension and postretirement obligation assumptions. Actual results could differ from those estimates and assumptions.

**SHORT-TERM INVESTMENTS AND RESTRICTED CASH**

Our short-term investments are invested primarily in demand deposits, which have very short maturity periods, and therefore earn an interest rate commensurate with low-risk instruments. We do not attempt to hedge our exposure to interest rate risk for our short-term investments. Our restricted cash in which the underlying instrument has a term of greater than twelve months from the balance sheet date is classified as non-current and is included in “Other assets” on our Consolidated Balance Sheet. As of December 31, 2012, all restricted cash, totaling \$1.5 million, was included in "Other assets." As of December 31, 2011, all restricted cash, totaling \$0.8 million, was classified as current and included in “Restricted cash” on our Consolidated Balance Sheet.

**TRADE ACCOUNTS RECEIVABLE**

Trade accounts receivable are stated at the amount we expect to collect. Trade accounts receivable do not bear interest. The allowance for doubtful accounts is our best estimate of the losses we expect will result from the inability of our customers to make required payments. We generally determine the allowance based on a combination of actual historical write-off experience and an analysis of specific customer accounts. As of December 31, 2012 and 2011, we had allowances for doubtful accounts of \$1.6 million and \$1.7 million, respectively. Bad debt expense, net, charged to selling, general and administrative expenses during 2012, 2011 and 2010 was \$0.2 million, \$1.0 million and \$0.1 million, respectively. All other activity impacting the allowance for doubtful accounts was immaterial for all periods.

INVENTORIES

At December 31, 2012, our inventories are stated at the lower of market or current average cost using the average cost method. Prior to the November 2011 sale of our Lewiston, Idaho, sawmill, we used the last-in, first-out, or LIFO, method to determine cost for our logs, wood fiber and the majority of our lumber.

46

---

table of contents

**PROPERTIES, PLANT AND EQUIPMENT**

Property, plant and equipment are stated at cost, including assets acquired under capital lease obligations and any interest costs capitalized, less accumulated depreciation. Depreciation of buildings, equipment and other depreciable assets is determined using the straight-line method. Estimated useful lives generally range from 10 to 40 years for land improvements; 10 to 40 years for buildings and improvements; 5 to 25 years for machinery and equipment; and 2 to 15 years for office and other equipment. Assets we acquire through business combinations have estimated lives that are typically shorter than the assets we construct or buy new.

**LONG-LIVED ASSETS**

Our long-lived assets include property, plant and equipment and amortizable intangible assets. We review the carrying value of long-lived assets for impairment annually and when events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. An impairment of long-lived assets exists when the carrying value is not considered to be recoverable through future undiscounted cash flows from operations and the carrying value of the asset or asset group exceeds the estimated fair value.

**GOODWILL AND INTANGIBLES**

Goodwill from an acquisition represents the excess of the cost of a business acquired over the net of the amounts assigned to assets acquired, including identifiable intangible assets and liabilities assumed. Goodwill and intangible assets resulted from our acquisition of Cellu Tissue in 2010. Intangible assets also resulted from our December 2012 acquisition of a wood chipping facility. See Note 4, "Business Combinations." We used estimates in determining and assigning the fair value of goodwill and intangible assets, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows and fair values of the related operations. Our intangible assets have definite lives and are amortized over their estimated useful lives. We assess our intangibles for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

As a result of our acquisition of Cellu Tissue in December 2010, we recorded \$229.5 million of goodwill as included on our Consolidated Balance Sheets as of December 31, 2012 and 2011. All of the recorded goodwill was assigned to our Consumer Products segment and reporting unit. Goodwill is not amortized but is tested for impairment annually as of November 1, as well as any time when events suggest impairment may have occurred. In the event the carrying value of our consumer products reporting unit, including goodwill, exceeds the estimated fair value of the reporting unit, an impairment loss would be recognized to the extent the carrying amount of the reporting unit's goodwill exceeds its implied fair value.

**PENSION AND OTHER POSTRETIREMENT EMPLOYEE BENEFITS**

The determination of pension plan expense and the requirements for funding our pension plans are based on a number of actuarial assumptions. Two critical assumptions are the discount rate applied to pension plan obligations and the rate of return on plan assets. For other postretirement employee benefit, or OPEB, plans, which provide certain health care and life insurance benefits to qualified retired employees, critical assumptions in determining OPEB expense are the discount rate applied to benefit obligations and the assumed health care cost trend rates used in the calculation of benefit obligations. We also participate in multiemployer defined benefit pension plans. We make contributions to these multiemployer plans, as well as make contributions to a trust fund established to provide retiree medical benefits for a portion of these employees.

The discount rate used in the determination of pension benefit obligations and pension expense is determined based on a review of long-term high-grade bonds and management's expectations. To determine the expected long-term rate of return on pension assets, we employ a process that analyzes historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return.

An increase in the discount rate or the rate of expected return on plan assets, all other assumptions remaining the same, would decrease pension plan expense, and conversely, a decrease in either of these measures would increase plan expense. The actual rates of return on plan assets may vary significantly from the assumptions used because of unanticipated changes in financial markets.

The estimated net loss and prior service cost (credit) for the defined benefit pension and OPEB plans is amortized from accumulated other comprehensive loss into net periodic cost (benefit) in accordance with current accounting guidance.

Periodic pension and OPEB expenses are included in "Cost of sales" and "Selling, general and administrative expenses" in the Consolidated Statements of Operations. The expense is allocated to all business segments.

In accordance with current accounting guidance governing defined benefit pension and other postretirement plans, at December 31, 2012 and 2011, long-term assets are recorded for overfunded plans and liabilities are recorded for underfunded single-employer plans. The funded status of a benefit plan is measured as the difference between plan assets at fair value and the projected benefit obligation. For underfunded single-employer plans, the estimated liability to be payable in the next twelve months is recorded as a current liability, with the remaining portion recorded as a long-term liability.

table of contents

**INCOME TAXES**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The determination of our provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits of uncertain tax positions are recorded in our consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge, if any, from tax authorities. When facts and circumstances change, we reassess these probabilities and record any changes in the consolidated financial statements as appropriate.

**REVENUE RECOGNITION**

We recognize revenue when there is persuasive evidence of a sales agreement, the price to the customer is fixed and determinable, collection is reasonably assured, and title and the risk of loss passes to the customer. Shipping terms generally indicate when title and the risk of loss have passed. Revenue is recognized at shipment for sales when shipping terms are FOB (free on board) shipping point. For sales where shipping terms are FOB destination, revenue is recognized when the goods are received by the customer. Revenue from both domestic and foreign sales of our products can involve shipping terms of either FOB shipping point or FOB destination or other shipping terms, depending upon the sales agreement with the customer.

In 2012 and 2011, we did not have any single customer that accounted for 10% or more of our total net sales. However, in 2010, we had a single customer in the Consumer Products segment, the Kroger Company, that accounted for approximately \$153.7 million, or 11%, of our total company net sales. We provide for trade promotions, customer cash discounts, customer returns and other deductions as reductions to net sales in the same period as the related revenues are recognized. Provisions for these items are determined based on historical experience or specific customer arrangements.

Revenue is recognized net of any sales taxes collected. Sales taxes, when collected, are recorded as a current liability and remitted to the appropriate governmental entities.

**ENVIRONMENTAL**

As part of our corporate policy, we have an ongoing process to monitor, report on and comply with environmental requirements. Based on this ongoing process, accruals for environmental liabilities that are not within the scope of specific authoritative guidance related to accounting for asset retirement obligations or conditional asset retirement obligations are established in accordance with guidance related to accounting for contingencies. We estimate our environmental liabilities based on various assumptions and judgments, the specific nature of which varies in light of the particular facts and circumstances surrounding each environmental liability. These estimates typically reflect assumptions and judgments as to the probable nature, magnitude and timing of required investigation, remediation and monitoring activities and the probable cost of these activities. Currently, we are not aware of any material environmental liabilities and have accrued for only specific environmental remediation costs that we have determined are probable and for which an amount can be reasonably estimated. Fees for professional services associated with environmental and legal issues are expensed as incurred.

**STOCKHOLDERS' EQUITY**

On July 28, 2011, we announced that our Board of Directors had declared a two-for-one stock split of our outstanding shares of common stock, which was effected in the form of a stock dividend distributed on August 26, 2011 to shareholders of record on August 12, 2011. On the August 26, 2011 distribution date,



there were 11,373,460 shares of common stock outstanding. Immediately following the distribution date, there were 22,746,920 outstanding shares of common stock. All common share and per share amounts have been adjusted for the stock split effected in the form of a stock dividend.

In addition, on July 28, 2011, we announced that our Board of Directors had authorized the repurchase of up to \$30 million of our common stock. Under the stock repurchase program, we were authorized to repurchase shares in the open market or as otherwise determined by management, subject to market conditions, business opportunities and other factors. During 2012, we repurchased 520,170 shares of outstanding common stock at a total cost of \$18.7 million, representing an average price of \$35.85 per share. We completed this repurchase program in the fourth quarter of 2012. The total number of shares repurchased under this program was 853,470 at an aggregate cost of \$30 million and an average price of \$35.15 per share.

table of contents

On January 21, 2013, in an event subsequent to the close of our 2012 fiscal year, and in conjunction with the sale of \$275 million aggregate principal amount of senior notes (the 2013 Notes; see Note 10, "Debt"), we announced that our Board of Directors approved a new stock repurchase program authorizing the repurchase of \$100 million of our common stock. We intend to complete this share repurchase program during 2013 through open market purchases, negotiated transactions or other means.

**DERIVATIVES**

We had no activity during the years ended December 31, 2012, 2011 and 2010 that required hedge or derivative accounting treatment. However, to partially mitigate our exposure to market risk for changes in utility commodity pricing, we use firm price contracts to supply a portion of the natural gas requirements for our manufacturing facilities. As of December 31, 2012, these contracts covered approximately 4% of the expected average monthly requirements for 2013. For the years ended December 31, 2012, 2011 and 2010, approximately 29%, 2% and 24%, respectively, of our natural gas volumes were supplied through firm price contracts. These contracts qualify for treatment as "normal purchases or normal sales" under authoritative guidance and thus require no mark-to-market adjustment.

**NOTE 3 Recently Adopted and Prospective Accounting Standards**

We reviewed all new accounting pronouncements issued during the year ended December 31, 2012 and concluded that there are none that we believe will have a significant or material impact to our current or future consolidated financial statements, financial positions, results of operations, liquidity or disclosures.

**NOTE 4 Business Combinations****WOOD CHIPPING FACILITY ACQUISITION**

On December 28, 2012, we acquired the assets of a wood chipping facility located in Clarkston, Washington, near our Lewiston, Idaho facility, in an effort to bolster our wood fiber position and obtain short-term and long-term cost savings. The total consideration associated with the acquisition was approximately \$11 million, which includes contingent consideration over an 18 month period of up to \$1.5 million in cash to be paid by the company, based on certain performance and indemnity guarantees. At December 31, 2012, this \$1.5 million is considered non-current restricted cash and is reflected as a change in cash flow used for financing activities in our Consolidated Statement of Cash flows. We allocated the purchase price to the tangible and amortizable intangible assets acquired based on their estimated fair values at the date of acquisition, resulting in the recognition of approximately \$6 million in equipment, \$4 million in intangible assets for customer relationships and a \$1 million intangible asset for a non-compete agreement with the former owners. No goodwill was recorded.

No supplemental pro-forma information is presented for the acquisition due to the immaterial pro-forma effect of the acquisition on our results of operations for all years presented.

**CELLU TISSUE ACQUISITION**

On December 27, 2010, we acquired Cellu Tissue for total consideration paid of \$247.0 million. The purchase price included a \$242.2 million cash payment for 100% of the issued and outstanding common stock of Cellu Tissue, and a \$4.8 million cash payment to the holders of Cellu Tissue stock options and restricted stock, which represented \$12 per share, less each option's exercise price. The acquisition was financed with existing cash and proceeds from the issuance of \$375 million of 7.125% Senior Notes due 2018 (the 2010 Notes; see Note 10, "Debt"). The acquisition resulted in the recognition of \$229.5 million of goodwill, which is not deductible for tax purposes. For fiscal year 2010, we included in our Consolidated Statements of Operations and Cash Flows \$7.3 million of net sales and \$6.3 million of operating losses from the Cellu Tissue operations after the December 27, 2010 acquisition date. Included in these losses were approximately \$6.1 million of pre-tax employee severance expenses. Cellu Tissue's consolidated results of operations from December 28, 2010 forward are included in our Consumer Products segment.

table of contents

We allocated the purchase price to the net assets of Cellu Tissue acquired in the acquisition based on our estimates of the fair value of assets and liabilities as follows:

(In thousands)	Amount
Current assets	\$128,079
Property, plant and equipment	276,499
Goodwill	229,533
Intangibles	56,400
Other assets	1,500
Assets acquired	692,011
Current liabilities	97,071
Long-term debt, less current portion	287,002
Deferred income taxes	60,221
Other liabilities	732
Liabilities assumed	445,026
Net assets acquired	\$246,985

We estimated the fair value of the assets and liabilities of Cellu Tissue utilizing information available at the time of acquisition. We considered outside third-party appraisals of the tangible and intangible assets to determine the applicable fair market values.

Long-term debt included the fair value of Cellu Tissue's senior subordinated notes as of December 27, 2010, which were retired concurrently with the acquisition. We also repaid Cellu Tissue's credit facility of \$32.5 million. We assumed Cellu Tissue's industrial revenue bonds of \$15.6 million, which were subsequently redeemed in 2011 (see Note 10, "Debt").

All costs associated with advisory, legal and other due diligence-related services performed in connection with acquisition-related activity are expensed as incurred. These costs were \$20.4 million for 2010 and were recorded as selling, general and administrative expenses on the Consolidated Statements of Operations.

The following unaudited pro forma financial information presents the combined results of operations as if Cellu Tissue had been combined with us as of the beginning of 2010. The pro forma financial information includes the accounting effects of the business combination, including the adjustment of amortization of intangible assets, depreciation of property, plant and equipment, interest expense and elimination of intercompany sales, as if Cellu Tissue were actually combined with us as of the beginning of 2010.

However, the information does not reflect the costs of any integration activities. The pro forma results include estimates and assumptions, which management believes are reasonable. The unaudited pro forma financial information below is not necessarily indicative of either future results of operations or results that might have been achieved had Cellu Tissue been combined with us as of the beginning of 2010.

(In thousands; Unaudited)	2010
Pro forma net sales	\$1,902,579
Pro forma net earnings	88,713

## NOTE 5 Inventories

(In thousands)	2012	2011
Pulp, paperboard and tissue products	\$147,627	\$162,426
Materials and supplies	67,889	62,376
Logs, pulpwood, chips and sawdust	15,950	17,713
Lumber	—	1,556
	\$231,466	\$244,071

At December 31, 2011, approximately \$0.6 million of our remaining lumber inventories were valued on a LIFO basis. During the three months ended March 31, 2012, the remaining lumber inventory from the sawmill was sold. The sale of this inventory, which was valued at costs prevailing in prior years under the LIFO method, had the effect of increasing earnings before income taxes in the period ended March 31,

2012 by an immaterial amount. The fluctuations of LIFO inventories increased earnings before income taxes by approximately \$10.6 million million in 2011, and had no impact in 2010.

50

---

table of contents

## NOTE 6 Property, Plant and Equipment

(In thousands)	2012	2011
Machinery and equipment	\$1,866,263	\$1,660,636
Buildings and improvements	299,642	249,801
Land improvements	52,929	51,703
Land	11,827	11,804
Office and other equipment	10,946	6,058
Construction in progress	37,160	98,258
	\$2,278,767	\$2,078,260
Less accumulated depreciation and amortization	(1,401,390 )	(1,342,694 )
	\$877,377	\$735,566

The December 31, 2012 and 2011 buildings and improvements and machinery and equipment combined balances each include \$23.1 million associated with capital leases.

Depreciation and amortization expense, including amounts associated with capital leases, totaled \$74.6 million, \$70.6 million and \$46.2 million in 2012, 2011 and 2010, respectively. For 2012, 2011 and 2010, we capitalized \$12.6 million, \$3.7 million and \$0.5 million of interest expense, respectively, associated with our TAD tissue expansion project, which includes the construction of our new tissue manufacturing and converting facilities in Shelby, North Carolina, and upgrades to our tissue manufacturing facility in Las Vegas, Nevada.

## NOTE 7 Goodwill and Intangible Assets

The carrying amount of goodwill is reviewed at least annually for impairment as of November 1. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit is greater than zero and its estimated fair value exceeds its carrying amount, goodwill of the reporting unit is not considered impaired. For the purpose of goodwill impairment testing we identify two reporting units, Consumer Products and Pulp and Paperboard, the same as our two reportable operating segments (see Note 17, "Segment Information"). All of the recorded goodwill is assigned to our Consumer Products reporting unit.

As of November 1, 2012 and 2011, we performed calculations of both a discounted cash flow and market-based valuation model for our Consumer Products reporting unit. The assumptions used in these models allowed us to evaluate the estimated fair value of our reporting unit. The determination of these assumptions required significant estimates on our part. Due to the inherent uncertainty involved in making such estimates, actual results could differ from those assumptions. However, we evaluated the merits of each significant assumption, both individually and in the aggregate, used to determine the estimated fair value of our reporting unit for reasonableness. Upon completion of this exercise, we concluded that the estimated fair value of the Consumer Products reporting unit exceeded its carrying amount. We determined that no further testing was necessary and did not record any impairment loss on our goodwill for the years ended December 31, 2012 and 2011.

Intangible asset amounts represent the acquisition date fair values of identifiable intangible assets acquired. The fair values of the intangible assets were determined by using the income approach, discounting projected future cash flows based on management's expectations of the current and future operating environment. The rates used to discount projected future cash flows reflected a weighted average cost of capital based on our industry, capital structure and risk premiums including those reflected in the current market capitalization. Definite-lived intangible assets are amortized over their useful lives, which range from 2.5 to 10 years. Authoritative guidance requires that the carrying amount of a long-lived asset with a definite life that is held-for-use be evaluated for recoverability whenever events or changes in circumstances indicate that the entity may be unable to recover the asset's carrying amount. There were no such events or changes in circumstances that required us to test our definite-lived intangible assets for impairment for the years ended December 31, 2012 and 2011. We do not have any

indefinite-lived intangible assets recorded from acquisitions.

51

---

table of contents

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

	December 31, 2012			
(Dollars in thousands, lives in years)	Useful Life	Historical Cost	Accumulated Amortization	Net Balance
Customer relationships	9.0	\$53,957	\$(11,237 )	\$42,720
Trade names and trademarks	10.0	5,300	(1,060 )	4,240
Non-compete agreements	2.5 - 5.0	1,674	(881 )	793
Total intangible assets		\$60,931	\$(13,178 )	\$47,753
	December 31, 2011			
(Dollars in thousands, lives in years)	Useful Life	Historical Cost	Accumulated Amortization	Net Balance
Customer relationships	9.0	\$50,000	\$(5,682 )	\$44,318
Trade names and trademarks	10.0	5,300	(530 )	4,770
Non-compete agreements	2.5	1,100	(440 )	660
Total intangible assets		\$56,400	\$(6,652 )	\$49,748

As of December 31, 2012, estimated future amortization expense related to intangible assets is as follows (in thousands):

Years ending December 31,	Amount
2013	\$6,975
2014	6,663
2015	6,608
2016	6,587
2017	6,587
Thereafter	14,333
Total	\$47,753

## NOTE 8 Income Taxes

Earnings (loss) before income taxes is comprised of the following amounts in each tax jurisdiction:

(In thousands)	2012	2011	2010
United States	\$111,278	\$72,156	\$76,196
Canada	313	(1,236 )	—
Earnings before income taxes	\$111,591	\$70,920	\$76,196

The income tax provision is comprised of the following:

(In thousands)	2012	2011	2010
Current			
Federal	\$27,724	\$9,619	\$12,331
State	6,637	6,880	5,056
Foreign	229	(30 )	—
	34,590	16,469	17,387
Deferred			
Federal	16,243	12,865	(16,371 )
State	(3,180 )	1,931	1,380
Foreign	(193 )	(19 )	—
	12,870	14,777	(14,991 )
Income tax provision	\$47,460	\$31,246	\$2,396

table of contents

The income tax provision differs from the amount computed by applying the statutory federal income tax rate of 35.0% to earnings before income taxes due to the following:

(In thousands)	2012	2011	2010	
Computed expected tax provision	\$39,063	\$24,822	\$26,668	
State and local taxes, net of federal income tax impact	4,398	1,482	4,157	
Adjustment for state deferred tax rate	(742	) 2,916	—	
State investment tax credits	(9,077	) —	(1,649	)
Federal credits and net operating losses	4,121	(412	) (25,153	)
Federal manufacturing deduction	(3,288	) (2,443	) (2,993	)
Uncertain tax positions	4,801	2,610	(3,796	)
Patient Protection and Affordable Care Act	—	—	3,290	
Non-deductible acquisition costs	—	(1,215	) 1,263	
Change in valuation allowances	6,932	2,796	—	
U.S. tax provision on foreign operations	(33	) 365	—	
Other	1,285	325	609	
Income tax provision	\$47,460	\$31,246	\$2,396	
Effective tax rate	42.5	% 44.1	% 3.1	%

We have tax benefits relating to equity-based compensation that are being utilized to reduce our U.S. taxable income. Our Consolidated Balance Sheet reflects net operating losses and tax credit carryforwards excluding amounts resulting from equity-based compensation. We have made an accounting policy election to follow the “with-and-without” or “incremental” method for ordering tax benefits derived from employee equity-based compensation awards. As a result of this method, net operating loss carryforwards not generated from equity-based compensation and which were in excess of equity-based compensation expense are utilized before the current period's equity-based tax deduction (excess tax benefits from equity-based compensation awards are recognized last). Excess tax benefits from equity-based compensation awards that are determined to reduce U.S. taxable income following this method are recognized when realized as increases to additional paid-in capital as a component of stockholders' equity. As of December 31, 2011, we had a total amount of excess tax benefits that were not recognized on our Consolidated Balance Sheet of approximately \$3.2 million. During the year ended December 31, 2012, we generated additional excess tax benefits of \$14.0 million relating primarily to the settlement of vested performance share awards to employees. Based on the incremental method, our excess tax benefits associated with equity-based compensation plans were allocated directly to additional paid-in capital as a component of stockholders' equity, reducing income taxes payable, in the amount of \$15,837, \$885 and \$855, in the years ended December 31, 2012, 2011, and 2010, respectively. As of December 31, 2012, we have a total amount of excess tax benefits that are not recognized on our Consolidated Balance Sheet of approximately \$1.4 million.



table of contents

(In thousands)	2012	2011
Deferred tax assets:		
Employee benefits	\$8,630	\$7,930
Postretirement employee benefits	52,751	53,862
Incentive compensation	9,130	7,949
Pensions	31,140	28,081
Federal and state credit carryforwards	20,447	30,809
Net operating losses	7,649	16,749
Federal benefit from state taxes resulting from uncertain tax positions	5,595	5,595
Other	5,757	6,492
Total deferred tax assets	\$141,099	\$157,467
Valuation allowance	(14,957)	(8,025)
Deferred tax assets, net of valuation allowance	\$126,142	\$149,442
Deferred tax liabilities:		
Plant and equipment	\$(157,973)	\$(166,885)
Intangible assets	(10,843)	(10,879)
Inventories	(314)	(1,570)
Total deferred tax liabilities	(169,130)	(179,334)
Net deferred tax liabilities	\$(42,988)	\$(29,892)

Net deferred tax assets (liabilities) consist of:

(In thousands)	2012	2011
Current deferred tax assets	\$20,473	\$41,237
Current deferred tax liabilities	(3,337)	(1,771)
Net current deferred tax assets	17,136	39,466
Non-current deferred tax assets	110,762	108,205
Non-current deferred tax liabilities	(170,886)	(177,563)
Net non-current deferred tax liabilities	(60,124)	(69,358)
Net deferred tax liabilities	\$(42,988)	\$(29,892)

We are registered with the Internal Revenue Service, or IRS, as both an alternative fuel mixer and a producer of cellulosic biofuel. During 2009 we received refundable tax credit payments in connection with our use of "black liquor," a by-product of the kraft pulp manufacturing process, in an alternative fuel mixture to produce energy at our pulp mills. The amount of the refundable tax credit is equal to \$0.50 per gallon of alternative fuel mixture used. The Alternative Fuel Mixture Tax Credit, or AFMTC, expired on December 31, 2009. The Cellulosic Biofuel Producer Credit, or CBPC, enables us to claim \$1.01 per gallon in regards to black liquor produced and used as a fuel by us at our pulp mills in 2009. During 2010, the IRS clarified the ability to convert previously claimed gallons from the AFMTC to the CBPC. We are eligible to convert gallons previously claimed under the AFMTC to the CBPC; however, due to CBPC carryovers from 2010, we did not convert additional gallons during 2011. Under current federal tax law, we have the ability to convert additional gallons to CPBC through March 2013.

During the year ended December 31, 2010 we amended our 2009 corporate income tax return and claimed approximately 25.3 million gallons of fuel under the CBPC for that portion of black liquor produced in 2009 for which we did not claim the AFMTC. This equated to an additional federal income tax credit of \$25.5 million, which was recognized as a benefit to our tax provision in the fourth quarter of 2010. Additionally, we further amended our 2009 corporate income tax return to convert approximately 39.8 million gallons of fuel under the AFMTC to the CBPC. This equated to an additional federal income tax credit of \$20.3 million, which was recognized as a benefit to our tax provision in 2010. The CBPC is a non-refundable income tax credit which is deemed to be taxable income in the year the benefit is

received. Thus, the CBPC benefit was reduced by the related corporate income tax obligation, resulting in a net income tax benefit of \$27.1 million in 2010.

There was a net increase to our income tax expense for the year ended December 31, 2012 resulting from \$6.2 million in tax expense related to our decision to further amend our 2009 corporate income tax return to convert certain gallons claimed under the CPBC back to gallons under the AFMTC. The tax expense attributable to the AFMTC conversion was comprised of \$3.4 million relating to the conversion back to the AFMTC and a resulting additional \$2.8 million increase in our liabilities for uncertain tax positions.

table of contents

During 2012 and 2011, we recorded a \$0.7 million tax benefit and \$2.9 million tax expense, respectively, reflecting a remeasurement of state deferred tax assets and liabilities using anticipated tax rates which will be in effect when the underlying assets and liabilities will reverse. The 2011 change in state tax rate is primarily attributable to the change in our tissue business operations after the acquisition of Cellu Tissue on December 27, 2010.

As of December 31, 2012, we had deferred tax assets arising from deductible temporary differences, tax losses and tax credits of \$141.1 million before the offset of certain deferred tax liabilities. With the exception of certain deferred tax assets related to federal foreign tax credits, state tax losses and state tax credits, management believes it is more likely than not that forecasted income, together with the tax effect of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets.

During 2012, the valuation allowance for deferred tax assets increased by a net \$6.9 million. We decreased the valuation allowances for state tax losses incurred by \$0.5 million and increased the valuation allowances for state tax credits by \$8.2 million. Both of these items were recorded as current period deferred tax expense or benefit. We also reduced the valuation allowance relating to foreign tax credits by \$0.8 million, which was recorded as a deferred tax benefit to the income tax provision. The reduction is based upon tax planning strategies that we believe will more likely than not allow us to utilize a portion of the foreign tax credits before they expire. During 2011, the valuation allowance for deferred tax assets increased by a net \$2.8 million. We increased the valuation allowances for state tax losses incurred by certain subsidiaries and state tax credits by \$2.5 million and \$2.2 million, respectively. Both of these items were recorded as current period deferred tax expense. We also reduced the valuation allowance relating to foreign tax credits by \$1.9 million, which was recorded as a deferred tax benefit to the income tax provision. The reduction is based upon tax planning strategies that we believe will more likely than not allow us to utilize a portion of the foreign tax credits before they expire. The valuation allowance did not change in 2010.

During the fourth quarter of 2012, the IRS commenced an audit of our tax returns for the tax years ending December 31, 2008 through December 31, 2011.

Tax years subject to examination by major taxing jurisdictions are as follows:

Jurisdiction	Years
United States	2008 - 2012
Canada	2008 - 2012
Arkansas	2009 - 2012
California	2008 - 2012
Georgia	2009 - 2012
Idaho	2008 - 2012
Illinois	2009 - 2012
Wisconsin	2008 - 2012

Tax credits and losses subject to expiration by major taxing jurisdictions are as follows (in thousands):

Jurisdiction	Gross Values	Years
United States		
Net operating losses	\$7,143	2030

Foreign tax credits	3,832	2016 - 2019
Other federal tax credits	644	2026 - 2030
Connecticut tax losses	59,681	2018 - 2031
Georgia tax losses	9,130	2028 - 2031
Idaho tax credits	4,954	2013 - 2026
North Carolina tax credits	16,142	2015 - 2016
Oklahoma tax losses	9,403	2030 -2032

As of December 31, 2012 there were no undistributed earnings relating to our Canadian subsidiary, Interlake Acquisition Corporation, as all historical earnings were repatriated under Cellu Tissue ownership. Management's intent is to reinvest future earnings indefinitely.

A review of our uncertain income tax positions at December 31, 2012 and 2011 indicates that liabilities are required to be recorded for gross unrecognized tax benefits following authoritative accounting guidance. The following presents a roll forward of our unrecognized tax benefits and associated interest and penalties, as included in the Accrued Taxes line item in non-current liabilities in our Consolidated Balance Sheets.

table of contents

(In thousands)	Gross Unrecognized Tax Benefits, Excluding Interest and Penalties	Interest and Penalties	Total Gross Unrecognized Tax Benefits
Balance at January 1, 2011	\$69,633	\$2,378	\$72,011
(Decrease) increase in prior year tax positions	(174	) 2,435	2,261
Increase in current year tax positions	222	—	222
Reductions as a result of a lapse of the applicable statute of limitations	(30	) —	(30 )
Balance at December 31, 2011	\$69,651	\$4,813	\$74,464
(Decrease) increase in prior year tax positions	(731	) 1,882	1,151
Increase in current year tax positions	154	—	154
Increase in prior year tax positions	3,275	—	3,275
Reductions as a result of a lapse of the applicable statute of limitations	(345	) —	(345 )
Balance at December 31, 2012	\$72,004	\$6,695	\$78,699

Unrecognized tax benefits net of related deferred tax assets at December 31, 2012, if recognized, would favorably impact our effective tax rate by decreasing our tax provision by \$73.1 million.

We reflect accrued interest related to tax obligations, as well as penalties, in our provision for income tax. For the years ended December 31, 2012, 2011 and 2010, we accrued interest and no penalties of \$1.9 million, \$2.4 million and \$2.4 million, respectively, in our income tax provision.

We entered into a tax sharing agreement with Potlatch upon the December 2008 spin-off that will generally govern each party's rights, responsibilities and obligations with respect to taxes, including ordinary course of business taxes and taxes, if any, incurred as a result of any failure of the spin-off to be tax free. Under the tax sharing agreement, we expect that, with certain exceptions, we will be responsible for the payment of all income and non-income taxes attributable to our operations. The tax sharing agreement also sets forth our rights and responsibilities for tax obligations and refunds attributable to tax periods prior to the spin-off date.

Under the tax sharing agreement, we will be responsible for any taxes imposed on Potlatch that arise from the failure of the spin-off, together with certain related transactions, to qualify as a tax-free distribution for U.S. federal income tax purposes, including any tax that would result if Potlatch were to fail to qualify as a REIT as a result of income recognized by Potlatch if the spin-off were determined to be taxable, to the extent such failure to qualify is attributable to actions, events or transactions relating to our stock, assets or business, or a breach of the relevant representations or covenants we made in the tax sharing agreement. The tax sharing agreement imposes restrictions on our and Potlatch's ability to engage in certain actions following the spin-off and sets forth the respective obligations of each party with respect to the filing of tax returns, the administration of tax contests, assistance and cooperation and other matters.

## NOTE 9 Accounts Payable and Accrued Liabilities

(In thousands)	2012	2011
Trade accounts payable	\$75,949	\$65,040
Accrued wages, salaries and employee benefits	42,491	37,430
Accrued taxes on income	9,428	2,204
Accrued utilities	8,205	7,265
Accrued taxes other than income taxes payable	6,993	11,257
Accrued interest	5,242	5,245

Accrued discounts and allowances	4,785	5,588
Accrued transportation	4,417	3,801
Other	8,086	6,801
	\$ 165,596	\$ 144,631

56

---

table of contents

## NOTE 10 Debt

## \$375 MILLION SENIOR NOTES DUE 2018

On October 22, 2010, we sold \$375 million aggregate principal amount of senior notes, which we refer to as the 2010 Notes. The 2010 Notes mature on November 1, 2018, have an interest rate of 7.125% and were issued at their face value. The issuance of these notes generated net proceeds of \$367.5 million after deducting offering expenses. The net proceeds from the issuance of the 2010 Notes were used to finance in part our acquisition of Cellu Tissue, to refinance certain existing indebtedness of Cellu Tissue, and to pay fees and expenses incurred as part of the 2010 Note offering, acquisition of Cellu Tissue and related transactions.

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

Prior to November 1, 2013, we may redeem up to 35% of the 2010 Notes at a redemption price equal to 107.125% of the principal amount plus accrued and unpaid interest with the proceeds from one or more qualified equity offerings. We have the option to redeem all or a portion of the 2010 Notes at any time before November 1, 2014 at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest and a “make whole” premium. On or after November 1, 2014, we may redeem all or a portion of the 2010 Notes at specified redemption prices plus accrued and unpaid interest. In addition, we may be required to make an offer to purchase the 2010 Notes upon the sale of certain assets and upon a change of control.

## REDEMPTION OF \$150 MILLION SENIOR NOTES DUE 2016 AND ISSUANCE OF \$275 MILLION SENIOR NOTES DUE 2023

In June 2009, we issued senior unsecured notes, which we refer to as the 2009 Notes, in the aggregate principal amount of \$150 million. The 2009 Notes, which were due on June 15, 2016 and had an interest rate of 10.625%, were issued at a price equal to 98.792% of their face value.

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

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

On February 22, 2013, in an event occurring subsequent to the close of our 2012 fiscal year end, we exercised our option to redeem all of the 2009 Notes at a redemption price equal to approximately \$166 million, which consisted of 100% of the principal amount, plus an approximate \$13 million “make whole”

premium and accrued and unpaid interest of approximately \$3 million. We will record the make whole premium and a portion of the unpaid interest as components of debt retirement costs in the first quarter of 2013. Proceeds to fund the redemption of our 2009 Notes were made available through the sale of \$275 million aggregate principal amount senior notes on January 23, 2013, which we refer to as the 2013 Notes. The 2013 Notes mature on February 1, 2023, have an interest rate of 4.5% and were issued at their face value.

The 2013 Notes are guaranteed by our existing and future direct and indirect domestic subsidiaries. The 2013 Notes are equal in right of payment with all other existing and future unsecured senior indebtedness and are senior in right of payment to any future subordinated indebtedness. The 2013 Notes are effectively subordinated to all of our existing and future secured indebtedness, including borrowings under our secured revolving credit facility, which is secured by certain of our accounts receivable, inventory and cash. The terms of the 2013 Notes limit our ability and the ability of any restricted subsidiaries to borrow money; pay dividends; redeem or repurchase capital stock; make investments; sell assets; create restrictions on the payment of dividends or other amounts to us from any restricted subsidiaries; enter into transactions with affiliates; enter into sale and lease back transactions; create liens; and consolidate, merge or sell all or substantially all of our assets.



table of contents

Prior to February 1, 2016 we may redeem up to 35% of the 2013 Notes at a redemption price equal to 104.5% of the principal amount plus accrued and unpaid interest with the proceeds from one or more qualified equity offerings. We have the option to redeem all or a portion of the 2013 Notes at any time before February 1, 2018 at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest and a “make whole” premium. On or after February 1, 2018 we may redeem all or a portion of the 2013 Notes at specified redemption prices plus accrued and unpaid interest. In addition, we may be required to make an offer to purchase the 2013 Notes upon the sale of certain assets and upon a change of control.

**CITYFOREST INDUSTRIAL BONDS**

Prior to our acquisition of Cellu Tissue, Cellu Tissue CityForest LLC, or CityForest, a wholly-owned subsidiary of Cellu Tissue, was party to a loan agreement, dated as of March 1, 1998, with the City of Ladysmith, Wisconsin. Pursuant to this agreement, the City of Ladysmith loaned the proceeds of its Variable Rate Demand Solid Waste Disposal Facility Revenue Bonds, Series 1998, or IRBs, to CityForest to finance the construction by CityForest of a solid waste disposal facility. As a result of our acquisition of Cellu Tissue, we assumed the IRBs. During the third quarter of 2011, we redeemed the remaining \$15.2 million principal amount of outstanding IRBs.

**REVOLVING CREDIT FACILITY**

On November 26, 2008, we entered into a \$125 million senior secured revolving credit facility with certain financial institutions. The amount available to us under the revolving credit facility is based on the lesser of 85% of our eligible accounts receivable plus approximately 65% of our eligible inventory, or \$125 million. The revolving credit facility has been subsequently amended and its current term ends on September 30, 2016.

As of December 31, 2012, there were no borrowings outstanding under the credit facility, but approximately \$5.9 million of the credit facility was being used to support outstanding standby letters of credit. Loans under the credit facility bear interest (i) for LIBOR loans, LIBOR plus between 1.75% and 2.25%, and (ii) for base rate loans, a per annum rate equal to the greatest of (a) the prime rate for such day; (b) the federal funds effective rate for such day, plus 0.50%; or (c) LIBOR for a 30-day interest period as determined on such day, plus 1.0%, plus between 0.25% and 0.75%. The percentage margin on all loans is based on our fixed charge coverage ratio for the most recent four quarters. As of December 31, 2012, we would have been permitted to draw approximately \$119.1 million under the credit facility at LIBOR plus 1.75% or base rate plus 0.25%.

A minimum fixed charge coverage ratio is the only financial maintenance covenant under our credit facility and is triggered when there are any commitments or obligations outstanding and availability falls below 12.5% or an event of default exists, at which time the minimum fixed charge coverage ratio must be at least 1.0-to-1.0. As of December 31, 2012, the fixed charge coverage ratio for the most recent four quarters was 3.6-to-1.0.

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

**NOTE 11 Other Long-Term Obligations**

(In thousands)	2012	2011
Long-term lease obligations, net of current portion	\$25,240	\$25,546
Deferred proceeds	11,668	13,040
Deferred compensation	9,939	8,100
Other	4,063	1,788

\$50,910

\$48,474

58

---

table of contents

NOTE 12 Savings, Pension and Other Postretirement Employee Benefit Plans

Certain of our employees are eligible to participate in defined contribution savings and defined benefit postretirement plans. These include 401(k) savings plans, defined benefit pension plans including company-sponsored and multiemployer plans, and Other Postretirement Employee Benefit, or OPEB, plans, each of which is discussed below.

401(k) Savings Plans

Substantially all of our employees are eligible to participate in 401(k) savings plans, which include a company match component. In 2012, 2011 and 2010, we made matching 401(k) contributions on behalf of employees of \$14.9 million, \$8.1 million and \$5.7 million, respectively. The increase in 2012 is the result of an increase in the company contribution to the Clearwater Paper Corporation 401(k) Plan in order to compensate for the December 15, 2010 closure to new participants and December 31, 2011 freezing of benefits to existing participants of the salaried pension plan.

Company-Sponsored Defined Benefit Pension Plans

A majority of our salaried employees and a portion of our hourly employees are covered by company-sponsored noncontributory defined benefit pension plans.

In the fourth quarter of 2012, we recorded a curtailment loss of \$0.5 million in net periodic cost, and a corresponding decrease in Other Comprehensive Income, as a result of certain hourly employees at our Cypress Bend, Arkansas pulp and paperboard facility electing to cease accruing further pension benefits effective December 31, 2012. In exchange, beginning January 1, 2013 and lasting for a certain number of years, these employees began receiving an enhanced employer contribution to one of our existing 401(k) savings plan in which they participate. In the fourth quarter of 2011, we recorded a curtailment loss of \$2.8 million in net periodic cost, and a corresponding decrease in Other Comprehensive Income, as a result of the sale of our sawmill. In addition, we recorded a \$0.4 million decrease in our pension liability with a corresponding decrease in Accumulated Other Comprehensive Loss. Effective December 15, 2010, the salaried pension plan was closed to new entrants, and effective December 31, 2011, the salaried pension plan was frozen and ceased accruing further benefits. As a result of these changes to the salaried pension plan, both announced in the fourth quarter of 2010, we recorded a loss of \$0.2 million.

Company-Sponsored OPEB Plans

We also provide benefits under company-sponsored defined benefit retiree health care and life insurance plans, which cover certain salaried and hourly employees. Most of the retiree health care plans require retiree contributions and contain other cost-sharing features. The retiree life insurance plans are primarily noncontributory.

Funded Status of Company-Sponsored Plans

As required by current standards governing the accounting for defined benefit pension and other postretirement plans, we recognized the funded status of our company-sponsored plans on our Consolidated Balance Sheets at December 31, 2012 and 2011. The funded status is measured as the difference between plan assets at fair value (with limited exceptions) and the benefit obligation. For a pension plan, the benefit obligation is the projected benefit obligation; for any other postretirement employee benefit plan, such as a retiree health care plan, the benefit obligation is the accumulated postretirement employee benefit obligation.

We use a December 31 measurement date for our benefit plans.

table of contents

The changes in benefit obligation, plan assets and funded status for company-sponsored benefit plans as of December 31 are as follows:

(In thousands)	Pension Benefit Plans		Other Postretirement Employee Benefit Plans	
	2012	2011	2012	2011
Benefit obligation at beginning of year	\$307,658	\$272,012	\$136,710	\$141,519
Service cost	2,485	7,725	693	702
Interest cost	14,693	15,092	5,815	6,857
Plan changes	—	—	(5,278	) —
Mergers, sales, closures, special term benefits	—	(422	) —	—
Actuarial losses (gains)	30,612	28,552	3,151	(5,433
Medicare Part D subsidies received	—	—	569	355
Benefits paid	(22,191	) (15,301	) (7,042	) (7,290
Benefit obligation at end of year	333,257	307,658	134,618	136,710
Fair value of plan assets at beginning of year	218,557	216,650	18	16
Actual return on plan assets	37,308	4,456	1	2
Employer contribution	20,882	12,752	—	—
Benefits paid	(22,191	) (15,301	) —	—
Fair value of plan assets at end of year	254,556	218,557	19	18
Funded status at end of year	\$(78,701	) \$(89,101	) \$(134,599	) \$(136,692

Amounts recognized in the Consolidated Balance Sheets:

(In thousands)	Pension Benefit Plans		Other Postretirement Employee Benefit Plans	
	2012	2011	2012	2011
Current liabilities	\$(281	) \$(264	) \$(8,856	) \$(9,597
Noncurrent liabilities	(78,420	) (88,837	) (125,743	) (127,095
Net amount recognized	\$(78,701	) \$(89,101	) \$(134,599	) \$(136,692

Amounts recognized (pre-tax) in Accumulated Other Comprehensive Loss as of December 31 consist of:

(In thousands)	Pension Benefit Plans		Other Postretirement Employee Benefit Plans	
	2012	2011	2012	2011
Net loss	\$177,343	\$176,439	\$24,408	\$21,258
Prior service cost (credit)	1,414	2,525	(6,504	) (3,906
Net amount recognized	\$178,757	\$178,964	\$17,904	\$17,352

Information as of December 31 for certain pension plans included above with accumulated benefit obligations in excess of plan assets were as follows:

(In thousands)	2012	2011
Projected benefit obligation	\$333,257	\$307,658
Accumulated benefit obligation	333,257	307,658
Fair value of plan assets	254,556	218,557

Pre-tax components of Net Periodic Cost and other amounts recognized in Other Comprehensive Income (Loss) for the years ended December 31 were as follows:

table of contents

## Net Periodic Cost (Benefit):

(In thousands)	Pension Benefit Plans			Other Postretirement Employee Benefit Plans		
	2012	2011	2010	2012	2011	2010
Service cost	\$2,485	\$7,725	\$8,018	\$693	\$702	\$995
Interest cost	14,693	15,092	15,375	5,815	6,857	7,712
Expected return on plan assets	(19,685 )	(19,532 )	(19,391 )	—	—	—
Amortization of prior service cost (credit)	634	1,193	1,205	(2,680 )	(1,795 )	(1,795 )
Amortization of actuarial loss	12,085	8,382	8,671	—	—	2,083
Curtailements	477	2,776	183	—	—	—
Net periodic cost	\$10,689	\$15,636	\$14,061	\$3,828	\$5,764	\$8,995

## Other amounts recognized in Other Comprehensive Income (Loss):

(In thousands)	Pension Benefit Plans			Other Postretirement Employee Benefit Plans		
	2012	2011	2010	2012	2011	2010
Net loss (gain)	\$12,989	\$43,207	\$(19,216 )	\$3,150	\$(5,435 )	\$(9,471 )
Prior service credit	(477 )	(2,776 )	(183 )	(5,278 )	—	—
Amortization of prior service (cost) credit	(634 )	(1,193 )	(1,205 )	2,680	1,795	1,795
Amortization of actuarial loss	(12,085 )	(8,382 )	(8,671 )	—	—	(2,083 )
Total recognized in other comprehensive loss (income)	\$(207 )	\$30,856	\$(29,275 )	\$552	\$(3,640 )	\$(9,759 )
Total recognized in net periodic cost (benefit) and other comprehensive loss (income)	\$10,482	\$46,492	\$(15,214 )	\$4,380	\$2,124	\$(764 )

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive loss into net periodic cost (benefit) over the next fiscal year are \$15.5 million and \$0.4 million, respectively. The estimated prior service credit for the OPEB plans that will be amortized from accumulated other comprehensive loss into net periodic cost (benefit) over the next fiscal year is \$2.7 million.

The Medicare Prescription Drug Improvement and Modernization Act of 2003 introduced a drug benefit under Medicare Part D and a federal subsidy to sponsors of retiree health care benefit plans that provide an equivalent benefit. Our actuaries determined that certain benefits provided under our plans are actuarially equivalent to the Medicare Part D standard plan and are eligible for the employer subsidy. During 2012 and 2011, we received subsidy payments totaling \$0.6 million and \$0.4 million for each respective year.

Weighted average assumptions used to determine the benefit obligation as of December 31 were:

	Pension Benefit Plans			Other Postretirement Employee Benefit Plans		
	2012	2011	2010	2012	2011	2010
Discount rate	4.15 %	4.90 %	5.70 %	4.05 %	4.95 %	5.60 %
Rate of salaried compensation increase	—	—	4.00	—	—	—

Weighted average assumptions used to determine the net periodic cost (benefit) for the years ended December 31 were:

Pension Benefit Plans	Other Postretirement
-----------------------	----------------------

	Employee Benefit Plans					
	2012	2011	2010	2012	2011	2010
Discount rate	4.90	% 5.70	% 5.75	% 4.95	% 5.60	% 5.75
Expected return on plan assets	8.00	8.00	8.50	—	—	—
Rate of salaried compensation increase	—	4.00	4.00	—	—	—

61

---

table of contents

The discount rate used in the determination of pension benefit obligations and pension expense was determined based on a review of long-term high-grade bonds as well as management's expectations. The discount rate used to calculate OPEB obligations was determined using the same methodology we used for our pension plans.

The expected return on plan assets assumption is based upon an analysis of historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return.

The assumed health care cost trend rate used to calculate OPEB obligations in 2012 was 7.0%, and the rate used to calculate OPEB expense in 2012 was 7.5%, with both rates grading to 4.7% over approximately 60 years. This assumption has a significant effect on the amounts reported. A one percentage point change in the health care cost trend rates would have the following effects:

(In thousands)	1% Increase	1% Decrease
Effect on total of service and interest cost components	\$644	\$(544)
Effect on postretirement employee benefit obligation	12,450	(10,707)

The investments of our defined benefit pension plans are held in a Master Trust. The assets of our OPEB plans are held within an Internal Revenue Code section 401(h) account for the payment of retiree medical benefits within the Master Trust.

The Master Trust has a securities lending agreement. The agreement authorizes the lending agent to loan securities owned by the Master Trust to an approved list of borrowers. Under the agreement, the lending agent is responsible for negotiating each loan for an unspecified term while retaining the power to terminate the loan at any time. At the time each loan is made, the lending agent requires collateral equal to, but not less than, 102% of the market value of the loaned securities and accrued interest. The Master Trust directs the agent as to the type of investment pool in which to invest the borrower's collateral based on established policy with specific limits; accordingly, the right to receive the collateral and obligation to return it are disclosed as a component of Master Trust investments. While the securities are loaned, the Master Trust retains all rights of ownership, except it waives its right to vote such securities. Securities loaned subject to this securities lending agreement totaled \$3.3 million at December 31, 2012. These securities are principally corporate common stocks.

Current accounting rules governing fair value measurement establish a framework for measuring fair value, which provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plans have the ability to access.
- Level 2 Inputs to the valuation methodology include:
  - Quoted prices for similar assets or liabilities in active markets;
  - Quoted prices for identical or similar assets or liabilities in inactive markets;
  - Inputs other than quoted prices that are observable for the asset or liability; and
  - Inputs that are derived principally from or corroborated by observable market data by correlation or other means
 If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

62

---



table of contents

Securities in the Master Trust are stated at fair value. Fair value is based upon quotations obtained from national securities exchanges, if available. Where securities do not have a quoted market price, the recorded amount represents estimated fair value. Many factors are considered in arriving at that fair market value. Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used during 2012.

Corporate common stock and mutual funds: Investments are valued at quoted market prices.

Common and collective trust: The investment in common and collective trusts is based on the fair value of the underlying assets and is expressed in units.

Corporate debt securities: In general, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while management believes the valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables set forth by level, within the fair value hierarchy, the investments at fair value for our company-sponsored pension benefit plans:

(In thousands)	December 31, 2012			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$3,786	\$—	\$—	\$3,786
Common and collective trusts:				
International small cap	—	12,725	—	12,725
Global/International equity	—	16,656	—	16,656
Domestic equity – small/mid cap	—	17,339	—	17,339
International equity emerging markets	—	17,672	—	17,672
Common stocks:				
Industrials	9,475	—	—	9,475
Energy	1,966	—	—	1,966
Consumer	8,270	—	—	8,270
Healthcare	7,386	—	—	7,386
Finance	13,000	—	—	13,000
Utilities	2,305	—	—	2,305
Information technology	6,828	—	—	6,828
Foreign	6,078	—	—	6,078
Mutual funds:				
Foreign large blend	18,907	—	—	18,907
Long-term bond fund	114,557	—	—	114,557
Corporate debt securities	—	1,073	—	1,073
Subtotal	\$192,558	\$65,465	\$—	\$258,023
Payable held under securities lending agreement				(3,467 )
Total investments at fair value				\$254,556

table of contents

(In thousands)	December 31, 2011			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$9,843	\$—	\$—	\$9,843
Common and collective trusts:				
International small cap	—	10,588	—	10,588
Global/International equity	—	13,748	—	13,748
Domestic equity – small/mid cap	—	15,939	—	15,939
International equity emerging markets	—	14,602	—	14,602
Common stocks:				
Industrials	5,545	—	—	5,545
Energy	2,595	—	—	2,595
Consumer	9,714	—	—	9,714
Healthcare	4,321	—	—	4,321
Finance	10,235	—	—	10,235
Utilities	4,234	—	—	4,234
Information technology	4,847	—	—	4,847
Foreign	5,000	—	—	5,000
Mutual funds:				
Foreign large blend	15,048	—	—	15,048
Long-term bond fund	99,728	—	—	99,728
Corporate debt securities	—	1,045	—	1,045
Subtotal	\$171,110	\$55,922	\$—	\$227,032
Payable held under securities lending agreement				(8,475 )
Total investments at fair value				\$218,557

Our OPEB plan had approximately \$19,000 held in cash and equivalents at December 31, 2012, which were categorized as level 1.

In 2010, we established our own formal investment policy guidelines for our company-sponsored plans. These guidelines were set by our benefits committee, which is comprised of members of our management and has been assigned its fiduciary authority over management of the plan assets by our Board of Directors. The committee's duties include periodically reviewing and modifying those investment policy guidelines as necessary and insuring that the policy is adhered to and the investment objectives are met. The investment policy includes specific guidelines for specific categories of fixed income and convertible securities. Assets are managed by professional investment managers who are expected to achieve a reasonable rate of return over a market cycle. Long-term performance is a fundamental tenet of the policy. The general policy states that plan assets would be invested to seek the greatest return consistent with the fiduciary character of the pension funds and to allow the plans to meet the need for timely pension benefit payments. The specific investment guidelines stipulate that management is to maintain adequate liquidity for meeting expected benefit payments by reviewing, on a timely basis, contribution and benefit payment levels and appropriately revising long-term and short-term asset allocations. Management takes reasonable and prudent steps to preserve the value of pension fund assets and to avoid the risk of large losses. Major steps taken to provide this protection included:

Assets are diversified among various asset classes, such as domestic equities, international equities, fixed income and convertible liquid reserves. The long-term asset allocation ranges are as follows:

Domestic equities	10%-32%
International equities, including emerging markets	10%-32%
Corporate bonds	38%-80%
Liquid reserves	0%-1%



table of contents

Periodically, reviews of allocations within these ranges are made to determine what adjustments should be made based on changing economic and market conditions and specific liquidity requirements.

Assets were managed by professional investment managers and could be invested in separately managed accounts or commingled funds.

Assets were not invested in securities rated below BBB- by S&P or Baa3 by Moody's.

The investment guidelines also required that the individual investment managers were expected to achieve a reasonable rate of return over a market cycle. Emphasis was placed on long-term performance versus short-term market aberrations. Factors considered in determining reasonable rates of return included performance achieved by a diverse cross section of other investment managers, performance of commonly used benchmarks (e.g., Russell 3000 Index, MSCI World ex-U.S. Index, Barclays Capital Long Credit Index), actuarial assumptions for return on plan investments and specific performance guidelines given to individual investment managers.

At December 31, 2012, eleven active investment managers managed substantially all of the pension funds, each of whom had responsibility for managing a specific portion of these assets. Plan assets were diversified among the various asset classes within the allocation ranges approved by the benefits committee.

Our company-sponsored pension plans were underfunded by \$78.7 million at December 31, 2012 and \$89.1 million at December 31, 2011. As a result of being underfunded, we are required to make contributions to our qualified pension plans. In 2012 we contributed \$20.6 million to these pension plans. We also contributed \$0.2 million to our non-qualified pension plan in 2012. Our cash contributions in 2013 are estimated to be approximately \$20 million. We do not anticipate funding our OPEB plans in 2013 except to pay benefit costs as incurred during the year by plan participants.

Estimated future benefit payments, which reflect expected future service and expected Medicare prescription subsidy receipts, are as follows for the years indicated:

(In thousands)	Pension Benefit Plans	Other Postretirement Employee Benefit Plans	Expected Medicare Subsidy
2013	\$ 17,144	\$9,565	\$690
2014	17,606	9,895	723
2015	18,413	10,138	752
2016	19,037	10,515	778
2017	19,629	10,431	808
2018-2022	103,890	47,754	4,460

#### Multiemployer Defined Benefit Pension Plans

Hourly employees at two of our manufacturing facilities participate in multiemployer defined benefit pension plans: the PACE Industry Union Management Pension Fund, which is managed by United Steelworkers, or USW, Benefits; and the International Association of Machinist & Aerospace Workers National Pension Fund, or IAM. We make contributions to these plans, as well as make contributions to a trust fund established to provide retiree medical benefits for a portion of these employees, which is also managed by USW Benefits. The risks of participating in these multiemployer plans are different from single-employer plans in the following respects:

Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.

If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.

If we choose to stop participating in any of our multiemployer plans, we may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a "withdrawal liability." Due to the current unknown impact of future plan performance or the success of current and future funding

improvement or rehabilitation plans to restore solvency to the plans, we are unable to determine whether or not we would ever choose to stop participating in any multiemployer plan, and if so, the amount and timing of any future withdrawal liability, changes in future funding obligations, or the impact of increased contributions, including those that could be triggered by a mass withdrawal of other employers from a multiemployer plan. Future funding obligations or future withdrawal liabilities would likely be material to our results of operations, financial condition or cash flows. A withdrawal liability is recorded for accounting purposes when withdrawal is probable and the amount of the withdrawal obligation is reasonably estimable.

65

---

table of contents

Our participation in these plans for the annual period ended December 31, 2012, is outlined in the table below. The "EIN" and "Plan Number" columns provide the Employee Identification Number, or EIN, and the three-digit plan number. The most recent Pension Protection Act, or PPA, zone status available in 2012 and 2011 is for a plan's year-end as of December 31, 2011, and December 31, 2010, respectively. The zone status is based on information we received from the plans and is certified by each plans' actuary. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent but more than 65 percent funded, and plans in the green zone are at least 80 percent funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan, or FIP, or a rehabilitation plan, or RP, is either pending or has been implemented as required by the PPA as a measure to correct its underfunded status. The last column lists the expiration date(s) of the collective-bargaining agreement(s) to which the plans are subject.

In 2012, the contribution rates for the IAM plan increased to \$3.25 an hour, up from \$3.00 an hour in 2011 and \$2.75 an hour in 2010, affecting the comparability of the contributions year over year. Similarly, in November of 2011, the USW plan's contribution rates increased from \$2.4285 an hour to \$2.6714 an hour. The USW plan's rate increase was implemented as part of the RP in lieu of the legally required surcharge, paid by the employers, to assist the fund's financial status. As such, the USW contribution rate changes affect comparability of the contributions year over year. We were listed in the USW Plan's Form 5500 report as providing more than five percent of the total contributions for the years 2011 and 2010. At the date of issuance of our consolidated financial statements, Form 5500 reports for these plans were not available for the 2012 plan year.

Pension Fund	EIN	Plan Number	PPA Zone		FIP/RP Status Pending/Implemented	Contributions (in thousands)			Surcharge Imposed	Expiration Date of Collective Bargaining Agreement
			2012	2011		2012	2011	2010		
IAM	51-6031295	002	Green	Green	N/A	\$288	\$269	\$244	No	5/31/2016
USW	11-6166763	001	Red	Red	Implemented	5,673	5,648	5,218	No	8/31/2014
Total Contributions:						\$5,961	\$5,917	\$5,462		

## NOTE 13 Earnings Per Share

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

	2012	2011	2010
Basic average common shares outstanding <sup>1</sup>	23,298,663	22,913,881	22,947,400
Incremental shares due to:			
Restricted stock units	24,086	220,457	356,048
Performance shares	291,036	817,946	366,504
Diluted average common shares outstanding	23,613,785	23,952,284	23,669,952
Basic net earnings per common share	\$2.75	\$1.73	\$3.22
Diluted net earnings per common share	2.72	1.66	3.12
Anti-dilutive shares excluded from calculation	9,992	88,674	—

<sup>1</sup> Basic average common shares outstanding include restricted stock awards that are fully vested, but are deferred for future issuance. See Note 14, "Equity-Based Compensation Plans" for further discussion.

## NOTE 14 Equity-Based Compensation Plans

The Clearwater Paper Corporation 2008 Stock Incentive Plan, or Stock Plan, which has been approved by our stockholders, provides for equity-based awards in the form of restricted shares, restricted stock units, or RSUs, performance shares, stock options, or stock appreciation rights to selected employees, outside directors, and consultants of the company. The Stock Plan became effective on December 16, 2008.

Under the Stock Plan, as amended, we are authorized to issue up to approximately 4.1 million shares, which includes approximately 0.7 million additional shares authorized in connection with our acquisition of Cellu Tissue that are available for issuance as equity-based awards only to any employees, outside directors, or consultants who were not employed on December 26, 2010 by Clearwater Paper Corporation or any of its subsidiaries. At December 31, 2012, approximately 1.9 million shares were available for future issuance under the Stock Plan.

We recognize equity-based compensation expense for all equity-based payment awards made to employees and directors, including RSUs and performance shares, based on estimated fair values and net of estimates of future forfeitures. Expense is classified in

table of contents

selling, general and administrative expense in our Consolidated Statements of Operations and is recognized on a straight-line basis over the requisite service periods of each award. Based on the terms of the Stock Plan, retirement-eligible employees become fully vested in outstanding awards on the later of that date they reach retirement eligibility or at the end of the first calendar year of each respective grant. We account for this feature when determining the service period over which to recognize expense for each grant of RSUs and performance shares.

Employee equity-based compensation expense was recognized as follows:

(In thousands)	2012	2011	2010
Restricted stock units	\$970	\$1,212	\$1,544
Performance shares	7,364	5,446	3,275
Total employee equity-based compensation	\$8,334	\$6,658	\$4,819
Related tax benefit	\$2,886	\$2,290	\$1,582

**RESTRICTED STOCK UNITS**

RSUs granted under our Stock Plan are generally subject to a vesting period of one to three years. RSU awards will accrue dividend equivalents based on dividends paid, if any, during the RSU vesting period. The dividend equivalents will be converted into additional RSUs that will vest in the same manner as the underlying RSUs to which they relate. RSUs granted under our Stock Plan do not represent common stock, and therefore the holders do not have voting rights unless and until shares are issued upon settlement.

A summary of the status of outstanding unvested RSU awards as of December 31, 2012, 2011 and 2010, and changes during those years, is presented below:

	2012		2011		2010	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Unvested shares outstanding at						
January 1	169,344	\$11.33	437,272	\$6.96	849,512	\$7.04
Granted	52,294	34.59	23,138	38.42	32,428	24.23
Vested	(155,177 )	8.82	(286,486 )	6.88	(425,556 )	8.42
Forfeited	(2,734 )	34.07	(4,580 )	8.64	(19,112 )	7.14
Unvested shares outstanding at	63,727	35.57	169,344	11.33	437,272	6.96
December 31						
Aggregate intrinsic value (in thousands)		\$2,496		\$6,030		\$17,119

During 2012, 288,336 shares of RSUs were settled, of which 112,682 shares were settled and distributed. The remaining 175,654 shares, which would have resulted in certain executive compensation being above the Internal Revenue Code section 162(m) threshold, were deferred to preserve tax deductibility for the company. Included in the total shares settled during 2012 were RSUs of which a portion vested each year over a three year period ending in January 2012. After adjusting for minimum tax withholdings and deferred shares, a net 78,029 shares were issued during 2012. The minimum tax withholdings payment made in 2012 in connection with issued shares was \$1.3 million.

The fair value of each RSU share award granted during 2012 was estimated on the date of grant using the grant date market price of our common stock. The total fair value of share awards that vested during 2012 was \$1.4 million.

As of December 31, 2012, there was \$1.2 million of total unrecognized compensation cost related to outstanding RSU awards. The cost is expected to be recognized over a weighted average period of 2.2



years.

67

---

table of contents

## PERFORMANCE SHARES

Performance share awards granted under our Stock Plan have a three-year performance period, with generally the same service period, and shares are issued after the end of the period if the employee provides the requisite service and the performance measure is met. The performance measure is a comparison of the percentile ranking of our total stockholder return compared to the total stockholder return performance of a selected peer group. The performance measure is considered to represent a “market condition” under authoritative accounting guidance, and thus, the market condition is considered when determining the estimate of the fair value of the performance share awards. The number of shares actually issued, as a percentage of the amount subject to the performance share award, could range from 0%-200%.

Performance share awards granted under our Stock Plan do not represent common stock, and therefore the holders do not have voting rights unless and until shares are issued upon settlement. During the performance period, dividend equivalents accrue based on dividends paid, if any, and are converted into additional performance shares, which vest or are forfeited in the same manner as the underlying performance shares to which they relate. Generally, if an employee terminates prior to completing the requisite service period, all or a portion of their awards are forfeited and the previously recognized compensation cost is reversed. If an employee provides the requisite service through the end of the performance period, but the performance measure is not met, following authoritative guidance for awards with a market condition, previously recognized compensation cost is not reversed.

The fair value of performance share awards is estimated using a Monte Carlo simulation model. For performance shares granted in 2012, the following assumptions were used in our Monte Carlo model:

Closing price of stock on date of grant	\$35.30	
Risk free rate	0.39	%
Measurement period	3 years	
Volatility	46	%

In addition to the above assumptions, the dividend yields for all companies were assumed to be zero since dividends are included in the definition of total shareholder return.

A summary of the status of outstanding performance share awards as of December 31, 2012, 2011 and 2010, and changes during those years, is presented below:

	2012		2011		2010	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding share awards at January 1	749,538	\$19.52	638,870	\$13.00	524,588	\$5.64
Granted	150,865	40.24	110,668	57.18	141,522	39.36
Settled	(499,680)	5.65	—	—	—	—
Forfeited	(8,068)	42.15	—	—	(27,240)	8.14
Outstanding share awards at December 31	392,655	44.67	749,538	19.52	638,870	13.00
Aggregate intrinsic value (in thousands)		\$15,376		\$26,691		\$25,012

The service and performance period for 499,680 outstanding performance shares granted in 2009 ended on December 31, 2011. Those performance shares were settled and distributed during the first quarter of 2012. The number of shares actually distributed, as a percentage of the performance shares granted, was 200%. After adjusting for the related minimum tax withholdings, a net 660,944 shares were issued in the first quarter of 2012. The related minimum tax withholdings payment made in the first quarter of 2012 in connection with issued shares was \$11.9 million. On December 31, 2012, the performance period for

performance shares granted in 2010 ended, and those performance shares will be settled and distributed, at a range of 0%-200% of shares granted, in the first quarter of 2013.

As of December 31, 2012, there was \$3.4 million of unrecognized compensation cost related to outstanding performance share awards. The cost is expected to be recognized over a weighted average period of 1.5 years.

68

---

table of contents**DIRECTOR AWARDS**

In connection with joining our Board of Directors, in January 2009 our outside directors were granted an award of phantom common stock units, which were credited to an account established on behalf of each director and vested ratably over a three-year period with the final vesting in January 2012. Subsequent equity awards have been granted annually in May, or on a pro-rata basis as applicable, to our outside directors in the form of phantom common stock units as part of their annual compensation, which are credited to their accounts. These awards vest ratably over a one-year period. These accounts will be credited with additional phantom common stock units equal in value to dividends paid, if any, on the same amount of common stock. Upon separation from service as a director, the vested portion of the phantom common stock units held by the director in a stock unit account are converted to cash based upon the then market price of the common stock and paid to the director. Due to its cash-settlement feature, we account for these awards as liabilities rather than equity and recognize the equity-based compensation expense or income at the end of each reporting period based on the portion of the award that is vested and the increase or decrease in the value of our common stock. We recorded director equity-based compensation expense totaling \$1.4 million, \$1.5 million and \$3.7 million for the years ended December 31, 2012, 2011 and 2010, respectively. At December 31, 2012 and 2011, the liability amounts associated with director equity-based compensation included in "Other long-term obligations" on our Consolidated Balance Sheets were \$9.1 million and \$7.7 million, respectively.

**NOTE 15 Fair Value Measurements**

The estimated fair values of our financial instruments as of our balance sheet dates are presented below:

(In thousands)	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash, short-term investments and restricted cash (Level 1)	\$ 34,079	\$ 34,079	\$ 64,209	\$ 64,209
Long-term debt (Level 1)	523,933	572,625	523,694	556,313

Accounting guidance establishes a framework for measuring the fair value of financial instruments, providing a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities, or "Level 1" measurements, followed by quoted prices of similar assets or observable market data, or "Level 2" measurements, and the lowest priority to unobservable inputs, or "Level 3" measurements. The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used should seek to maximize the use of observable inputs and minimize the use of unobservable inputs.

Cash, short-term investments, restricted cash and long-term debt are the only items measured at fair value on a recurring basis. The carrying amount of our short-term investments approximates fair value due to their very short maturity periods, and such investments are at or near market yields.

We do not have any financial assets measured at fair value on a nonrecurring basis. Nonfinancial assets measured at fair value on a nonrecurring basis include items such as long-lived assets held and used that are measured at fair value resulting from impairment, if deemed necessary.

**NOTE 16 Commitments and Contingencies****LEASE COMMITMENTS**

Our operating leases cover manufacturing, office, warehouse and distribution space, equipment and vehicles, which expire at various dates through 2018, as well as capital leases related to our North Carolina converting and manufacturing facilities. As leases expire, it can be expected that, in the normal course of business, certain leases will be renewed or replaced.

table of contents

As of December 31, 2012, under current operating and capital lease contracts, we had future minimum lease payments as follows:

(In thousands)	Capital	Operating
2013	\$2,330	\$14,966
2014	2,375	10,102
2015	2,420	6,613
2016	2,466	5,142
2017	2,513	4,165
Thereafter	37,361	3,959
Total future minimum lease payments	\$49,465	\$44,947
Less interest portion	(27,177	)
Present value of future minimum lease payments	\$22,288	

Rent expense for operating leases was \$16.6 million, \$16.1 million and \$10.0 million for the years ended December 31, 2012, 2011 and 2010, respectively.

70

---

table of contents

## NOTE 17 Segment Information

We are organized in two reportable operating segments: Consumer Products and Pulp and Paperboard. Intersegment pulp transfers from our Pulp and Paperboard segment to our Consumer Products segment are transferred at cost. As a result, there are no eliminations required to reconcile our total consolidated net sales to the segments' total net sales.

Following is a tabular presentation of business segment information for each of the past three years.

Corporate information is included to reconcile segment data to the financial statements.

(In thousands)	2012	2011	2010
Segment net sales:			
Consumer Products	\$1,134,556	\$1,092,133	\$570,047
Pulp and Paperboard	739,748	835,840	802,918
Total segment net sales	\$1,874,304	\$1,927,973	\$1,372,965
Operating income:			
Consumer Products	\$93,347	\$42,806	\$80,791
Pulp and Paperboard <sup>1</sup>	103,910	92,827	64,869
	197,257	135,633	145,660
Corporate and eliminations <sup>1</sup>	(51,870	) (20,188	) (46,893
Income from operations	\$145,387	\$115,445	\$98,767
Depreciation and amortization:			
Consumer Products	\$54,547	\$50,391	\$16,994
Pulp and Paperboard	23,113	26,073	28,658
Corporate	1,673	469	2,076
Total depreciation and amortization	\$79,333	\$76,933	\$47,728
Assets:			
Consumer Products	\$1,178,438	\$1,081,988	\$969,450
Pulp and Paperboard	344,614	355,886	377,674
	1,523,052	1,437,874	1,347,124
Corporate	110,404	133,444	198,212
Total Assets	\$1,633,456	\$1,571,318	\$1,545,336
Capital expenditures:			
Consumer Products	\$183,330	\$117,059	\$33,902
Pulp and Paperboard	19,954	15,355	10,208
	203,284	132,414	44,110
Corporate	3,831	5,329	2,923
Total capital expenditures	\$207,115	\$137,743	\$47,033

Results for Pulp and Paperboard for 2011 included additional expenses associated with the sale of the

<sup>1</sup> Lewiston, Idaho sawmill, which were partially offset by LIFO inventory liquidation and other adjustments recorded at the corporate level.

table of contents

Our manufacturing facilities and all other assets are located within the continental United States, except for one production facility in St. Catharines, Ontario, Canada. We sell and ship our products to customers in many foreign countries. Geographic information regarding our net sales is summarized as follows:

(In thousands)	2012	2011	2010
United States	\$1,726,561	\$1,751,482	\$1,236,400
Japan	63,368	63,584	53,390
Canada	29,557	31,256	15,060
Taiwan	11,061	16,205	12,257
Korea	9,655	5,426	6,258
Australia	7,786	6,246	6,173
Mexico	6,102	13,619	9,843
China	3,488	15,081	9,128
Germany	2,500	3,042	2,729
Netherlands	14	3,163	4,181
Other foreign countries	14,212	18,869	17,546
Total Net Sales	\$1,874,304	\$1,927,973	\$1,372,965

## NOTE 18 Financial Results by Quarter (Unaudited)

	Three Months Ended							
	March 31		June 30		September 30		December 31	
(In thousands— except per-share amounts)	2012	2011	2012	2011	2012	2011	2012	2011
Net Sales	\$457,798	\$465,830	\$473,572	\$494,627	\$480,233	\$501,125	\$462,701	\$466,391
Costs and expenses:								
Cost of sales	(403,076 )	(414,920 )	(398,546 )	(433,358 )	(409,822 )	(448,927 )	(396,428 )	(405,325 )
Selling, general and administrative expenses	(29,074 )	(27,364 )	(30,529 )	(27,476 )	(30,649 )	(26,815 )	(30,793 )	(28,343 )
Total operating costs and expenses	(432,150 )	(442,284 )	(429,075 )	(460,834 )	(440,471 )	(475,742 )	(427,221 )	(433,668 )
Income from operations	25,648	23,546	44,497	33,793	39,762	25,383	35,480	32,723
Net earnings	\$3,726	\$5,604	\$21,489	\$13,923	\$19,064	\$8,645	\$19,852	\$11,502
Net earnings per common share								
Basic	\$0.16	\$0.25	\$0.92	\$0.60	\$0.82	\$0.38	\$0.86	\$0.51
Diluted	0.16	0.24	0.91	0.59	0.80	0.37	0.84	0.48

table of contents

## NOTE 19 Supplemental Guarantor Financial Information

On October 22, 2010 we issued the 2010 Notes. Certain of our 100% owned, domestic subsidiaries guarantee the 2010 Notes on a joint and several basis. As of December 31, 2012, the 2010 Notes were not guaranteed by Interlake Acquisition Corporation Limited or Cellu Tissue-CityForest, LLC. There are no significant restrictions on the ability of the guarantor subsidiaries to make distributions to Clearwater Paper, the issuer of the 2010 Notes. The following tables present the results of operations, financial position and cash flows of Clearwater Paper and its subsidiaries, the guarantor and non-guarantor entities, and the eliminations necessary to arrive at the information for Clearwater Paper on a consolidated basis.

## Clearwater Paper Corporation

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

Twelve Months Ended December 31, 2012

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	\$1,375,732	\$459,328	\$ 65,468	\$ (26,224 )	\$1,874,304
Cost and expenses:					
Cost of sales	(1,149,413 )	(438,106 )	(46,577 )	26,224	(1,607,872 )
Selling, general and administrative expenses	(96,816 )	(19,187 )	(5,042 )	—	(121,045 )
Total operating costs and expenses	(1,246,229 )	(457,293 )	(51,619 )	26,224	(1,728,917 )
Income from operations	129,503	2,035	13,849	—	145,387
Interest expense, net	(33,796 )	—	—	—	(33,796 )
Earnings before income taxes	95,707	2,035	13,849	—	111,591
Income tax provision	(42,440 )	(9,385 )	(5,012 )	9,377	(47,460 )
Equity in income of subsidiary	1,487	8,837	—	(10,324 )	—
Net earnings	\$54,754	\$ 1,487	\$ 8,837	\$ (947 )	\$64,131
Other comprehensive loss, net of tax	(428 )	—	—	—	(428 )
Comprehensive income	\$54,326	\$ 1,487	\$ 8,837	\$ (947 )	\$63,703

## Clearwater Paper Corporation

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

Twelve Months Ended December 31, 2011

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	\$1,403,865	\$460,689	\$ 63,419	\$ —	\$1,927,973
Cost and expenses:					
Cost of sales	(1,198,955 )	(444,232 )	(59,343 )	—	(1,702,530 )
Selling, general and administrative expenses	(89,019 )	(17,913 )	(3,066 )	—	(109,998 )
Total operating costs and expenses	(1,287,974 )	(462,145 )	(62,409 )	—	(1,812,528 )
Income (loss) from operations	115,891	(1,456 )	1,010	—	115,445
Interest expense, net	(44,187 )	(92 )	(530 )	—	(44,809 )
Other, net	—	—	284	—	284
Earnings before income taxes	71,704	(1,548 )	764	—	70,920
Income tax provision	(34,018 )	3,525	1,297	(2,050 )	(31,246 )
Equity in income of subsidiary	4,038	2,061	—	(6,099 )	—
Net earnings	\$41,724	\$4,038	\$ 2,061	\$ (8,149 )	\$39,674
Other comprehensive loss, net of tax	(16,913 )	—	—	—	(16,913 )
Comprehensive income	\$24,811	\$4,038	\$ 2,061	\$ (8,149 )	\$22,761





table of contents

Clearwater Paper Corporation  
Condensed Consolidating Balance Sheet  
At December 31, 2012

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>ASSETS</b>					
Current assets:					
Cash	\$11,105	\$5	\$ 1,469	\$—	\$12,579
Short-term investments	20,000	—	—	—	20,000
Restricted cash	—	—	—	—	—
Receivables, net	109,129	38,167	8,876	(2,029 )	154,143
Taxes receivable	20,712	116	—	—	20,828
Inventories	171,333	53,648	6,485	—	231,466
Deferred tax assets	11,750	4,400	195	791	17,136
Prepaid expenses	11,441	705	168	—	12,314
Total current assets	355,470	97,041	17,193	(1,238 )	468,466
Property, plant and equipment, net	624,019	205,017	48,341	—	877,377
Goodwill	229,533	—	—	—	229,533
Intangible assets, net	4,531	37,222	6,000	—	47,753
Intercompany receivable (payable)	41,663	(91,343 )	50,471	(791 )	—
Investment in subsidiary	259,466	98,555	—	(358,021 )	—
Other assets, net	9,948	379	—	—	10,327
<b>TOTAL ASSETS</b>	<b>\$1,524,630</b>	<b>\$346,871</b>	<b>\$ 122,005</b>	<b>\$(360,050 )</b>	<b>\$1,633,456</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>					
Current liabilities:					
Accounts payable and accrued liabilities	\$132,413	\$27,645	\$ 7,567	\$(2,029 )	\$165,596
Current liability for pensions and other postretirement employee benefits	9,137	—	—	—	9,137
Total current liabilities	141,550	27,645	7,567	(2,029 )	174,733
Long-term debt	523,933	—	—	—	523,933
Liability for pensions and other postretirement employee benefits	204,163	—	—	—	204,163
Other long-term obligations	50,602	308	—	—	50,910
Accrued taxes	76,617	1,771	311	—	78,699
Deferred tax liabilities (assets)	(13,129 )	57,681	15,572	—	60,124
Accumulated other comprehensive loss, net of tax	(115,693 )	—	—	—	(115,693 )
Stockholders' equity excluding accumulated other comprehensive loss	656,587	259,466	98,555	(358,021 )	656,587
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$1,524,630</b>	<b>\$346,871</b>	<b>\$ 122,005</b>	<b>\$(360,050 )</b>	<b>\$1,633,456</b>



table of contents

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

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



table of contents

Clearwater Paper Corporation  
Condensed Consolidating Statement of Cash Flows  
Twelve Months Ended December 31, 2012

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Net earnings	\$54,754	\$ 1,487	\$ 8,837	\$ (947 )	\$64,131
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:					
Depreciation and amortization	48,191	25,578	5,564	—	79,333
Deferred tax expense (benefit)	9,840	5,109	(1,288 )	(791 )	12,870
Equity-based compensation expense	9,703	—	—	—	9,703
Employee benefit plans	9,366	—	—	—	9,366
Changes in working capital, net	25,252	35,234	795	—	61,281
Change in taxes receivable, net	(11,755 )	593	334	—	(10,828 )
Excess tax benefits from equity-based payment arrangements	(15,837 )	—	—	—	(15,837 )
Change in non-current accrued taxes	3,023	1,771	(559 )	—	4,235
Funding of qualified pension plans	(20,627 )	—	—	—	(20,627 )
Change in restricted cash	769	—	—	—	769
Other, net	3,180	1,117	—	—	4,297
Net cash provided by operating activities	115,859	70,889	13,683	(1,738 )	198,693
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Change in short-term investments, net	35,001	—	—	—	35,001
Additions to plant and equipment	(190,296 )	(11,011 )	(2,469 )	—	(203,776 )
Cash paid for acquisitions, net of cash acquired	(9,264 )	—	—	—	(9,264 )
Proceeds from the sale of assets	—	1,035	—	—	1,035
Net cash used for investing activities	(164,559 )	(9,976 )	(2,469 )	—	(177,004 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Purchase of treasury stock	(18,650 )	—	—	—	(18,650 )
Investment from (to) parent	75,208	(61,809 )	(15,137 )	1,738	—
Excess tax benefits from equity-based payment arrangements	15,837	—	—	—	15,837
Payment of tax withholdings on equity-based payment arrangements	(13,234 )	—	—	—	(13,234 )
Other, net	(1,502 )	—	—	—	(1,502 )
Net cash provided by (used for) financing activities	57,659	(61,809 )	(15,137 )	1,738	(17,549 )
Increase (decrease) in cash	8,959	(896 )	(3,923 )	—	4,140
Cash at beginning of period	2,146	901	5,392	—	8,439
Cash at end of period	\$ 11,105	\$ 5	\$ 1,469	\$ —	\$ 12,579



table of contents

Clearwater Paper Corporation  
Condensed Consolidating Statement of Cash Flows  
Twelve Months Ended December 31, 2011

(In thousands)	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Net earnings	\$41,724	\$ 4,038	\$ 2,061	\$ (8,149 )	\$39,674
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:					
Depreciation and amortization	45,439	25,956	5,538	—	76,933
Deferred tax expense	7,264	5,473	2,040	—	14,777
Equity-based compensation expense	8,134	—	—	—	8,134
Employee benefit plans	16,897	—	—	—	16,897
Changes in working capital, net	(133,142 )	23,959	23,171	—	(86,012 )
Change in taxes receivable, net	(1,368 )	1,939	(217 )	—	354
Excess tax benefits from equity-based payment arrangements	(885 )	—	—	—	(885 )
Change in non-current accrued taxes	2,453	—	—	—	2,453
Funding of qualified pension plans	(12,498 )	—	—	—	(12,498 )
Change in restricted cash	4,160	—	—	—	4,160
Other, net	3,734	672	2	—	4,408
Net cash (used in) provided by operating activities	(18,088 )	62,037	32,595	(8,149 )	68,395
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Change in short-term investments, net	71,094	—	—	—	71,094
Additions to plant and equipment	(117,525 )	(15,654 )	(890 )	—	(134,069 )
Proceeds from the sale of assets	12,826	—	—	—	12,826
Net cash used for investing activities	(33,605 )	(15,654 )	(890 )	—	(50,149 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Repayment of Cellu Tissue debt	—	—	(15,595 )	—	(15,595 )
Purchase of treasury stock	(11,350 )	—	—	—	(11,350 )
Investment from (to) parent	51,621	(47,210 )	(12,560 )	8,149	—
Excess tax benefits from equity-based payment arrangements	885	—	—	—	885
Payment of tax withholdings on equity-based payment arrangements	(2,400 )	—	—	—	(2,400 )
Other, net	(636 )	—	—	—	(636 )
Net cash provided by (used for) financing activities	38,120	(47,210 )	(28,155 )	8,149	(29,096 )
Effect of exchange rate changes	—	—	361	—	361
(Decrease) increase in cash	(13,573 )	(827 )	3,911	—	(10,489 )
Cash at beginning of period	15,719	1,728	1,481	—	18,928



Cash at end of period	\$2,146	\$ 901	\$ 5,392	\$—	\$8,439
-----------------------	---------	--------	----------	-----	---------

77

---

table of contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Clearwater Paper Corporation:

We have audited the accompanying consolidated balance sheets of Clearwater Paper Corporation and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, cash flows, and stockholders' equity for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Clearwater Paper Corporation and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Clearwater Paper Corporation's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 22, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Seattle, Washington  
February 22, 2013

table of contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Clearwater Paper Corporation:

We have audited Clearwater Paper Corporation's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Clearwater Paper Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting in Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Clearwater Paper Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Clearwater Paper Corporation and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, cash flows, and stockholders' equity for each of the years in the three-year period ended December 31, 2012, and our report dated February 22, 2013 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Seattle, Washington  
February 22, 2013

79

---

table of contents

ITEM 9.

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure  
None.

ITEM 9A.

Controls and Procedures

Evaluation of Controls and Procedures

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

Subject to the limitations noted above, our management, with the participation of our CEO and CFO, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the fiscal year covered by this annual report on Form 10-K. Based on that evaluation, the CEO and CFO have concluded that, as of such date, our disclosure controls and procedures are effective to meet the objective for which they were designed and operate at the reasonable assurance level.

Changes in Internal Controls

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

Management Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) of the Exchange Act).

Under the supervision of and with the participation of our CEO and our CFO, our management conducted an assessment of the effectiveness of our internal control over financial reporting based on the framework and criteria established in Internal Control — Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management has concluded that as of December 31, 2012 our internal control over financial reporting was effective. The effectiveness of our internal control over financial reporting as of December 31, 2012 has been audited by KPMG LLP, our independent registered public accounting firm, as stated in its report which is included in this Annual Report on Form 10-K.

ITEM 9B.

Other Information

None.

table of contents

Part III

ITEM 10.

Directors, Executive Officers and Corporate Governance

Information regarding our directors is set forth under the heading “Board of Directors” in our definitive proxy statement, to be filed on or about March 25, 2013, for the 2013 annual meeting of stockholders, referred to in this report as the 2013 Proxy Statement, which information is incorporated herein by reference. Information concerning Executive Officers is included in Part I of this report in Item 1. Information regarding reporting compliance with Section 16(a) for directors, officers or other parties is set forth under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” in the 2013 Proxy Statement and is incorporated herein by reference.

We have adopted a Code of Business Conduct and Ethics that applies to all directors and employees and a Code of Ethics for Senior Financial Officers that applies to our CEO, CFO, COO, the President, the Controller and other Senior Financial Officers identified by our Board of Directors. You can find each code on our website by going to the following address: [www.clearwaterpaper.com](http://www.clearwaterpaper.com), selecting “Investor Relations” and “Corporate Governance,” then selecting the link for “Code of Business Conduct and Ethics” or “Code of Ethics for Senior Financial Officers.” We will post any amendments, as well as any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, on our website. To date, no waivers of the Code of Business Conduct and Ethics or the Code of Ethics for Senior Financial Officers have been considered or granted.

Our Board of Directors has adopted corporate governance guidelines and charters for the Board of Directors’ Audit Committee, Compensation Committee, and Nominating and Governance Committee.

You can find these documents on our website by going to the following address:

[www.clearwaterpaper.com](http://www.clearwaterpaper.com), selecting “Investor Relations” and “Corporate Governance,” then selecting the appropriate link.

The Audit Committee of our Board of Directors is an “audit committee” for purposes of Section 3(a)(58) of the Exchange Act. As of December 31, 2012, the members of that committee were Boh A. Dickey (Chair), William D. Larsson and William T. Weyerhaeuser. On January 7, 2013, our board of Directors appointed Beth E. Ford to the Audit Committee. The Board of Directors has determined that Messrs, Dickey and Larsson are each an “audit committee financial expert” and that all of the members of the Audit Committee are “independent” as defined under the applicable rules and regulations of the SEC and the listing standards of the New York Stock Exchange.

ITEM 11.

Executive Compensation

Information required by Item 11 of Part III is included under the heading “Executive Compensation Discussion and Analysis” in our 2013 Proxy Statement, to be filed on or about March 25, 2013, relating to our 2013 Annual Meeting of Shareholders and is incorporated herein by reference.

table of contents

## ITEM 12.

Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters Information required by Item 12 of Part III is included in our 2013 Proxy Statement, to be filed on or about March 25, 2013, relating to our 2013 Annual Meeting of Shareholders and is incorporated herein by reference.

The following table provides certain information as of December 31, 2012, with respect to our equity compensation plans:

PLAN CATEGORY	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS <sup>1</sup>	WEIGHTED AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS <sup>2</sup>	NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE UNDER EQUITY COMPENSATION PLANS
Equity compensation plans approved by security holders	858,376	—	1,944,127
Equity compensation plans not approved by security holders	—	—	—
Total	858,376	—	1,944,127

<sup>1</sup> Includes 785,310 performance shares and 73,066 restricted stock units, or RSUs, which are the maximum number of shares that could be awarded under the performance share and RSU programs, not including future dividend equivalents, if any are paid.

<sup>2</sup> Performance shares and RSUs do not have exercise prices and therefore are not included in the weighted average exercise price calculation.

## ITEM 13.

Certain Relationships and Related Transactions, and Director Independence

Information required by Item 13 of Part III is included under the heading “Transactions with Related Persons” in our 2013 Proxy Statement, to be filed on or about March 25, 2013, relating to our 2013 Annual Meeting of Shareholders and is incorporated herein by reference.

## ITEM 14.

Principal Accounting Fees and Services

Information required by Item 14 of Part III is included under the heading “Fees Paid to Independent Registered Public Accounting Firm” in our 2013 Proxy Statement relating, to be filed on or about March 25, 2013, to our 2013 Annual Meeting of Shareholders and is incorporated herein by reference.

table of contents

PART IV

ITEM 15.

Exhibits, Financial Statement Schedules

FINANCIAL STATEMENTS

Our consolidated financial statements are listed in the Index to Consolidated Financial Statements on page 39 of this report.

FINANCIAL STATEMENT SCHEDULES

All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

EXHIBITS

Exhibits are listed in the Exhibit Index on pages 85-89 of this report.

83

---



table of contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CLEARWATER PAPER CORPORATION

(Registrant)

By /S/ Linda K. Massman  
Linda K. Massman  
President, Chief Executive Officer and  
Director (Principal Executive Officer)

Date: February 22, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

		Date
By /S/ Linda K. Massman Linda K. Massman	President, Chief Executive Officer and Director (Principal Executive Officer)	February 22, 2013
By /S/ John D. Hertz John D. Hertz	Senior Vice President, Finance and Chief Financial Officer (Duly Authorized Officer; Principal Financial Officer)	February 22, 2013
By /S/ Johnathan D. Hunter Johnathan D. Hunter	Vice President, Corporate Controller (Duly Authorized Officer; Principal Accounting Officer)	February 22, 2013
* Boh A. Dickey	Director and Chair of the Board	February 22, 2013
* Frederic W. Corrigan	Director	February 22, 2013
* Beth E. Ford	Director	February 22, 2013
* Kevin J. Hunt	Director	February 22, 2013
* Gordon L. Jones	Director	February 22, 2013
* William D. Larsson	Director	February 22, 2013
* Michael T. Riordan	Director	February 22, 2013

\*  
Dr. William T. Weyerhaeuser      Director  
\*By

February 22, 2013

/S/ Michael S. Gadd  
Michael S. Gadd  
(Attorney-in-fact)

84

---

table of contents

## Exhibit Index

EXHIBIT NUMBER	DESCRIPTION
2.1*	Separation and Distribution Agreement, dated December 15, 2008, between Clearwater Paper Corporation (the "Company") and Potlatch Corporation (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission (the "Commission") on December 18, 2008).
2.2*	Agreement and Plan of Merger, dated as of September 15, 2010, by and among the Company, Cellu Tissue Holdings, Inc., and Sand Dollar Acquisition Corporation (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed with the Commission on September 21, 2010).
3.1*	Restated Certificate of Incorporation of the Company, effective as of December 16, 2008, as filed with the Secretary of State of the State of Delaware (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Commission on December 18, 2008).
3.2*	Amended and Restated Bylaws of the Company, effective as of December 16, 2008 (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the Commission on December 18, 2008).
4.1*	Indenture, dated as of June 11, 2009, between the Company and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K filed by the Company with the Commission on June 12, 2009).
4.2*	Form of 10 5/8% Senior Notes due 2016 (incorporated by reference to Exhibit A to the Indenture filed as Exhibit 4.2 to the Current Report on Form 8-K filed by the Company with the Commission on June 12, 2009).
4.3*	Indenture, dated as of October 22, 2010, between the Company and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K filed by the Company with the Commission on October 27, 2010).
4.4*	Form of 7 1/8% Senior Notes due 2018 (incorporated by reference to Exhibit A to the Indenture filed as Exhibit 4.1 to the Current Report on Form 8-K filed by the Company with the Commission on October 27, 2010).
10.1*	Employee Matters Agreement, dated December 15, 2008, between the Company and Potlatch Corporation (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2010).
10.2*	

Tax Sharing Agreement, dated December 15, 2008, among the Company, Potlatch Corporation, Potlatch Forest Holdings, Inc. and Potlatch Land & Lumber, LLC (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the Commission on December 18, 2008).

10.3\*

Loan and Security Agreement, dated as of November 26, 2008, by and among the Company and Bank of America, N.A., as administrative agent, and the lenders party thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on December 3, 2008).

85

---

table of contents

10.3(i)*	First Amendment to Loan and Security Agreement, dated as of September 15, 2010, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Commission on September 21, 2010).
10.3(ii)*	Second Amendment to Loan and Security Agreement, dated as of October 22, 2010, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on October 27, 2010).
10.3(iii)*	Third Amendment to Loan and Security Agreement, dated as of February 7, 2011, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.3(iii) to the Company's Annual Report on Form 10-K filed with the Commission on March 11, 2011).
10.3(iv)*	Fourth Amendment to Loan and Security Agreement, dated as of March 2, 2011, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.3(iv) to the Company's Annual Report on Form 10-K filed with the Commission on March 11, 2011).
10.3(v)*	Fifth Amendment to Loan and Security Agreement, dated as of August 17, 2011, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2011).
10.3(vi)*	Sixth Amendment to Loan and Security Agreement, dated as of September 28, 2011, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2011).
10.3(vii)	Seventh Amendment to Loan and Security Agreement, dated as of September 27, 2012, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company.
10.3(viii)*	Eighth Amendment to Loan and Security Agreement, dated as of January 17, 2013, by and among the financial institutions signatory thereto, Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on January 24, 2013).
10.4*1	Form of Indemnification Agreement entered into between the Company and each of its directors and executive officers (incorporated by reference to Exhibit 10.15 to Amendment No. 4 to the Company's Registration Statement on Form 10 filed with the Commission on November 19, 2008).
10.5*1	Employment Agreement between Gordon L. Jones and the Company dated effective December 16, 2011 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on December 14, 2011).

- 10.5(i)\*<sup>1</sup> Amendment to Employment Agreement Between Gordon L. Jones and the Company dated effective October 4, 2012 (incorporated by reference to Exhibit 10.5(i) to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2012).
- 10.6\*<sup>1</sup> Employment Agreement between Linda K. Massman and the Company dated effective November 1, 2011 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on December 14, 2011).
- 10.6(i)\*<sup>1</sup> Amendment to Employment Agreement between Linda K. Massman and the Company dated effective January 1, 2012 (incorporated by reference to Exhibit 10.6(i) to the Company's quarterly Report on Form 10-Q filed for the quarter ended March 31, 2012).

table of contents

10.7 <sup>1</sup>	Employment Agreement between Linda K. Massman and the Company, dated effective January 1, 2013.
10.7(i) <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan-Restricted Stock Unit Agreement, dated as of January 1, 2013, with Linda K. Massman.
10.8* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on December 19, 2008).
10.8(i)* <sup>1</sup>	Amendment No. 1 to Clearwater Paper Corporation 2008 Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Commission on December 28, 2010).
10.8(ii)* <sup>1</sup>	Amendment No. 2 to Clearwater Paper Corporation 2008 Stock Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2011).
10.9* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Performance Share Agreement (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on December 19, 2008).
10.9(i)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Amendment to Performance Share Agreement, effective March 2, 2009 (incorporated by reference to Exhibit 10.11(i) to the Company's Quarterly Report on Form 10-Q filed for the quarter ended June 30, 2009).
10.9(ii)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Performance Share Agreement, as amended and restated May 12, 2009, to be used for performance share awards approved subsequent to May 12, 2009, (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2010).
10.9(iii)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Performance Share Agreement, as amended and restated December 1, 2009, to be used for annual performance share awards approved subsequent to December 31, 2009 (incorporated by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2010).
10.9(iv)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Performance Share Agreement, to be used for annual restricted stock unit awards approved subsequent to December 31, 2011 (incorporated by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K filed December 14, 2011).
10.10* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Commission on December 19, 2008).

10.10(i)\*<sup>1</sup> Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Restricted Stock Unit Agreement, as amended and restated May 12, 2009, to be used for restricted stock unit awards approved subsequent to May 12, 2009 (incorporated by reference to Exhibit 10.12(i) to the Company’s Quarterly Report on Form 10-Q filed for the quarter ended June 30, 2009).

10.10(ii)\*<sup>1</sup> Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Restricted Stock Unit Agreement, as amended and restated December 1, 2009, to be used for annual restricted stock unit awards approved subsequent to December 31, 2009, (incorporated by reference to Exhibit 10.12(ii) to the Current Report on Form 8-K filed by the Registrant on December 4, 2009).



table of contents

10.10(iii)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of RSU Deferral Agreement for Annual LTIP and Founders Grant RSUs (incorporated by reference to Exhibit 10.3 to the Company’s Current Report on Form 8-K filed December 14, 2011).
10.10(iv)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of RSU Deferral Agreement for Founders Grant RSUs (incorporated by reference to Exhibit 10.4 to the Company’s Current Report on Form 8-K filed December 14, 2011).
10.10(v)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Restricted Stock Unit Award, to be used for annual restricted stock unit awards approved subsequent to December 31, 2011 (incorporated by reference to Exhibit 10.5 to the Company’s Current Report on Form 8-K filed December 14, 2011).
10.10(vi)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan-Form of Restricted Stock Unit Award, to be used for special restricted stock unit awards (incorporated by reference to Exhibit 10.10(vii) to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2012).
10.10(vii)* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan-Form of RSU Deferral Agreement for Annual LTIP RSUs (incorporated by reference to Exhibit 10.10(viii) to the Company's Quarterly Report on Form 10-Q filed for the quarter ended September 30, 2012).
10.11* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan—Form of Stock Option Agreement (incorporated by reference to Exhibit 10.13(i) to the Company’s Quarterly Report on Form 10-Q filed for the quarter ended June 30, 2009).
10.12* <sup>1</sup>	Clearwater Paper Corporation Annual Incentive Plan (incorporated by reference to Exhibit 10.14(i) to the Company’s Current Report on Form 8-K filed with the Commission on May 14, 2010).
10.13* <sup>1</sup>	Clearwater Paper Corporation Management Deferred Compensation Plan (incorporated by reference to Exhibit 10.6 to the Company’s Current Report on Form 8-K filed with the Commission on December 19, 2008).
10.13(i)* <sup>1</sup>	Amendment to Clearwater Paper Corporation Management Deferred Compensation Plan, dated April 27, 2010 (incorporated by reference to Exhibit 10.15(i) to the Company’s Quarterly Report on Form 10-Q filed for the quarter ended March 31, 2010).
10.14* <sup>1</sup>	Clearwater Paper Executive Severance Plan (incorporated by reference to Exhibit 10(i) to the Company's Current Report on Form 8-K filed with the Commission on December 17, 2012).
10.15* <sup>1</sup>	Amended and Restated Clearwater Paper Corporation Salaried Supplemental Benefit Plan (incorporated by reference to Exhibit 10.15 to the Company's Annual Report on Form 10-K filed for the year ended December 31, 2011).

- 10.16\*<sup>1</sup> Clearwater Paper Corporation Benefits Protection Trust Agreement (incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K filed for the year ended December 31, 2008).
- 10.17\*<sup>1</sup> Clearwater Paper Corporation Deferred Compensation Plan for Directors (incorporated by reference to Exhibit 10.10 to the Company's Current Report on Form 8-K filed with the Commission on December 19, 2008).
- 10.18\*<sup>1</sup> Clearwater Paper Change of Control Plan (incorporated by reference to Exhibit 10(ii) to the Company's Current Report on Form 8-K filed with the Commission on December 17, 2012).

table of contents

10.19* <sup>1</sup>	Offer Letter, dated June 25, 2012, with John D. Hertz, (incorporated by reference to Exhibit 10.10(vi) to the Company's Quarterly Report on Form 10-Q filed for the quarter ended June 30, 2012).
10.20* <sup>1</sup>	Clearwater Paper Corporation 2008 Stock Incentive Plan-Restricted Stock Unit Award, dated July 3, 2012, with John D. Hertz (incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
10.21 <sup>1</sup>	Letter Agreement between Robert P. DeVleming and the Company, dated January 21, 2013.
(12)	Computation of Ratio of Earnings to Fixed Charges.
(21)	Clearwater Paper Corporation Subsidiaries.
(23)	Consent of Independent Registered Public Accounting Firm.
(24)	Powers of Attorney.
(31)	Rule 13a-14(a)/15d-14(a) Certifications.
(32)	Furnished statements of the Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350.
101	Pursuant to Rule 405 of Regulation S-T, the following financial information from the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012, is formatted in XBRL interactive data files: (i) Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010; (ii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2011 and 2010; (iii) Consolidated Balance Sheets at December 31, 2012 and 2011, (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010, (v) Consolidated Statements of Stockholders' Equity for the years ended December 31, 2012, 2011 and 2010 and (vi) Notes to Consolidated Financial Statements.

\* Incorporated by reference.

1 Management contract or compensatory plan, contract or arrangement.