Clearwater Paper Corp.

(buy)

Date	Projected Enterprise value (000)	EV / 5 yr median EBITDA	EV / TTM EBITDA	EV / Q1 '09 EBITDA
07/06/09	416,983	5.6	4.4	2.8
09/30/09	376,481	5.0	4.0	2.5
12/31/09	334,615	4.5	3.6	2.3

Ticker:	**CLW**
Share price:	**$25.88**
Market capitalization:	**$313 m**
Price / earnings (based on Q1 '09):	**6x**
Enterprise value:	**$417 m**
Average shares traded/day:	**155,000**

Thesis

Clearwater Paper Corp. (CLW) is a good business (EBITDA / assets > 11% for the last five years) at a reasonable price (less than 5.5x median trailing five year EBITDA, 8x 2008 free cash flow, 1.2x tangible book value). On these metrics, CLW is trading at 30% to 100% discount to its competitors. There are, however, two issues which make CLW an extraordinary value:

1. CLW is earning $455,000 per day tax-free courtesy of the alternative fuels clause contained in 2005 federal highway legislation and modified in a 2007 energy bill. CLW has participated in this program since late January 2009 and, year-to-date, has earned $74 million from it. These earnings are not included in the above EBITDA and free cash flow valuation calculations, but are included in the enterprise value calculation. The tax credit earnings have cut CLW's debt in half year-to-date and, if they continue through year-end, the company's debt will be eliminated.

2. Unlike other paper companies, CLW's business is thriving and its 2009 earnings, excluding the effects of the aforementioned tax credit, are likely to be significantly higher than its 2008 earnings.

We plan to purchase CLW shares in the near future.

Catalysts

- Continuation of the alternative fuel tax credit through 9/30/09 (possibly longer).
- Continuation of earnings similar to 1Q09 (implies CLW is trading at 5.2x earnings).
- Initiation of a dividend.

Background

Founded in 1927, CLW makes tissue paper ($37 million '08 operating earnings) and solid bleach sulfate (SBS) paperboard ($19 million '08 operating earnings). CLW also has a small lumber business which lost $14 million during 2008. CLW was spun off from Potlatch Forest Products Corp. on 12/16/08. Potlatch shareholders received one CLW share for every three and a half shares of Potlatch held. Please see the exhibits beginning on page six of this document for market data on CLW's two lines of business: tissue and SBS.

Valuation

CLW is trading at 8.9x 2008 free cash flow, 1.2x tangible book value and 5.5x 2008 EBITDA while its peers are trading at 11.5x free cash flow, 2.3x tangible book value and 8.1x EBITDA (CLW is lagging on a PE basis).[1] Adjusted for estimated cash received via their participation in the alternative fuels tax credit program (late January 2009 to present) and a debt refinancing completed June 9, CLW's current market capitalization and enterprise value are $313 million and $417 million respectfully. The following table outlines their current capital structure and valuation:

CLW Valuation & Capital Structure

(000 except share price)		
Shares outstanding, 4/29/09	11,355	
Performance shares, 3/31/09	267	2.4%
Restricted shares, 3/31/09	492	4.3%
diluted share count	12,113	
Share price, 7/6/09	25.88	
Market capitalization	**313,495**	
Cash, 3/31/09	15,829	
Cash received through 7/3/09 from alternative fuels tax credit	74,177	
Operating + capital lease obligations, 12/31/08	43,494	
Debt, 6/9/09	150,000	
Enterprise value, net	**416,983**	

CLW's valuation also appears quite modest in relation to their installed property, plant and equipment (PP&E). For instance, the ratio of CLW's gross PP&E to enterprise value currently is 3.8 while the average ratio for its competitors is 1. On this basis, CLW's equity would more than quadruple to reach parity to its competitors. Interestingly, CLW has one of the least amounts of financial leverage in the industry and, depending on how long the alternative fuels tax credit lasts, may be debt free by year end.

While CLW's valuation is compelling based on 2008 results, it appears to be extraordinary based upon recent developments. For instance, during 1Q09, CLW generated $15 million of earnings, $23 million of free cash flow and $37 million of EBITDA. Annualizing these numbers (for the most part, CLW's business is not cyclical) suggests that CLW is trading at 5.2x earnings, 3.4x free cash flow and 2.8x EBITDA. We have not included earnings from alternative fuel tax credits in this calculation, but we have reduced its enterprise value by $74 million based upon their earnings from the tax credit through 7/3/09 (thus reducing the EBITDA multiple). So what has changed since 2008? CLW was able to increase its pries during Q109 to compensate for higher raw material and energy costs which occurred in 2008. How can CLW raise prices in such a miserable business environment? The answer lies in CLW's two business lines:[2]

[1] See comparable company analysis in the appendix.
[2] CLW also has a small lumber business which lost $14 million pre-tax during 2008.

1. **Toilet paper** – CLW makes 56% of the private label tissue (toilet paper, paper towels, napkins) sold in grocery stores in the U.S. It turns out that toilet paper demand is quite stable despite turbulent economic conditions. In fact, there is some evidence that private label tissue, CLW's market niche, actually is benefiting from the economic turndown.

2. **Juice boxes** – CLW supplies 12% of the solid bleached sulfate paperboard (SBS) consumed in the U.S. SBS is a high grade packaging material and CLW caters to users who demand the highest grades of SBS (juice and milk producers, pharmaceutical companies and high-end printing applications such as the covers of annual reports). CLW's SBS is of such high grade that it is even exported to Japan, a notoriously discriminating market. To date, CLW's SBS business performed well during the current economic turmoil and, to the extent the dollar falls in value, one would expect export demand for their SBS to grow.

Good Business

Business quality may be defined as a business's ability to earn a return on capital over time, i.e., higher returns on capital over longer periods of time are characteristics of higher quality businesses. The following table shows the returns earned by CLW since 2004:

CLW Return on Assets

Year	EBITDA	EBITDA / assets
2004	59,000	8.7%
2005	53,000	7.8%
2006	101,000	14.9%
2007	104,000	15.3%
2008	75,000	11.1%
Mean	78,400	11.6%
Median	75,000	11.1%
12 ME 3/31/09	94,000	13.9%

CLW's returns averaged more than 11% since 2004 and, more importantly, are likely to remain above this average in coming years. We can make this assertion because, as mentioned above, 2008 was a particularly difficult year due costs increasing faster than CLW was able to increase their prices, a situation which has been remedied. The below average returns produced during 2004-05 may be explained by CLW's installation in 2004 of new equipment to make high-grade paper towels in its Las Vegas facility. CLW's paper towel business subsequently grew and the wisdom of this investment was corroborated by their higher returns earned in 2006 and 2007. While 11% return on assets is not outstanding, it is respectable and we therefore conclude that CLW is a good business.

Tax Credit

An alternative fuel tax credit provision originally appeared on page 802 of the *Safe Accountable Flexible Efficient Transportation Equity Act – a Legacy for Users,* known by its acronym, the SAFETEA-LU[3] act or simply the 2005 highway act.[4] The tax credit was originally intended to encourage operators of vehicle fleets to use alternative fuels, however, Congress extended the credit to manufacturers and other non-transportation applications in the 2007 energy bill. The

[3] The bizarre acronym resulted from the bill's sponsor, Representative Don Young, wish to pay tribute to his wife, Lu – I suppose it is the thought that counts.
[4] Palmer, Vaughn, *'Black Liquor' weirdness drips onto our pulp and paper industry*, The Vancouver Sun, 6/19/09.

legislation provides tax credits of 50 cents per gallon of alternative fuel burned by companies; alternative fuels specified in the modified legislation included biomass-based fuel.

The paper-making process starts with wood (logs, woodchips and sawdust). Paper products are made from the cellulose fibers (pulp) contained in the wood, but the wood contains many other chemicals including lignin, which has high energy content. The Kraft process is used to separate the cellulose from the lignin and other chemicals. The mixture of lignin and other non-cellulose byproducts of the Kraft process are called black liquor. Black liquor contains more than half of the energy content of the wood feedstock. As a result, pulp mills have been using black liquor as a fuel to heat their steam boilers since the 1930s.

During 2008, paper industry executives began to realize that black liquor fit the definition of a biomass-fuel (as defined in the 2007 energy bill) and began applying for the alternative fuel tax credits. CLW management got on board in late January 2009. Every two weeks CLW reports to the Internal Revenue Service (IRS) how much "alternative fuel" they burned. The IRS reviews the calculation and cuts a check to CLW for 50 cents per gallon of alternative fuel burned. CLW burns about 350 million gallons of black liquor annually and has collected about $74 million year-to-date ($455,000 per day). Though subject to dispute, generally speaking, tax credits are not subject to federal income taxes.

The alternative fuel tax credit program expires on 12/31/09, but it may end sooner for pulp mills. There is a movement in Congress to disqualify paper companies from participating in this program since pulp mills have been using black liquor as fuel for decades. The most likely scenario is that the program will be curtailed on 9/30/09 when the government's fiscal year ends. The following table shows the economics of the tax credit for CLW.

Economics of the Alternative Fuel Tax Credit for CLW

Period	**# days**	**Incremental tax credit (000)**	**Cumulative tax credit (000)**
January 2009	10		
February 2009	28		
March 2009	31		
	69	$31,400	**$31,400**
April 2009	30		
May 2009	31		
June 2009	30		
July through 7/3/09	3		
	94	$42,777	**$74,177**
July (balance)	28		
August 2009	31		
September 2009	30		
	89	$40,501	**$114,678**
October 2009	31		
November 2009	30		
December 2009	31		
	92	$41,867	**$156,545**

In conclusion, the data indicate that CLW is a good business trading at a modest valuation with a solid balance sheet. It also appears that CLW's business is likely to generate solid returns, regardless of the macro economic environment. Finally, the alternative energy tax credit program has vastly reduced CLW's net debt position, thus significantly reducing its enterprise value. For these reasons, we plan to purchase CLW shares in the near future.

Tissues Suppliers to U.S. Grocery Stores [5]

		Share Q1 2009
Procter & Gamble	branded	27%
Kimberly Clark	branded	23%
Georgia-Pacific	branded	20%
Clearwater	private label	14%
Other private label		12%
Other brand		4%
		100%

U.S. At Home Tissue Market, Consumption by Product [6]

Toilet	50%
Towel	35%
Napkin	8%
Facial	7%
	100%

U.S. Retail Tissue Channels[7]

Grocery	46%
Mass & Supercenter	29%
Club Stores	13%
Drug	7%
Dollar	3%
Other	2%
	100%

[5] CLW slide deck, 3/31/09.
[6] Potlatch Forest Products Corp. 10-12B, 11/29/08, p.62.
[7] *ibid*, p. 63.

Solid Bleach Sulfate (SBS) Producers, Market Share[8]

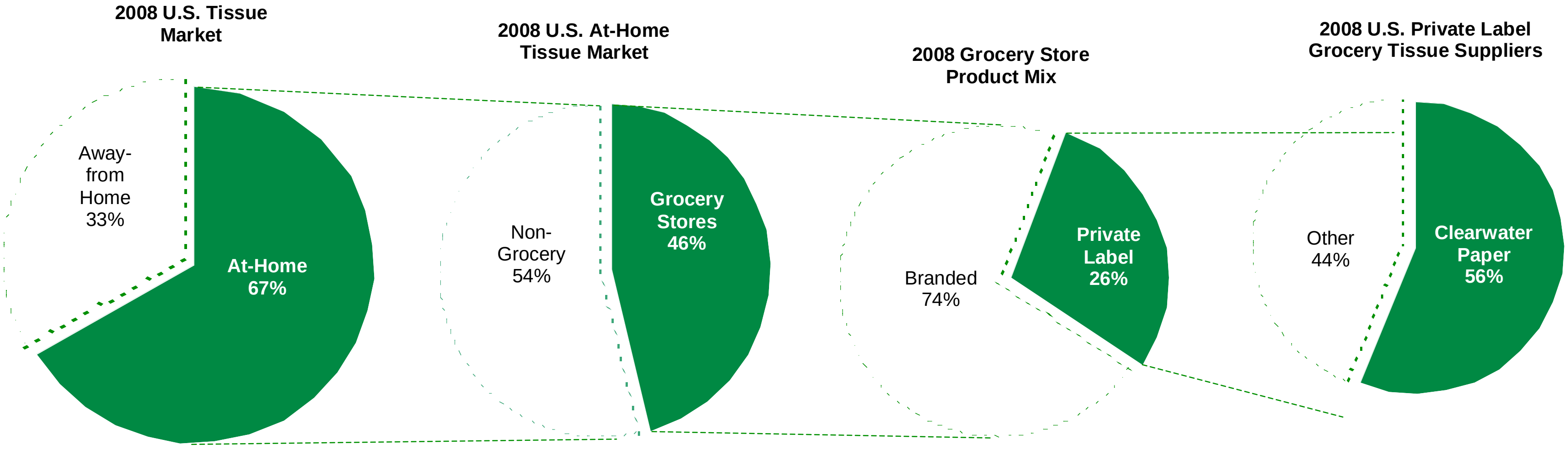
SBS producers	Share	Cumulative
International Paper	25%	25%
MeadWestvaco	22%	47%
Georgia-Pacific	13%	60%
Clearwater	12%	72%
Evergreen	12%	84%
Rock-Tenn	5%	89%
Weherhauser	5%	94%
Tembec Paperboard	3%	97%
Smurfit-Stone	3%	100%

Uses for SBS[9]

SBS uses	
Folded cartons (pharmaceuticals, cosmetics, DVDs)	42%
Cups & plates	24%
Liquid package (juice & milk)	19%
Commercial printing (postcards, signs, brochure covers)	12%
Other	3%
	100%

[8] CLW slide deck, 3/31/09.
[9] Potlatch Forest Products Corp. 10-12B, 11/29/08, pp. 61-62.

U.S. Tissue Market Structure



Source: CLW slide deck 3/31/09.

CLW Balance Sheets

(000)	7/3/09	3/31/09	12/31/08
Assets			
Cash + short-term investments	15,829	15,829	14,018
A/R	95,052	95,052	104,030
Inventories, net	160,261	160,261	154,351
Deferred income taxes	14,772	14,772	14,772
Prepaid expenses	5,872	5,872	2,408
total CA	**291,786**	**291,786**	**289,579**
Land	4,729	4,729	4,729
Plant & equipment, net	377,386	377,386	385,138
Other	4,512	4,512	3,820
total assets	**678,413**	**678,413**	**683,266**
Liabilities			
* Notes payable to banks		40,000	50,000
* Notes payable to Potlatch		100,000	100,000
* 2016 10.625% sr. notes	75,823		
A/P and other	99,990	99,990	116,471
Current pension liability	9,086	9,086	9,086
total CL	**184,899**	**249,076**	**275,557**
Pension liability	222,854	222,854	221,649
Other	3,645	3,645	3,234
Deferred taxes	6,312	6,312	1,837
total liabilities	**417,710**	**481,887**	**502,277**
Shareholders' equity	**260,703**	**196,526**	**180,989**
Tangible BV	260,703	196,526	180,989
Debt, net of cash	59,994	124,171	135,982
Earnings / assets	**9.0%**		**2.2%**
Earnings / equity	**23.3%**		**8.2%**
EBITDA / assets	**21.78%**		**11.0%**

* On 6/9/09, CLW sold $150 million of 2016 senior notes and paid-down its other debt. CLW's alternative fuel tax credits received through 7/3/09 have been netted against the debt.

CLW Income Statement

(000)	3 ME 3/31/09	3 ME 3/31/08	12 ME 12/31/08	12 ME 12/31/07	12 ME 12/31/06
Revenue	**286,700**	**307,437**	**1,255,309**	**1,183,032**	**1,116,921**
COGS	(245,645)	(288,105)	(1,179,397)	(1,083,824)	(1,033,602)
Gross profit	**41,055**	**19,332**	**75,912**	**99,208**	**83,319**
SG&A	(15,830)	(12,734)	(47,428)	(46,801)	(45,532)
Income from Canadian lumber settlement					8,476
* Interest cost, net	(2,014)	(2,014)	(8,056)	(8,056)	(8,056)
Income taxes	(8,015)	(1,102)	(5,594)	(14,073)	(12,400)
Earnings, GAAP	15,196	3,482	14,834	30,278	25,807
adjustments					(8,476)
tax on adjustments, assume 36%					3,051
Earnings, Adjusted	**15,196**	**3,482**	**14,834**	**30,278**	**20,382**
D+A	11,721	11,843	46,954	51,325	54,290
Capex	3,559	2,291	21,306	20,531	27,505
FCF	**23,358**	**13,034**	**40,482**	**61,072**	**47,167**
EBIT	**25,225**	**6,598**	**28,484**	**52,407**	**40,838**
EBITDA	**36,946**	**18,441**	**75,438**	**103,732**	**95,128**

Valuation metrics	***annualized***	***annualized***			
Market capitalization / earnings	5.2	22.5	21.1	10.4	15.4
Market capitalization / FCF	3.4	6.0	7.7	5.1	6.6
Market capitalization / tangible book value	1.2	1.7			
EV / EBIT	4.1	15.8	14.6	8.0	10.2
EV / EBITDA	2.8	5.7	5.5	4.0	4.4

employees	2.460	2.460	2.460		
Revenue / employee	466,179	499,898	510,288		
Earnings / employee	24,709	5,662	6,030		
gross margin	14.3%	6.3%	6.0%	8.4%	7.5%

* Estimated interest cost based on $150 million of 2016 notes sold 6/9/09, i.e., their current capital structure. We have not reduced the interest costs based on the $74 million of cash received year-to-date from the alternative fuel tax credit program.

CLW and Comparable Companies

Company	Clearwater			Rock-Tenn	MeadWestvaco
Period	12 ME 12/31/08			12 ME 9/30/08	12 ME 12/31/08
Ticker	CLW	mean	median	RKT	MWV
Income statement					
Revenue	1,255,309	13,429,975	13,026,000	2,838,900	6,637,000
COGS	(1,179,397)	(10,700,450)	(9,565,000)	(2,296,800)	(5,573,000)
Gross profit	75,912	2,729,525	3,461,000	542,100	1,064,000
SG&A	(47,428)	(1,731,275)	(1,654,000)	(326,100)	(809,000)
Interest cost	(13,147)	(261,750)	(234,000)	(87,000)	(210,000)
Other		91,000	34,000		34,000
Equity in unconsoldiated entities		72,467	49,000	2,400	
Minority interests		(49,100)	(5,300)	(5,300)	
Taxes	(5,594)	(233,225)	(157,950)	(44,300)	1,000
Earnings	**9,743**	**589,050**	**293,100**	**81,800**	**80,000**
D+A	46,954	682,325	623,500	135,300	472,000
CapEx	21,306	570,050	597,000	84,200	288,000
FCF	**35,391**	**701,325**	**556,700**	**132,900**	**264,000**
EBIT	**28,484**	**1,084,025**	**778,500**	**213,100**	**289,000**
EBITDA	**75,438**	**1,766,350**	**1,688,000**	**348,400**	**761,000**
Balance sheet					
Total assets, net of cash	680,048	13,585,275	12,815,500	2,941,100	7,906,000
PP&E, gross	1,595,272	13,695,325	11,359,500	2,247,300	6,996,000
Accumulated depreciation	1,205,405	6,558,200	5,767,000	(914,200)	3,478,000
PP&E, net	389,867	6,680,025	5,592,500	1,333,100	3,518,000
Total debt, net of cash **	59,994	5,001,725	3,725,000	1,626,900	1,849,000
Lease obligations	43,494	583,175	732,000	42,700	826,000
Book value***	260,248	2,913,625	3,422,500	640,500	2,967,000
Tangible book value	260,248	1,293,900	1,638,500	(263,400)	2,162,000
Employees	2.460	36.850	37.500	10.700	22.000
Valuation metrics					
Market cap / earnings	32.2	20.8	16.5	19.1	36.9
Market cap / FCF	**8.9**	**11.5**	**11.5**	11.7	11.2
Market cap / BV	1.2	2.8	2.0	2.4	1.0
Market cap / tangible BV	**1.2**	**4.8**	**2.3**	(5.9)	1.4
EV / EBIT	14.6	15.2	14.9	15.2	19.5
EV / EBITDA	**5.5**	**8.2**	**8.1**	9.3	7.4
Business metrics					
Revenue / employee	510,288	333,934	334,001	265,318	301,682
Earnings / emlployee	3,961	12,836	7,910	7,645	3,636
EBITDA / assets	11.1%	12.6%	11.0%	11.8%	9.6%
Earnings / BV	3.7%	17.8%	12.4%	12.8%	2.7%
Gross margin	6.0%	19.8%	17.6%	19.1%	16.0%
Gross PP&E / EV	3.8	1.0	1.0	0.7	1.2

* IP's '09 writedowns have been excluded.
** Based on $150 million debt net of cash and est. tax credits through 7/3/09.
*** Book value adjusted based on net debt estimate as of 7/3/09.

CLW and Comparable Companies

Company	Clearwater			International Paper*	Kimberly-Clark
Period	12 ME 12/31/08			12 ME 12/31/08	12 ME 12/31/08
Ticker	CLW	mean	median	IP	KMB
Income statement					
Revenue	1,255,309	13,429,975	13,026,000	24,829,000	19,415,000
COGS	(1,179,397)	(10,700,450)	(9,565,000)	(21,375,000)	(13,557,000)
Gross profit	75,912	2,729,525	3,461,000	3,454,000	5,858,000
SG&A	(47,428)	(1,731,275)	(1,654,000)	(2,499,000)	(3,291,000)
Interest cost	(13,147)	(261,750)	(234,000)	(492,000)	(258,000)
Other		91,000	34,000	267,000	(28,000)
Equity in unconsoldiated entities		72,467	49,000	49,000	166,000
Minority interests		(49,100)	(5,300)	(3,000)	(139,000)
Taxes	(5,594)	(233,225)	(157,950)	(271,600)	(618,000)
Earnings	**9,743**	**589,050**	**293,100**	**504,400**	**1,690,000**
D+A	46,954	682,325	623,500	1,347,000	775,000
CapEx	21,306	570,050	597,000	1,002,000	906,000
FCF	**35,391**	**701,325**	**556,700**	**849,400**	**1,559,000**
EBIT	**28,484**	**1,084,025**	**778,500**	**1,268,000**	**2,566,000**
EBITDA	**75,438**	**1,766,350**	**1,688,000**	**2,615,000**	**3,341,000**
Balance sheet					
Total assets, net of cash	680,048	13,585,275	12,815,500	25,769,000	17,725,000
PP&E, gross	1,595,272	13,695,325	11,359,500	29,815,000	15,723,000
Accumulated depreciation	1,205,405	6,558,200	5,767,000	15,613,000	8,056,000
PP&E, net	389,867	6,680,025	5,592,500	14,202,000	7,667,000
Total debt, net of cash **	59,994	5,001,725	3,725,000	10,930,000	5,601,000
Lease obligations	43,494	583,175	732,000	776,000	688,000
Book value***	260,248	2,913,625	3,422,500	4,169,000	3,878,000
Tangible book value	260,248	1,293,900	1,638,500	2,142,000	1,135,000
Employees	2.460	36.850	37.500	61.700	53.000
Valuation metrics					
Market cap / earnings	32.2	20.8	16.5	13.5	13.9
Market cap / FCF	**8.9**	**11.5**	**11.5**	8.0	15.0
Market cap / BV	1.2	2.8	2.0	1.6	6.0
Market cap / tangible BV	**1.2**	**4.8**	**2.3**	3.2	20.7
EV / EBIT	14.6	15.2	14.9	14.6	11.6
EV / EBITDA	**5.5**	**8.2**	**8.1**	7.1	8.9
Business metrics					
Revenue / employee	510,288	333,934	334,001	402,415	366,321
Earnings / emlployee	3,961	12,836	7,910	8,175	31,887
EBITDA / assets	11.1%	12.6%	11.0%	10.1%	18.8%
Earnings / BV	3.7%	17.8%	12.4%	12.1%	43.6%
Gross margin	6.0%	19.8%	17.6%	13.9%	30.2%
Gross PP&E / EV	3.8	1.0	1.0	1.6	0.5

* IP's '09 writedowns have been excluded.

** Based on $150 million debt net of cash and est. tax credits through 7/3/09.

*** Book value adjusted based on net debt estimate as of 7/3/09.

CLW Segment Analysis

(000)	12 ME 12/31/08	% of total	12 ME 12/31/07	% of total	12 ME 12/31/06	% of total
Revenue						
Consumer products	504,597	40%	451,972	38%	444,951	40%
Pulp & paperboard						
Paperboard	644,436	51%	569,380	48%	538,246	48%
Pulp	92,304	7%	102,606	9%	77,712	7%
Other	844	0%	1,070	0%	1,113	0%
Wood products	89,014	7%	121,359	10%	113,347	10%
eliminations	(75,886)	-6%	(63,355)	-5%	(58,448)	-5%
total revenue	**1,255,309**		**1,183,032**		**1,116,921**	
Operating income						
Consumer products	37,321	131%	17,622	34%	25,698	56%
Pulp & paperboard	18,916	66%	45,066	86%	26,064	56%
Wood products	(14,479)	-51%	(109)	0%	6,093	13%
eliminations	(13,274)	-47%	(10,172)	-19%	(11,592)	-25%
total op.income	**28,484**		**52,407**		**46,263**	

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The Big Print

Research Service & Methodology

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4. Developing inferences from data through the application of first principles.

5. Because the emphasis is on capital preservation, the *Special Situation Report* aggressively looks for reasons not to invest. The firm invests its own capital in every recommended transaction.

The objective of *Hackett's Special Situation Report* is to move the investment process from *decision making under uncertainty,* past *decision making under risk,* toward *decision making under certainty*.

The *Special Situation Report* is available on a subscription basis; custom research is also available for institutional and accredited investors.