

2/11/2024

Why Clearwater Paper Corp is a short as of today's date, 2 days before earnings release.

Core Problem: Declining SBS Prices and Margins

- Solid Bleached Sulfate (SBS) paperboard prices have been falling due to a combination of customer destocking, oversupply, and weak demand in key end-markets (foodservice, CPG, and retail packaging).
- In Q3, SBS pricing dropped 11.7% YoY, pulling down margins despite a 67.2% increase in shipment volumes (Augusta acquisition-driven).
- For Q4, pricing must rise significantly above the 9-month average (\$1,223/ton) to avoid further full-year margin compression, which is unlikely given the cyclical nature of the industry.

Demand Challenges: SBS is Cyclical and Weak

- SBS demand is driven by foodservice, packaged goods, and retail trends, all of which are sensitive to economic conditions.
 - Economic slowdown: Weak consumer spending on discretionary goods (luxury packaging, cosmetics) reduces SBS demand.
 - Inventory destocking: Customers (e.g., fast food chains, packaging converters) are running down inventories rather than placing new orders, further weakening demand.
 - Sustainability headwinds: Many customers are shifting to cheaper, recycled alternatives (like CRB), which could permanently erode SBS market share.

Oversupply in the SBS Market

- The SBS industry is facing overcapacity, with too much production relative to demand.
 - Large competitors like WestRock, Graphic Packaging, and International Paper have stronger cost structures and can weather pricing pressures better than CLW.
 - CLW's smaller scale and reliance on SBS make it particularly vulnerable in this competitive, oversupplied environment.

Short-Term Growth is Misleading

- Q3 and YTD 2024 shipment growth (+67.2% YoY) was entirely driven by the Augusta acquisition.
- Organic growth is weak, as shown by falling pricing and soft SBS demand.
- The Augusta contribution masks underlying weakness in CLW's core business, and shipment growth will plateau after the acquisition benefit normalizes.

Financial Vulnerability: Weak Margins and Debt

- CLW's margins are under pressure due to falling SBS prices and rising input costs (freight, energy, and chemicals).
- Higher interest rates could increase the cost of servicing debt, especially if CLW's free cash flow deteriorates further.
- The company is highly reliant on SBS after selling its tissue business, leaving it exposed to cyclical swings without diversification.

No Clear Catalyst for Recovery

- For SBS prices to rebound, the market would need either a surge in demand or significant capacity cuts, neither of which appear imminent.
- Foodservice and CPG demand remain weak, and sustainability trends continue to push companies toward recycled alternatives.
- CLW has limited pricing power in a competitive market dominated by larger players.

Conclusion: Why CLW is a Short Before Earnings (Feb 13, 2025)

1. Falling SBS prices and weak demand will likely lead to compressed margins in Q4, as pricing is unlikely to recover above the 9-month average (\$1,223/ton).
2. Short-term growth from the Augusta acquisition is masking underlying weakness in CLW's core business.
3. Economic uncertainty, destocking, and sustainability trends are headwinds for SBS demand, further limiting CLW's pricing power.
4. Overcapacity and competition from larger players will continue to pressure pricing and market share.
5. Financial vulnerability (weaker cash flow, higher debt costs) leaves CLW exposed to prolonged market challenges.

Investment Action:

- **Short CLW ahead of its earnings on Feb. 13, 2025, as weak Q4 pricing and margins will likely lead to disappointing results and guidance.**