**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.***