

THE SPIN-OFF REPORT

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Clearwater Paper Corporation

Spin-Off from Potlatch Corporation

Price (11/17/2008): N/A

Shares Outstanding: 15.9 million

Market Capitalization: N/A

Estimated Fair Value: \$40 per share

Ticker: CLW

Indicated Dividend: N/A

Yield: N/A

Investment Summary & Recommendation

Potlatch Corporation (NYSE: PCH), a timber REIT and pulp-based manufacturing company, announced on July 17, 2008, that it intends to pursue a tax-free spin-off of its consumer products facilities, its pulp and paperboard facilities, and its wood products facility in Lewiston, Idaho. PCH management's focus on enhancing its stature as a REIT and maximizing the value of its forestland assets served as a motivation for the company's decision to undertake the separation of its consumer products and pulp and paperboard operations. The spin-off company will be named Clearwater Paper Corporation ("Clearwater") and is expected to trade on the New York Stock Exchange under the ticker "CLW." The distribution will be made to existing shareholders via a pro rata dividend at an exchange ratio tentatively set at 1 share of CLW for every 2.5 shares of PCH. The shareholder of record date has not yet been established. We believe the transaction will close in mid-December 2008.

We assign a fair value estimate of \$40 per share to Clearwater based on a target EV/EBITDA multiple of 7x our 2009 EBITDA estimate of \$109.7 million. It is worth noting that this fair value estimate is equivalent to \$16 per share based on an exchange ratio of 1:1.

We do not believe the market is currently assigning this level of valuation to Clearwater, however, as this would represent over 60% of the \$26 share price of Potlatch Corporation ("Potlatch") as of November 14, 2008. One could argue that the majority of Potlatch's value, pre-spin, lies in the company's 1.65 million acres of timberland holdings, which appear to be worth more than the current enterprise value of Potlatch using conservative estimates. If Potlatch is already trading at a discount to the estimated intrinsic value of these holdings, a discount that is similar to other publically-traded timber REITS, we would be surprised if the market were assigning significant value to the Clearwater assets.

This would be reflective of what we are seeing in the market, as a number of pulp and paper manufacturers have underperformed during 2008. This underperformance is reflected in the recent history of the Dow Jones Paper index, which has declined 67% year-to-date versus a 36% decline in the Dow Jones Industrial Average during the same time period. The paper sector's lagging performance can be attributed to the incidence of increased expenses across the industry, which has put pressure on margins. The weakness in the housing market has slowed lumber mill operations and, therefore, the production of residual wood fibers, which are used as inputs in the pulp manufacturing process. These supply pressures have led to an increase in wood fiber costs, while higher oil prices have led to higher prices for petrochemicals, which are also used as inputs in the manufacturing process.

Although costs have increased, we highlight that the demand for Clearwater's products (primarily paperboard for packaging and tissue paper) remains relatively strong, as these end markets appear to be less cyclical than the end markets of Potlatch's legacy operations or of other segments of the paper industry. This observation is borne out by Clearwater's results during the first nine months of 2008, when net sales grew 13% versus the first nine months of 2007. We believe this stable demand will lead to mid-single-digit growth in revenue and free cash flow, and a reasonable expectation for higher levels of growth in net income due to lower levels of capital expenditures and declining depreciation expenditures.

The company's expense structure will likely be pressured for some time by the depressed housing market. However, we view Clearwater as representing an attractive long-term value at the right price and believe the company's spin-off from Potlatch could present an interesting opportunity for investors.

Company Description

Clearwater will operate a pulp and paperboard business, a consumer products business, and a lumber products business. Clearwater is expected to carry \$150 million of indebtedness upon spin-off, or approximately 1.4x its estimated 2009 EBITDA of \$110 million. This indebtedness will consist of a \$50 million draw on its revolving credit facility (the cash to be distributed to Potlatch) and \$100 million of debentures, expiring in December 2009, that the company will assume from Potlatch. It is worth noting that Clearwater would be able to fund the redemption of its debentures with the equivalent of two years of projected free cash flow. Following the spin-off of Clearwater, Potlatch Corporation would appear to retain all but \$100 million of the approximately \$435 million in total debt shown on its balance sheet as of September 30, 2008.

Pulp and Paperboard. This division manufactures and markets bleached paperboard for the high-end segment of the packaging industry. It is the leading producer of solid bleached sulfate ("SBS") paperboard in the United States. This division also produces bleached softwood market pulp, which is used as a basis for many paper products, and slush pulp, which it supplies to the company's consumer products business. Clearwater operates two pulp and paperboard facilities, one in Idaho and one in Arkansas.

This division's top ten paperboard customers accounted for over 50% of total paperboard shipments from each of its mills in each of the last four years.

Clearwater's pulp and paperboard mill in Idaho is one of only two SBS mills, and the only coated SBS mill, in the western United States. This allows the company to minimize transportation costs to Asia and gives it a cost advantage relative to competitors in the eastern United States.

Consumer Products. This division is the leading US provider of private-label tissue products, accounting for approximately 55% of the total private-label tissue products sold in US grocery stores in 2007. The company manufactures paper on three machines in its Idaho facility and on one machine in its Nevada facility.

Lumber Products. This division produces dimensional framing lumber and appearance-grade cedar products. It also supplies wood chips to the company's pulp and paperboard business.

Operating margins for Clearwater have suffered as a result of higher prices for wood fiber, the principal raw material in the pulp-making process. Wood fiber, primarily wood chips and sawdust, is a by-product of lumber mill operations, which have slowed significantly due to the weakness in the housing market. This lower supply has caused prices for wood fiber to increase (see Exhibit 1). In 2007, the predecessor of Clearwater sourced 31% of its wood fiber from

Potlatch Corporation, with the balance procured from other suppliers through both contractual and spot market transactions. Clearwater is expected to obtain a similar percentage of its wood fiber requirements from PCH following the completion of the spin-off.

Exhibit 1 Average Cost per Ton of Wood Chips and Sawdust

	2005	2006	2007	YTD2008
Avg. Cost per Ton of Wood Chips and Sawdust	\$132	\$136	\$163	\$204
<i>% Price Increase</i>		3%	20%	25%

Source: Company reports.

The company has also seen weaker margins as a result of higher energy costs, which accounted for approximately 10% of production costs year-to-date.

Valuation

We place a fair value estimate of \$40 on Clearwater shares based on a target EV/EBITDA multiple of 7x our 2009 EBITDA projection of \$109.7 million (see Exhibit 2).

Exhibit 2 Fair Value Calculation for Clearwater Paper

(\$ in thousands, except per-share amounts)

2009 EBITDA Estimate	109,760
Target EV/EBITDA Multiple	7x
<hr/> Enterprise Value	<hr/> 768,318
Net Debt	108,869
<hr/> Implied Equity Value	<hr/> 659,450
FD Shares Outstanding	15.9
<hr/> Estimated Fair Value per Share	<hr/> \$41.43

Source: Company reports, *Spin-Off Report* estimates.

This 2009 EBITDA estimate represents nearly 13% growth from our 2008 estimates and is 5% higher than pro forma 2007 levels. A target EV/EBITDA multiple of 7x represents the average multiple for the group of comparable companies shown in Exhibit 3. We would argue, however, that Clearwater deserves to trade at a higher-than-average multiple, as its end markets appear to be less cyclical than those of its competitors, which produce materials used by print and merchandising display operators.

Exhibit 3 Comparable Company EV/EBITDA Multiples

	Wausau Paper (NYSE: WPP)	Domtar Corp (NYSE: UFS)	Neenah Paper (NYSE: NP)	Rock-Tenn Company (NYSE: RKT)	Average
Run-Rate EBITDA	55,082	816,000	105,800	292,000	
Enterprise Value	577,399	2,974,260	474,785	2,845,375	
EV/EBITDA	10.5x	3.6x	4.5x	9.7x	7.1x
Primary End Markets	Specialty Products Printing & Writing Towel & Tissue	Freesheet Paper (office/business)	Filtration Printing & Writing	Packaging Paperboard Merchandising Displays	

Source: Company reports, *Spin-Off Report* estimates.

Our fair value estimate of \$40 per share is based on the company's expected exchange ratio of 1 share of Clearwater paper for every 2.5 shares of Potlatch.

This fair value estimate also represents a free cash flow yield of nearly 10%, which, when combined with projected FCF per share growth of 5%, approaches a 15% total return assuming a constant FCF multiple (see Exhibit 4).

Exhibit 4 Free Cash Flow Per Share Calculation

(\$ in thousands, except per-share amounts)

	PF2007	2008E	2009E	2010E
Cash from Operations	104,105	75,638	80,545	83,531
CapEx	(20,531)	(20,000)	(20,000)	(20,000)
FCF	83,574	55,638	60,545	63,531
FCF/Share	\$5.31	\$3.50	\$3.80	\$3.99
Growth - %			8.8%	4.9%

Source: Company reports, *Spin-Off Report* estimates.

We do not believe the market is currently assigning this level of valuation to Clearwater and consider it likely that Clearwater will represent an attractive opportunity for investors once it begins regular-way trading. This view is based on our belief that Potlatch's current valuation is primarily driven by the estimated intrinsic value of its timberlands, to which the company currently trades at a discount (see Exhibit 5).

Exhibit 5 Enterprise Value Relative to Intrinsic Value of Timberlands: Potlatch Corp.

(\$ in millions, except per-acre and per-share amounts)

Current Enterprise Value of Potlatch (inclusive of Clearwater Paper)

Current Price per Share (11/14/08)	\$26.27
FD Shares Outstanding (millions)	39.8
Estimated Equity Value	\$1,045
Net Debt (9/30/08)	\$447
Estimated Enterprise Value	\$1,493

Estimated Intrinsic Value of Timberlands

Higher-and-Better Use Land

Acres of Timberland (millions)	0.25
Estimated Value per Acre	\$2,000
Estimated Intrinsic Value of Timberlands	\$500

Core Timberland

Acres of Timberland (millions)	1.4
Estimated Value per Acre	\$1,200
Estimated Intrinsic Value of Timberlands	\$1,680

Total Estimated Intrinsic Value of Timberlands	\$2,180
Current Discount of EV to Value of Timberlands	31.5%

Source: Company reports, *Spin-Off Report* estimates.

We believe the valuations per acre are conservative estimates of these timberlands' true value. As an example, Potlatch has sold land at an average price of \$1,700 per acre in 2008 (excluding the sale of non-core land in northern Minnesota), despite a shift in land sales away from the higher-priced HBU (higher-and-better-use) land, which was selling for \$2,800 per acre earlier in the year.

One could argue that the value being attributed to the Clearwater assets is negligible, as reflected by the fact that Potlatch is currently trading at a discount to its timberland holdings that is comparable to that of Plum Creek Timber Co. (NYSE: PCL), a timber REIT with operations similar to that of Potlatch, excluding the Clearwater assets (see Exhibit 6).

One could also arrive at a very constructive view of Potlatch's valuation, inclusive of its ownership of Clearwater Paper, by applying, to the \$2.18 billion estimated intrinsic value of its timberland assets, PCL's 21.7% enterprise value discount to its timberland asset value (see Exhibit 6). The \$1.7 billion enterprise value implied by that analysis, less Potlatch's \$447 million in net debt, would point to an equity valuation of \$1.26 billion. Moreover, adding that implied equity value to the aforementioned \$659 million estimated fair value of Clearwater Paper, as calculated in Exhibit 2, would suggest a total equity value for Potlatch, inclusive of Clearwater,

of \$1.9 billion. That estimated total equity value materially exceeds PCH's current market capitalization of \$1 billion.

**Exhibit 6 Enterprise Value Relative to Intrinsic Value of Timberlands:
Plum Creek Timber Co.**

(\$ in millions, except per-acre and per-share amounts)

Current Enterprise Value of Plum Creek

Current Price per Share (11/14/08)	\$33.88
FD Shares Outstanding (millions)	171.8
<hr/>	
Equity Value	\$5,821
Net Debt (9/30/08)	\$2,427
<hr/>	
Enterprise Value	\$8,248

Estimated Intrinsic Value of Timberlands

Higher-and-Better Use Land

Acres of Timberland (millions)	1.84
Estimated Value per Acre	\$2,000
Estimated Intrinsic Value of Timberlands	\$3,680

Core Timberland

Acres of Timberland (millions)	5.71
Estimated Value per Acre	\$1,200
Estimated Intrinsic Value of Timberlands	\$6,852

Total Estimated Intrinsic Value of Timberlands	\$10,532
Current Discount of EV to Value of Timberlands	21.7%

Source: Company reports, *Spin-Off Report* estimates.

If one assumes the spin-off is not instantly value enhancing (though it certainly may be) and further assumes that the valuation of Potlatch will be buoyed by the intrinsic value of its timberland assets, one can foresee the possibility that Clearwater could trade at a significant discount to fair value upon spin-off.

Conclusion

The housing market and the higher energy prices seen through most of 2008 have taken a toll on Clearwater's margins. We view these factors as being cyclical, however, and believe an eventual return to normalized market conditions will bring the pulp and paperboard industry back into favor.

Despite these margin pressures and the difficult economic environment, demand continues to grow organically, there is significant potential to penetrate new markets within the US to further expand revenues, and the company appears poised to introduce a round of price increases that should further bolster profitability. Capital requirements also appear to have slowed from the levels seen in recent years, which should allow for earnings growth to significantly outpace top-line growth. (See Exhibits 7 and 8 for Clearwater's income statement and balance sheet.)

In summary, we believe Clearwater could represent an attractive long-term investment opportunity, as the market may be unfairly punishing the company's valuation in the midst of the current adverse business cycle. We have assigned a fair value estimate of \$40 per share to Clearwater based on a modest target multiple of 7x 2009 EBITDA and would recommend that investors consider purchasing Clearwater should the company begin regular-way trading at an appropriate discount to this price target.

Exhibit 7 Clearwater Paper Corp.: Income Statement

(\$ in thousands, except per-share amounts)

	PF2007	2008E	2009E
Net Sales	1,173,326	1,220,259	1,281,272
<i>Growth - %</i>	6.0%	4.0%	5.0%
Materials, Labor and Other	1,033,099	1,086,031	1,133,926
<i>% of Sales</i>	88.0%	89.0%	88.5%
SG&A	36,127	36,850	37,587
<i>Growth - %</i>	-0.4%	2.0%	2.0%
<i>% of Sales</i>	3.1%	3.0%	2.9%
EBITDA	104,100	97,379	109,760
<i>EBITDA Margin</i>	8.9%	8.0%	8.6%
<i>Growth - %</i>	12.5%	-6.5%	12.7%
Depreciation	51,325	46,493	43,550
EBIT	52,775	50,886	66,210
<i>EBIT Margin</i>	4.5%	4.2%	5.2%
Income from Settlement	0	0	0
Interest Expense, Net		1,111	13,283
Pretax Income	52,775	49,775	52,927
Income Tax Provision	19,006	17,919	23,836
<i>Rate - %</i>	36.0%	36.0%	36.0%
Net Earnings	33,769	32,967	42,374
<i>Margin</i>	2.9%	2.7%	3.3%
Pension and Other Benefits	(1,374)	0	0
Net Income	32,395	32,967	42,374
Earnings per FD Share	\$2.06	\$2.07	\$2.66
<i>Growth - %</i>	2.0%	0.7%	28.5%
FD Shares Outstanding - millions	15.8	15.9	15.9

Source: Company reports, *Spin-Off Report* estimates.

Exhibit 8 Clearwater Paper Corp.: Balance Sheet

(\$ in thousands)

	PF2007	2008E	2009E
Assets			
Cash	9	5,586	66,131
Receivables, Net	96,545	100,407	105,427
Inventories	140,526	146,147	153,454
Prepaid Expenses	1,400	1,456	1,529
Deferred Taxes	8,645	8,991	9,440
Total Current Assets	247,125	262,587	335,982
Land	4,729	4,729	4,729
Plant and Equipment, Net	408,441	381,948	358,398
Pension Assets	37,064	36,323	35,596
Other Assets	86	86	86
Total Assets	697,445	685,672	734,791
Liabilities			
AP and Accrued Liabs.	114,073	118,636	124,568
Other Post-retirement Benefits	7,792	7,636	7,483
Total Current Liabilities	121,865	126,272	132,051
Other Post-retirement Benefits	129,293	126,707	124,173
Long-Term Debt	0	175,000	175,000
Other Long-Term Obligations	2,093	2,032	2,032
Deferred Taxes	74,820	74,820	74,820
Total SE	369,374	180,841	226,715
Total Liabilities and SE	697,445	685,672	734,791

Source: Company reports, *Spin-Off Report* estimates.