

Neenah Paper Inc  
Form 10-K  
March 16, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 001-32240

## NEENAH PAPER, INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-1308307**

(I.R.S. Employer  
Identification No.)

**3460 Preston Ridge Road  
Alpharetta, Georgia**

(Address of principal executive offices)

**30005**

(Zip Code)

Registrant's telephone number, including area code: **(678) 566-6500**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Common Stock \$0.01 Par Value  
Preferred Stock Purchase Rights

Name of Each Exchange on Which Registered

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the registrant's common stock held by non-affiliates on June 30, 2006 (based on the closing stock price on the New York Stock Exchange) on such date was \$450 million.

As of February 28, 2006, there were 14,811,520 shares of the Company's common stock outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Certain information contained in the definitive proxy statement for the Company's Annual Meeting of Stockholders to be held on May 14, 2007 is incorporated by reference into Part III hereof.

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## PART I

In this report, unless the context requires otherwise, references to we, us, our, Neenah or the Company are intended to mean Neenah Paper, Inc. and its consolidated subsidiaries.

### Item 1. Business

#### Overview

Neenah, a Delaware corporation, was incorporated in April 2004 in contemplation of the spin-off by Kimberly-Clark Corporation ( Kimberly-Clark ) of its fine paper and technical products businesses in the United States and its Canadian pulp business (collectively, the Pulp and Paper Business ). We had no material assets or activities until Kimberly-Clark's transfer to us of the Pulp and Paper business on November 30, 2004. On that date, Kimberly-Clark completed the distribution of all of the shares of our common stock to the stockholders of Kimberly-Clark (the Spin-Off ). Kimberly-Clark stockholders received a dividend of one share of our common stock for every 33 shares of Kimberly-Clark common stock held. Based on a private letter ruling Kimberly-Clark received from the Internal Revenue Service, receipt of our shares in the Spin-Off was tax-free for United States federal income tax purposes. Following the Spin-Off, we are an independent public company and Kimberly-Clark has no ownership interest in us.

We are a leading international producer of premium fine papers and technical products. We also produce bleached kraft market pulp in Canada, where we own approximately 500,000 acres of timberlands and have non-exclusive rights to harvest wood off approximately 200,000 acres of other timberlands. We have three primary operations: our fine paper business, our technical products business and our pulp business.

Our fine paper business is a leading producer of premium writing, text, cover and specialty papers used in corporate annual reports, corporate identity packages, invitations, personal stationery and high-end packaging. Our products include some of the most recognized and preferred papers in North America, where we enjoy leading market positions in many of our product categories. We sell our products primarily to authorized paper distributors, converters and specialty businesses. Our fine paper manufacturing facilities are located in Neenah and Whiting, Wisconsin.

Our technical products business is a leading producer of transportation and other filter media and durable, saturated and coated substrates for a variety of end uses. We sell our technical products globally into 17 product categories, and we focus on categories where we believe we are a market leader or have a competitive advantage, which include, among others, transportation and other filter media, nonwoven wall coverings, specialty tape, label, abrasive, medical packaging and heat transfer technical products markets. We are also a global supplier of materials used to create customer-specific components for furniture, book covers and original equipment manufacturers' products. Our customers are located in more than 35 countries. Our technical products manufacturing facilities are located in Munising, Michigan and near Munich and Frankfurt, Germany.

Our pulp business primarily produces northern bleached softwood kraft pulp used by paper mills to manufacture tissue and printing and writing papers. Our pulp business consists of a mill located in Pictou, Nova Scotia together with related timberlands. The Pictou mill is comprised of a single-line pulp facility, which produces primarily softwood pulp, as well as timberlands encompassing approximately 500,000 acres of owned and 200,000 acres of licensed or managed land in Nova Scotia. Timberland operations on land owned and licensed by the Pictou mill are provided by third-party contractors. In 2006, the Pictou mill produced approximately 260,000 metric tons of bleached kraft pulp.

#### Recent Developments

In June 2006, we completed the sale of approximately 500,000 acres of woodlands in Nova Scotia for gross proceeds of \$139.1 million. The agreement includes a fiber supply agreement to secure a source of fiber for the Company's Pictou pulp mill. The transaction resulted in a net pre-tax gain of \$131.6 million. See Note 3 of Notes to Consolidated and Combined Financial Statements, Sale of Woodlands.

In August 2006, we completed the transfer of our Terrace Bay mill and related woodlands operations (excluding certain working capital amounts and post-employment obligations) to certain affiliates of Buchanan Forest Products Ltd. ( Buchanan ). Pursuant to the terms of the agreement, Buchanan assumed responsibility for substantially all liabilities related to the future operation of the mill in exchange for a payment of \$18.6 million. See Note 4 of Notes to Consolidated and Combined Financial Statements, Discontinued Operations.

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In October 2006, we completed the purchase of the outstanding interests of FiberMark Services GmbH & Co. KG and the outstanding interests of FiberMark Beteiligungs GmbH (collectively Neenah Germany ). Neenah Germany was acquired from FiberMark, Inc. and FiberMark International Holdings LLC for \$218 million in cash. The assets acquired as a result of the acquisition of Neenah Germany consist of three mills located near Munich and Frankfurt Germany, that produce a wide range of products, including transportation and other filter media, non-woven wall coverings, masking and other tapes, abrasive backings, and specialized printing and coating substrates. Neenah Germany is being operated as part of our Technical Products business. See Note 5 of Notes to Consolidated and Combined Financial Statements, Acquisitions.

In March 2007, we acquired the Fox Valley Corporation, which owns Fox River Paper Company, LLC ( Fox River ). We paid \$52 million in cash for the acquisition and financed it through a combination of cash and debt drawn against our existing revolving credit facility. The assets acquired as a result of the acquisition of Fox River consist of four U.S. paper mills and various related assets, producing premium fine papers with well-known brands including STARWHITE®, SUNDANCE®, ESSE® and OXFORD®. The Fox River assets will be operated as part of our fine paper business.

In conjunction with the acquisition of Fox River, we announced plans to permanently close the Housatonic mill, located near Great Barrington, Massachusetts. The Housatonic mill, the smallest of the fine paper plants acquired in the Fox River acquisition, has annual production capacity of approximately 15,000 tons per year and is expected to cease manufacturing operations by the end of the second quarter. The Housatonic mill was not profitable due to its small size, cost structure and the pricing of many of the grades made there. Closing the mill will allow us to eliminate costs and improve margins while still serving the needs of key customers. We expect to incur one-time cash costs of approximately \$3 million, which includes approximately \$2 million for employee severance pay and approximately \$1 million of other charges related to the closure. See Note 20 of Notes to Consolidated and Combined Financial Statements, Subsequent Events .

### Company Structure

**Our corporate structure consists of Neenah Paper, Inc., and four wholly-owned direct subsidiaries.**

**Neenah Paper, Inc.** Neenah is a Delaware corporation that holds our trademarks and patents related to all of our U.S. businesses (except Fox River), all of our U.S. inventory, the real estate, mills and manufacturing assets associated with our fine paper businesses in Neenah and Whiting, WI, and all of the equity in our subsidiaries which are listed below. The common stock of Neenah is publicly traded on the New York Stock Exchange under the symbol NP. Neenah Paper Sales, Inc, a Delaware corporation and wholly owned subsidiary of Neenah Paper, Inc., was merged into Neenah Paper, Inc. on December 31, 2006.

**Neenah Paper Michigan, Inc.** Neenah Paper Michigan, Inc. is a Delaware corporation that owns the real estate, the mill and the manufacturing assets associated with our U.S. technical products business.

**NPCC Holding Company LLC.** NPCC Holding Company LLC is a Delaware limited liability company and wholly owned subsidiary of Neenah. It owns all of the equity of Neenah Paper Company of Canada. Neenah Paper Company of Canada is a Nova Scotia limited liability company that owns the real estate, the mill and the manufacturing assets associated with our pulp business operations in Pictou, Nova Scotia. It also conducts timberlands operations in the Province of Nova Scotia.

**Fox Valley Corporation (name to be changed to Neenah Paper FVC, Inc).** Fox Valley Corporation is a Delaware corporation and wholly owned subsidiary of Neenah Paper, Inc., and owns all of the equity of Fox River Paper Company, LLC (name to be changed to Neenah Paper FR, LLC). Fox River Paper Company, LLC is a Delaware limited liability company that owns the real estate, mills and manufacturing assets associated with our operations in Appleton, WI, Great Barrington, MA, Ripon, CA and Urbana, OH.

**Neenah Paper International Holding Company, LLC.** Neenah Paper International Holding Company, LLC is a Delaware limited liability company and wholly owned subsidiary of Neenah Paper. It owns all of the equity of Neenah Paper International, LLC. Neenah Paper International LLC is a Delaware limited liability company that owns all of the equity of Neenah Germany GmbH and in conjunction with Neenah Germany GmbH all of the equity of Neenah Services GmbH & Co. KG. Neenah Services GmbH & Co. KG is a German KG and with its subsidiaries owns the

real estate and the manufacturing assets associated with our technical products business operations in Germany.

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## History of the Businesses

*Fine Paper Business.* The fine paper business was incorporated in 1885 as the Neenah Paper Company, which initially operated a single paper mill located adjacent to the Fox River in Neenah, Wisconsin. Kimberly-Clark acquired the mill in 1956. In 1981, Kimberly-Clark purchased an additional mill located in Whiting, Wisconsin to increase the production capacity of the fine paper business. In the late 1980s and early 1990s, Kimberly-Clark expanded the capacity of the fine paper business in response to increased demand by rebuilding Whiting's two paper machines and building two new paper machines at the Whiting mill. The Neenah facility underwent a major expansion in the early 1990s with the installation of a new paper machine, a new finishing center, a new customer service center and a distribution center expansion. As a result of decreased demand, in the 2000s the Neenah mill retired two of its older paper machines. In March 2007, we acquired Fox River a leading U.S. producer of premium fine papers. See Recent Developments.

*Technical Products Business.* In 1952, Kimberly-Clark purchased the Munising mill, located in Munising, Michigan, which previously had produced sulfite pulp and butcher wrap paper. Subsequent to the purchase, Kimberly-Clark converted the mill to produce durable, saturated and coated papers for sale and use in a variety of industrial applications for its technical products business. In 2006, we purchased three mills located near Munich and Frankfurt, Germany from FiberMark, Inc. and FiberMark International Holdings LLC. The mills produce a wide range of products, including transportation and other filter media, non-woven wall coverings, masking and other tapes, abrasive backings, and specialized printing and coating substrates.

*Pulp Business.* The Pictou pulp mill was built in 1967 by the Scott Paper Company. Kimberly-Clark acquired the Pictou pulp mill and related timberlands operations in 1995 as part of its merger with the Scott Paper Company. The Terrace Bay pulp mill was built by Kimberly-Clark in 1948. In 2006, we disposed of the Terrace Bay mill and related woodlands (See Business Recent Developments ).

## Business Strategy

*Increase the Size of our Paper Businesses Relative to Our Overall Product Mix.* We believe our experienced team of employees and management are pursuing business strategies designed to take advantage of our existing strengths in our paper businesses including our strong market positions, efficient operations, high-quality products and well recognized brands while responding to the challenges faced by each unit. We expect to seek growth opportunities in our paper businesses, both organically and through acquisitions, that will allow these businesses to represent an increasing portion of Neenah Paper's overall business composition.

*Deliver Consistent Profitable Growth.* We believe that our fine paper and technical products production assets provide us with a flexible, efficient and low cost platform for growth and that our focus on cost efficiencies in pulp operations also will allow us to improve our results.

*Provide Investors with Attractive Returns.* We believe return on capital is an important metric and that operating as a stand-alone company better allows us to allocate capital to our core businesses based on business priority and financial returns. We also expect to provide returns to investors over time by paying dividends in line with peer companies.

## Products

*Fine Paper Business.* The fine paper business manufactures and sells branded world-class premium writing, text, cover and specialty papers used in corporate annual reports, corporate identity packages, invitations, personal stationery and high-end packaging. Net sales of the fine paper business were approximately \$224 million in 2006, \$222 million in 2005 and \$221 million in 2004.





Premium writing papers are used for business and personal stationery, corporate letterhead, corporate identity packages, private watermarked papers, envelopes and similar end-use applications. Market leading writing papers are sold by the fine paper business under the CLASSIC®, ENVIRONMENT®, NEENAH®, ATLAS® and OLD COUNCIL TREE® trademarks, which are denoted by a brand watermark in each sheet of writing paper. During 2006, we successfully introduced the NEENAH GREEN® environmental platform. Key components of the platform include (1) becoming the largest purchaser of green energy in the State of Wisconsin, (2) using papermaking waste by-products at a third party reprocessing site to create steam that is reused in papermaking, reducing carbon dioxide emissions by 80 percent at our Neenah mill and (3) introducing the first Forest Stewardship Council (FSC) watermarked paper and introducing it across all our CLASSIC® brands. We are the first premium text and cover manufacture to be certified as Processed Chlorine Free in our 100 percent post-consumer products. The fine paper business also sells private watermarked and other custom manufactured writing papers.

Text and cover papers are used in applications such as corporate annual reports, corporate identity packages, insert advertising, direct mail, facility brochures, business cards, hang tags, scrapbooks, and a variety of other uses where colors, textured finishes or heavier weight papers are desired. Our brands in this category include CLASSIC®, CLASSIC CREST® and ENVIRONMENT®. We also sell a variety of custom paper colors, paper finishes, and duplex/laminated papers.

The fine paper business produces and sells other specialty papers, including translucent papers, art papers, papers for optical scanning and other specialized applications, under the UV/ULTRA® II trademark and other brands.

*Technical Products Business.* The technical products business is a leading producer of durable, saturated and coated substrates for a variety of end uses, including tapes, premask, abrasives, filtration media, labels, medical packaging, decorative components, wallcovering, and image transfer papers. Net sales of our technical products business were approximately \$183 million in 2006, \$131 million in 2005 and \$132 million in 2004. KIMDURA®, MUNISING LP®, PREVAIL , NEENAH®, Gessner® and varitess® are brands of our technical products business.

Products of the technical products business are typically sold to other manufacturers as a component of a finished product. The technical products business sells its products into major market segments, including filtration, tape, premask, abrasives, wallcovering, label, medical packaging and ten specialty segments. Several key market segments served, including tape and abrasives, are global in scope.

The technical products business produces tape base sheets from latex saturated crepe and flat papers and sells them to manufacturers to produce finished pressure sensitive products for sale in automotive, automotive aftermarket, transportation, manufacturing and building construction, and industrial general purpose applications. Premask paper is used as a protective over wrap for products during the manufacturing process and for applying signs, labeling and other finished products.

The technical products business produces filtration media for automotive induction air, fuel, oil, and cabin air applications and vacuum cleaner bags and filters. Transportation filtration media are sold to suppliers of automotive companies and of the automotive aftermarket.

The technical products business is a leading producer of latex saturated and coated abrasive backing papers for use by sandpaper manufacturers. The finished lightweight sandpaper is sold in the automotive, automotive aftermarket, construction, metal and woodworking industries for both waterproof and dry sanding applications.

Label and tag products are produced from saturated (latex impregnated) base label stock and purchased synthetic (bi-axially stretched polypropylene film) base label stock. Top coatings are applied to the base label stock to allow for high quality variable and digital printing. The synthetic label stock of the technical products business is recognized as a high quality, UV (ultra-violet) stable product used for outdoor applications. The business sells its label and tag stock to pressure sensitive coaters, who in turn sell the coated label and tag stock to the label printing community.

Wallcovering substrates are made from saturated and coated wet-laid nonwovens and marketed to converters serving commercial and do-it-yourself markets.

The technical products business's medical packaging paper is a polymer impregnated base sheet that provides a breathable sterilization barrier. When sealed together with film, this paper becomes a medical packaging material that allows sterilization from steam, ethylene oxide, or gamma radiation and at the same time provides unique barrier properties.



Decorative components papers, designed for durability and flexibility, are made from light and medium weight latex saturated papers. The base paper can be reinforced with synthetic fiber for additional tear strength. Coatings can also be applied for printability. A variety of different base weights, colors and textures are available for sale to coater converters, distributors, publishers and printers for use in book covers, stationery and fancy packaging.

Image transfer papers are used to transfer an image from paper to tee shirts, hats, coffee mugs, and other surfaces. The technical products business produces and applies a proprietary imaging coating to its image transfer papers for use in digital printing applications. Image transfer papers are primarily sold through large retail outlets and through master distributors who then offer small quantity options and services to the large number of customers in the supply channel.

The technical products business also produces and sells several other specialty papers including furniture backer, printing substrates, and release paper.

*Pulp Business.* Our Pictou pulp mill produces virgin northern bleached softwood and hardwood kraft pulp and various blends of each for sale to paper mill customers located primarily in North America and Europe. In 2006, approximately 80% of our Pictou mills' output was consumed by Kimberly-Clark. The Pictou pulp mill's major products are Pictou HARMONY® Softwood (northern bleached softwood kraft pulp) and Pictou Hardwood (northern bleached hardwood kraft pulp).

Net sales of our pulp business were approximately \$189 million in 2006, \$184 million in 2005 and \$177 million in 2004.

#### **Markets and Customers**

*Fine Paper Business.* Premium papers are used primarily for stationery and corporate identification applications and represent approximately 3% of the uncoated free sheet market. Growth in the uncoated free sheet market has been restrained due to the increasing use of electronic media for communication. The stationery segment of this market is divided into cotton and sulfite grades. The text and cover paper segment of the market, used in corporate identification applications, is split between smooth papers and textured papers. Text papers have traditionally been utilized for special, high end collateral material such as corporate brochures, annual reports and special edition books. Cover papers are used as covers primarily for business cards, pocket folders, brochures and report covers including corporate annual reports.

The fine paper business sells its products through our sales and marketing organizations primarily in three channels: authorized paper distributors, converters and direct sales to specialty businesses. Distributor sales account for more than 80% of our customer base in the fine paper business, including distributor owned paper stores. There is also a small but growing sales channel in office supply catalogs and business copy center stores, primarily to distributors in North America. Less than 5% of the sales of our fine paper business in 2006 were exported to international distributors in Europe, South Africa, Asia and Australia.

Sales to the fine paper business's two largest customers (both of which are distributors) represented approximately 30% of its total sales in 2006. We have limited our distribution agreements to improve our ability to control the marketing of our products. Although a complete loss of either of these customers would cause a temporary decline in the business's sales volume, the decline could be partially offset by expanding sales to existing distributors, and further offset over a several month period with the addition of new distributors.

*Technical Products Business.* The technical products business relies on a direct sales team and marketing organization to sell its products in 17 separate market segments in the U.S. and internationally. Such segments, broadly defined as polymer impregnated and synthetic paper, include papers used as components in the following applications: transportation and other filter media, nonwoven wall coverings, saturated label, clean room papers, release papers, abrasives, masking tape, decal premask, heat transfer, medical packaging, decorative components, durable printing papers, furniture components, washable tag, and industrial components. Our technical products business is recognized as a leading specialty paper manufacturer in the following market segments: furniture components, washable tag, decal premask, saturated label, clean room, saturated release paper, reinforced medical packaging and saturated abrasive backings.



Several traditional products (abrasives, tapes, labels) are used in markets that are directly affected by economic business cycles. Other market segments such as heat transfer papers used in small/home office and consumer applications are relatively stable. Price competition is common in most of the segments served by the technical products business and has increased due to a trend of using film and other lower cost substrates instead of paper in some applications.

The technical products business relies on a team of direct sales representatives and customer service representatives to market and sell approximately 95% of its sales volume directly to customers and converters. Less than 5% of the sales of the technical products business are sold through industrial distributors.

The technical products business has over 500 customers worldwide. The distribution of sales in 2006 was approximately 55% in North America, 30% in Europe and 15% in Latin America and Asia. The distribution of sales during the fourth quarter of 2006, which includes the results of Neenah Germany for the period subsequent to its acquisition in October 2006, was approximately 30% in North America, 50% in Europe and 15% in Latin America and Asia and 5% in other countries. Customers typically convert and transform base papers and film into finished rolls and sheets by adding adhesives, coatings, and finishes. Such transformed product is then sold to end-users.

*Pulp Business.* Northern bleached softwood kraft pulp is used by paper mills to manufacture tissue and printing and writing paper. In 2005, worldwide demand for northern bleached softwood kraft market pulp (which excludes pulp produced for internal consumption by integrated pulp manufacturers) was estimated to be 13.0 million metric tons, of which about 6.6 million metric tons were produced in Canada. Western Europe consumed an estimated 5.7 million metric tons of northern bleached softwood kraft pulp in 2005, followed by the United States at 2.9 million metric tons and China at 1.6 million metric tons.

In 2006, Pictou produced about 248,000 metric tons of northern bleached softwood kraft pulp. In 2006, approximately 80% of Pictou's northern bleached softwood kraft pulp production was sold to Kimberly-Clark. Our Pictou mill has historically sold or transferred more than 90% of its output of northern bleached softwood kraft pulp to Kimberly-Clark.

In 2005, worldwide demand for northern bleached hardwood market pulp was estimated to be 18.1 million metric tons of which an estimated 1.7 million metric tons were northern bleached hardwood kraft pulp produced in Canada. In 2005, the United States consumed approximately 0.6 million metric tons of Canadian northern bleached hardwood kraft pulp, followed by Asia at 0.54 and Europe at 0.25 million metric tons.

In 2006, our Pictou mill produced about 12,000 metric tons of northern bleached hardwood kraft pulp. In 2006, our Pictou mill sold more than 80% its northern bleached hardwood kraft pulp production to Kimberly-Clark. The balance of the pulp mill's output of northern bleached hardwood kraft pulp was sold to our fine paper business and paper mills in the northeastern and midwestern United States.

Northern bleached softwood kraft pulp and northern bleached hardwood kraft pulp are commodity products whose prices are subject to substantial increase or decrease depending on production capacity and customer demand. Northern bleached hardwood kraft pulp is subject to increasing competition, primarily from lower priced South American eucalyptus pulp and excess capacity of northern bleached hardwood kraft pulp.

Historically, our Pictou mill has transferred its pulp directly to Kimberly-Clark and used brokers for sales to external customers. We utilize an internal sales team to generate sales to external customers.

For the years ended December 31, 2006, 2005 and 2004, we had pulp sales to Kimberly-Clark of \$163 million, \$135 million and \$137 million, respectively. Such sales represented approximately 86%, 73% and 77% of sales for our Pulp business in 2006, 2005 and 2004, respectively. No single customer, other than Kimberly-Clark, accounted for more than 10% of our net sales in those years.

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The following table presents further information about our businesses by geographic area (dollars in millions):

	Year Ended December 31,		
	2006	2005	2004
<b>Net sales</b>			
United States	\$ 357.3	\$ 352.9	\$ 354.0
Canada	189.3	183.8	177.0
Europe	49.7		
Intergeographic Items	(2.0 )	(2.0 )	(2.2 )
Consolidated	\$ 594.3	\$ 534.7	\$ 528.8

	December 31,		
	2006	2005	2004
<b>Total Assets</b>			
United States	\$ 223.5	\$ 231.9	\$ 241.8
Canada	180.8	305.1	315.5
Europe	340.4		
Total	\$ 744.7	\$ 537.0	\$ 557.3

### Raw Materials and Energy

*Fine Paper Business.* Hardwood pulp is the primary fiber used to produce products of the fine paper business. Our fine paper business consumed approximately 54,000, 63,000 and 54,000 metric tons of hardwood pulp in 2006, 2005 and 2004, respectively. Other significant raw material inputs in the production of fine paper products include cotton fiber, recycled fiber, dyes and fillers. An interruption in our supply of pulp or cotton could adversely affect our fine paper sales. The fine paper business purchases substantially all of its raw materials externally.

*Technical Products Business.* The technical products business purchases latex, a primary raw material used to produce its products, from various suppliers. Softwood pulp, including certain specialty pulp, is the other main raw material consumed. The technical products business purchases substantially all of its raw material requirements externally. We believe that all of the raw materials for our technical products operations, except for certain specialty latex grades and specialty softwood pulp, are readily available from several sources and that the loss of a single supplier would not cause a shutdown of our manufacturing operations. An interruption in the supply of certain latex specialty grades or specialty softwood pulp, however, could disrupt and eventually cause a shutdown of production of certain technical products.

*Pulp Business.* Wood chips are the primary raw material needed to produce hardwood and softwood pulp. Our Pictou mill obtains its wood chips from several sawmills under agreements whereby Pictou supplies to the sawmills wood harvested from its own timberlands and 200,000 acres of licensed and managed land in Nova Scotia, and in return the sawmills supply wood chips to the Pictou mill. In conjunction with the sale of approximately 500,000 acres of woodlands in Nova Scotia (see Recent Developments ), we entered into a fiber supply agreement (the FSA ) with the purchaser to secure a source of fiber for our Pictou pulp mill. Pursuant to the terms of the FSA, the purchaser will make available to us sufficient woodlands acreage to yield 200,000 metric tons of softwood timber annually. Timber purchases under the FSA are at market-based prices subject to semi-annual adjustment. The FSA expires on December 31, 2010 and we have the option to unilaterally extend the contract for an additional five years. The FSA can be extended for a subsequent five years upon our mutual agreement with the purchaser. The price of wood chips can vary significantly based on the cost of logs, the strength of demand in the lumber and pulp markets and the amount of timber available for harvesting on government owned land. Other important raw materials used by our pulp mill are chemicals and supplies. Our pulp mill purchases all of its other raw materials externally.





Except for wood chips used by our pulp mill and certain specialty latex grades and specialty softwood pulp used by our technical products business, we are not aware of any significant concentration of business transacted with a particular supplier that could, if suddenly eliminated, have a material adverse affect on our operations. In 2006, two suppliers provided more than 70% of the wood chips used by the Pictou mill. While we believe that alternative sources of critical supplies, such as wood chips, would be available, disruption of our primary sources could create a temporary, adverse effect on product shipments. An interruption in the supply of a latex specialty grade or of specialty softwood pulp to our technical products business, each of which is currently obtain from a single source, could disrupt and eventually cause a shutdown of production of certain technical products.

The pulp and paper making processes use significant amounts of energy, primarily electricity, natural gas, oil, coal and bark fuel to operate the equipment and paper machines used in the manufacture of pulp and the products of the fine paper and technical products businesses. In January 2006, we entered into an agreement to purchase 350 thousand pounds per year of Green Steam to supply energy at our Neenah paper mill. We anticipate that the agreement will substantially reduce the mill's annual consumption of natural gas. We generate substantially all of our electrical energy at the Munising and Pictou mills and approximately 20 percent of the electrical energy at our Bruckmühl mill. We also purchase green-e electrical energy from external sources, including electricity generated from biomass, windpower and low impact hydropower at our Wisconsin mills.

Availability of energy is not expected to be a problem in the foreseeable future, but the purchase price of such energy can and likely will fluctuate significantly based on changes in demand and other factors.

An adequate supply of water is needed to manufacture our products. We believe that there is an adequate supply of water for this purpose at each of our manufacturing locations.

#### **Working Capital**

*Fine Paper Business.* The fine paper business maintains approximately 10 days of raw material inventories to support its paper making operations and about 40 days of finished goods inventory to fill customer orders. Its sales terms range between 20 and 30 days for payment by its customers, with 20 day terms used most often. Supplier invoices are typically paid within 30 days.

*Technical Products Business.* On average, our U.S. technical products business maintains approximately 20 days of inventory of raw materials and supplies to support its manufacturing operations and approximately 18 to 20 days of finished goods inventory to support customer orders for its products. Sales terms in the technical products business vary depending on the type of product sold and customer category. Extended credit terms of 60 days or more are typically offered to customers located in international markets. On average sales are collected in approximately 35 to 40 days. On average supplier invoices are paid within 30 days.

On average, our German technical products business maintains approximately 30 days of inventory of raw materials and supplies to support its manufacturing operations and approximately 20 days of finished goods inventory to support customer orders for its products. Sales terms in the technical products business vary depending on the type of product sold and customer category. Extended credit terms of up to 120 days are typically offered to customers located in certain international markets. On average sales are collected in approximately 45 to 50 days. On average supplier invoices are paid within 20 days.

*Pulp Business.* Our Pictou pulp mill maintains harvested log inventories on the ground for up to six months. They also maintain other raw material and supplies inventories ranging from 3 to 30 days to support their pulp making operations. The pulp mills typically maintain finished pulp inventories of 7 to 8 days to fill customer orders, and inventories related to a few grades for up to 60 days. For purchases other than wood chips, the pulp mill typically carries accounts payable at 30 to 45 day levels in accordance with various purchasing terms. Chip purchases are generally paid in 5 to 10 days from receipt. Sales terms generally range from 30 to 60 days with the majority at 45 days pursuant to the pulp supply agreement with Kimberly-Clark.



## Competition

*Fine Paper Business.* We believe our fine paper business is a leading supplier of premium writing, text, cover and specialty papers in North America. The fine paper business competes directly in this market with Mohawk Fine Papers Inc., Wausau Paper Corp. and other smaller companies. We believe the primary bases of competition for premium writing, text and cover papers are brand recognition, product quality, service, availability and promotional support, with price becoming an increasingly important factor. We have and will continue to invest in advertising and other programs aimed at graphic designers, printers and corporate end-users in order to communicate the advantages of using our products.

*Technical Products Business.* In the tapes, abrasives, transportation and other filter media, nonwovens, wall coverings, medical packaging, label and decorative components segments, our technical products business competes in global markets with a number of large multinational competitors, including ArjoWiggins S.A.S., MeadWestvaco Corporation, Hollingsworth & Vose Company, Arkwright, Inc. and Ahlstrom Corporation. It also competes in some, but not all, of these segments with smaller regional manufacturers, such as Monadnock Paper Mills, Inc., Dresden Papier GmbH and Paper Line S.p.A. We believe the bases of competition in most of these segments are the ability to design and develop customized product features to meet customer specifications while maintaining quality, customer service and price. We believe our research and development program gives us an advantage in customizing base papers to meet customer needs. Although delivered pricing has become an increasingly important factor in supplier selection, our technical products business has been able to maintain its customer base in recent years.

*Pulp Business.* The principal competitors of our pulp mill in the production of softwood and hardwood kraft pulp are Tembec, West Fraser Timber Co. Ltd, SFK Pulp Fund, Bowater Incorporated and Domtar Inc. In addition, competition in hardwood pulp is increasing from lower priced eucalyptus pulp manufacturers in South America. Most of this pulp is sold to paper mills in the eastern and midwestern United States and in Europe. The basis of competition for pulp is primarily price, including the freight cost to customer locations, pulp performance attributes and consistent quality. Pulp pricing is cyclical with increases and decreases primarily driven by general economic conditions and pulp production capacity.

## Research and Development

Our main research and development laboratory is located in Roswell, Georgia. Our domestic technical products business maintains a research and development laboratory in Munising, Michigan to support its strategy of developing new products and technologies, and to support growth in its existing product lines and other strategically important markets. Our German technical products business maintains laboratory and research and development staff at each of its manufacturing locations and dedicated application engineers for key accounts to support product development and process improvements. We have recently expanded test equipment for filter media including the construction of a nano fiber pilot plant for the testing of advanced filter media applications. We have continually invested in product research and development with spending of \$3.5 million in 2006, \$2.2 million in 2005 and \$1.5 million in 2004.

## Intellectual Property

We own more than 50 trademarks with registrations in approximately 50 countries. Our business has built its market leading reputation on trademarked brands that date back as far as 1908. The CLASSIC family of brands is one of the most well known and respected trademarks in the printing and writing industry. The CLASSIC family includes CLASSIC CREST®, CLASSIC® Laid, CLASSIC® Linen, CLASSIC COLUMNS® and CLASSIC COTTON® papers. The CLASSIC family of products with the addition of the ENVIRONMENT®, ATLAS™, OLD COUNCIL TREE® and UV/ULTRA® II brands have played an important role in the marketing of the product lines of the fine paper business, which are recognized as an industry leader for quality, consistency and printing applications.

The KIMDURA® and MUNISING LP® trademarks have made a significant contribution to the marketing of synthetic film and clean room papers of the technical products business. The Gessner® and varitess® trademarks have played an important role in the marketing of Neenah Germany product lines.

## Edgar Filing: Neenah Paper Inc - Form 10-K

We own more than 40 patents and have multiple pending patent applications in the United States, Canada, Western Europe and certain other countries covering heat transfer paper, abrasives, medical packaging and fiber modification in the pulping process. We believe our heat transfer patents have contributed to establishing the technical products business as a leading supplier of heat transfer papers.

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## Backlog and Seasonality

*Fine Paper Business.* The fine paper business has historically experienced a steady flow of orders with marginally higher sales in the first quarter due to annual report production and a slight reduction in the third quarter due to maintenance downtime. Orders for stock products are typically shipped within two days, while custom orders are shipped within two to three weeks of receipt. Raw material purchases and manufacturing schedules are planned based on a combination of historical trends, customer forecasts and current market conditions. The order backlogs in the fine paper business on December 31, 2006 and December 31, 2005 were \$4.7 million and \$4.1 million, respectively, representing eight and six days, respectively, of sales. We have previously filled the order backlog from December 31, 2005 and expect to fill the order backlog from December 31, 2006 within the current fiscal year.

*Technical Products Business.* **Historically, the technical products business has had a steady quarter to quarter shipments flow with reductions in the third quarter due to reduced customer converting schedules and in the fourth quarter due to a reduction in inventory levels by our customers. Notwithstanding relatively steady shipments from quarter to quarter, the order flow for the technical products business is subject to seasonal peaks for several of its products, such as the larger volume grades of tape, abrasives, premask, and label stock used primarily in the downstream finished goods manufacturing process. To assure timely shipments during these seasonal peaks, the technical products business has agreements with certain customers to manufacture orders and hold them in inventory for later shipment. The technical products business also manages these peaks with sales on consignment. Such sales represent less than 10% of the technical products business's annual sales. Orders are typically shipped within six to eight weeks of receipt of the order. However, the technical products business periodically experiences periods where order entry levels surge, and order backlogs can increase substantially. Raw materials are purchased and manufacturing schedules are planned based on customer forecasts, current market conditions and individual orders for custom products. The order backlog in the technical products business on December 31, 2006 was approximately \$60 million and represented approximately 16 percent of estimated prior year sales annualized to include the results of Neenah Germany for a full year. The order backlogs in the technical products business on December 31, 2005 was approximately \$17 million and represented approximately 12 percent of prior year sales.** We have previously filled the order backlog from December 31, 2005 and expect to fill the order backlog from December 31, 2006 within the current fiscal year.

*Pulp Business.* Our Pictou pulp mill has historically taken a 10 to 14-day shutdown each year for major maintenance, thereby reducing pulp shipments in the quarter in which the shutdown occurs. In 2006, the maintenance shutdown at the Pictou mill was taken in October. Customer order patterns are consistent, except for a moderate reduction in European orders in the summer. In North America, orders are generally placed one month in advance, while European orders are based on a three-month rolling forecast.

## Employee and Labor Relations

As of December 31, 2006, we had approximately 1,900 regular full-time employees of whom 620 hourly and 280 salaried employees were located in the United States, 230 hourly and 80 salaried employees were located in Canada, and 450 hourly and 260 salaried employees were located in Germany.

Hourly employees at the Pictou pulp mill are represented by the Communications, Energy and Paperworkers Union of Canada. The collective bargaining agreement for the Pictou mill expires in May 2009.

Hourly employees at the Neenah, Whiting and Munising paper mills are represented by the United Steelworkers Union (the USW). The collective bargaining agreements for the Neenah, Whiting and Munising paper mills expire on February 1, 2009, July 1, 2009 and July 15, 2009, respectively. Additionally, these mills have bargained jointly with the union on pension matters. The agreements on pension matters for these mills expire in June 2007.

## Edgar Filing: Neenah Paper Inc - Form 10-K

Approximately 50 percent of salaried employees and 80 percent of hourly employees of Neenah Germany are eligible to be represented by the Mining, Chemicals and Energy Trade Union, Industriegewerkschaft Bergbau, Chemie and Energie (the IG BCE ). Union membership is voluntary, and under German law does not need to be disclosed to the Company. As a result, the number of employees covered by the collective bargaining agreement that expired on February 28, 2007 cannot be determined. The collective bargaining agreement covering union employees of Neenah Germany is negotiated by the IG BCE and a national trade association representing all employers in the industry. The collective bargaining agreement between the IG BCE and the national trade association expired on February 28, 2007. Negotiations on a new contract have not begun; however, we believe that expiration of the collective bargaining agreement will not result in a work stoppage.

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### **Environmental, Health and Safety Matters**

Our operations are subject to federal, state, provincial and local laws, regulations and ordinances relating to various environmental, health and safety matters. Our operations are in compliance with, or we are taking actions designed to ensure compliance with, these laws, regulations and ordinances. However, the nature of our operations exposes us to the risk of claims concerning non-compliance with environmental, health and safety laws or standards, and there can be no assurance that material costs or liabilities will not be incurred in connection with those claims. Except for certain orders issued by environmental, health and safety regulatory agencies with which we believe we are in compliance and which we believe are immaterial to our financial condition, results of operations and liquidity, we are not currently named as a party in any judicial or administrative proceeding relating to environmental, health and safety matters.

While we have incurred in the past several years, and will continue to incur, capital and operating expenditures in order to comply with environmental, health and safety laws, regulations and ordinances, we believe that our future cost of compliance with environmental, health and safety laws, regulations and ordinances, and our exposure to liability for environmental, health and safety claims will not have a material adverse effect on our financial condition, results of operations or liquidity. However, future events, such as changes in existing laws and regulations, or contamination of sites owned, operated or used for waste disposal by us (including currently unknown contamination and contamination caused by prior owners and operators of such sites or other waste generators) may give rise to additional costs which could have a material adverse effect on our financial condition, results of operations or liquidity.

**We incur capital expenditures necessary to meet legal requirements and otherwise relating to the protection of the environment at our facilities in the United States and internationally. For these purposes, we have planned capital expenditures for environmental projects during the period 2007 through 2010 of approximately \$2 million to \$3 million annually. Following the completion of engineering studies and negotiations with local authorities and other interested parties in Canada, we do not currently anticipate any material capital expenditures would be required at the Pictou mill related to the effluent treatment system, total sulphur emissions or other environmental matters until 2009 or later. Our anticipated capital expenditures for environmental projects are not expected to have a material adverse effect on our financial condition, results of operations or liquidity.**

**AVAILABLE INFORMATION**

We are subject to the reporting requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934. As such, we file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ( SEC ). Our SEC filings are available to the public over the Internet at the SEC s web site at [www.sec.gov](http://www.sec.gov). You may also read and copy any document we file at the SEC s public reference room in Washington, D.C., 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our common stock is traded on the New York Stock Exchange under the symbol NP. You may inspect the reports, proxy statements and other information concerning us at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

Our web site is [www.neenah.com](http://www.neenah.com). Our reports on Form 10-K, Form 10-Q and Form 8-K, as well as amendments to those reports, are and will be available free of charge on our web site as soon as reasonably practicable after we file or furnish such reports with the SEC. In addition, you may request a copy of any of these reports (excluding exhibits) at no cost upon written request to us at: Investor Relations, Neenah Paper, Inc., 3460 Preston Ridge Road, Suite 600, Alpharetta, Georgia 30005.

**Item 1A. Risk Factors**

*You should carefully consider each of the following risks and all of the other information contained in this Annual Report on Form 10-K. Some of the risks described below relate principally to our business and the industry in which we operate, while others relate principally to our indebtedness and separation from Kimberly-Clark. The remaining risks relate principally to the securities markets generally and ownership of our common stock.*

*Our business, financial condition, results of operations or liquidity could be materially adversely affected by any of these risks, and, as a result, the trading price of our common stock could decline. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.*



## **Risks Related to Our Business and Industry**

*Our pulp business operates in a cyclical industry which can have an impact on our operating results.*

Wood pulp is a commodity for which there are multiple other suppliers. Typically, commodities businesses compete primarily on the basis of price and availability. The revenues from producing a commodity tend to be cyclical, with periods of shortage and rapidly rising prices leading to increased production and increased industry investment until supply exceeds demand. Those periods are then typically followed by periods of reduced prices and excess and idle capacity until the cycle is repeated.

The following chart shows price information for northern bleached softwood kraft pulp from 1980 to 2006 and illustrates the cyclical nature of the pulp industry:

### **Pulp Price Trends**

#### **Northern Bleached Softwood Kraft Pulp**

Source: Resource Information Systems, Inc.

The markets and profitability of pulp have been, and are likely to continue to be, cyclical. Accordingly, we must continuously and effectively manage our production and capacity to be able to respond effectively to business cycles in the pulp industry. We use hedging arrangements to reduce our exposure to pulp price fluctuations, although these arrangements could result in us incurring higher costs than we would incur without the arrangements.

*If we are unable to effectively respond to the significant challenges faced by our pulp business, which has experienced losses in recent periods, our financial condition, results of operations and cash flows will be materially and adversely affected.*

We expect that our pulp business will continue to face a number of significant challenges relating to, among other things, the cyclical nature of the pulp industry (as described in the risk factor above), our cost structure and other factors.



Because our pulp business competes primarily on the basis of price and availability, the financial success of our pulp mill depends on its ability to produce pulp at a competitive cost. Our ability to contain or reduce costs at our pulp mills is significant to our business.

If our pulp business had been operated on a stand-alone basis during 2004 (prior to the Spin-Off) and if transfers of pulp to Kimberly-Clark in those years had reflected the prices at which we are selling pulp to Kimberly-Clark after the Spin-Off, we estimate that our pulp business would have reported negative gross profit of approximately \$19 million in 2004. The negative pro forma gross profit in 2004 would have represented a decrease in our gross profit of about \$26 million. The decrease in gross profit would have resulted from the resulting prices at which we would have sold pulp to Kimberly-Clark during those years.

*Fluctuations in currency exchange rates could adversely affect our results.*

Changes in the Canadian dollar exchange rate relative to the U.S. dollar have an effect on our results of operations and cash flows. Exchange rate fluctuations for the Canadian dollar can have a material impact on our financial results because substantially all of our pulp mill's expenses are incurred in Canadian dollars and our pulp revenues are denominated in U.S. dollars. For example, in 2006, a hypothetical \$0.01 increase in the Canadian dollar relative to the U.S. dollar would have decreased our income before income taxes by more than \$2 million, excluding additional currency remeasurement losses. We anticipate continued strength for the Canadian dollar relative to the U.S. dollar.

Exchange rate fluctuations for the Euro do not have a material effect on the operations or cash flows of our German technical products business. Our German technical products business incurs substantially all of its costs and sells most of its production in Europe and, therefore, its operations and cash flows are not materially affected by changes in the exchange rate of the Euro relative to the U.S. dollar. Changes in the Euro exchange rate relative to the U.S. dollar will, however, have an effect on our reported results of operations.

We use hedging arrangements to reduce our exposure to Canadian dollar exchange rate fluctuations, although these arrangements could result in us incurring higher costs than we would incur without the arrangements.

The following chart shows changes in the U.S./Canadian dollar exchange rate from 1980 to 2006:

**U.S. \$/Canadian \$ Exchange Rate History**

Source: Resource Information Systems, Inc.

In addition, because we transact business in other foreign countries, some of our revenues and expenses are denominated in a currency other than the local currency of our operations. As a result, changes in exchange rates between the currency in which the transaction is denominated and the local currency of our operations into which the transaction is being recorded can impact the amount of local currency recorded for such transaction. This can result in more or less local currency revenues or costs related to such transaction, and thus have an effect on our reported income before income taxes.

***The availability of and prices for raw materials and energy will significantly impact our business.***

We purchase a substantial portion of the raw materials and energy necessary to produce our products on the open market, 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 and government regulation. We do not have significant influence over our raw material or energy prices and generally do not possess enough power to pass increases in those prices along to purchasers of our products, unless those increases coincide with increased demand for the product. Therefore, raw material or energy prices could increase at the same time that prices for our products are decreasing. In addition, we may not be able to recoup other cost increases we may experience, such as those resulting from inflation or from increases in wages or salaries or increases in health care, pension or other employee benefits costs, insurance costs or other costs.

We obtain a portion of the wood fiber required for our Pictou pulp mill from timberland areas licensed by the Nova Scotia provincial government. The government has granted us non-exclusive licenses for substantial timberland areas from which we obtain fiber, and we also obtain fiber harvested from timberland areas licensed to others by this government. There can be no assurance that the amount of fiber that we are allowed to harvest from these licensed areas will not be decreased, or that our licenses will continue to be renewed or extended by the governments on acceptable terms. In the area where our Pictou pulp mill is located, there is increasing competition for wood fiber from various other users. Concerns over the sustainability of forestry practices may also lead to reductions in the timberlands available for harvest to supply our pulp mill. In addition, aboriginal groups have made land claims against various levels of government which, if successful, would further reduce the timberlands from which wood could be harvested for our mill. Changes in governmental practices and policies as they apply to us and to others from whom we obtain fiber also may result in less fiber being available, increased costs to obtain the fiber and additional expense in meeting forestry and silviculture standards. These results could have a material adverse effect upon our financial position, liquidity and results of operations.

In addition, in 2006, two suppliers provided over 70% of the wood chips used by the Pictou mill. While we believe that alternative sources of critical supplies, such as wood chips, would be available, disruption of our primary sources could create a temporary, adverse effect on product shipments. Also, an interruption in supply of a latex specialty grade or of specialty softwood pulp to our technical products business, each of which we currently obtain from a single source, could disrupt and eventually cause a shutdown of production of certain technical products.

***Our pulp mill may experience unexpected or prolonged shutdowns, which would adversely affect our financial position, results of operations and cash flows.***

Our Pictou pulp mill requires annual shutdowns to perform major maintenance because it normally operates continuously. We generally schedule shutdowns of two weeks each year at the mill. The annual scheduled shutdown impacts our profitability and cash flow in the fiscal quarter in which the shutdown occurs. The annual maintenance shutdown at Pictou occurred in October 2006, which resulted in substantially lower operating results and lower production volumes in that month. In addition to scheduled shutdowns, as described above, depressed pulp prices may cause the pulp mill to shut down for a period of time if pulp prices fall to a level where it would be uneconomic to operate.

Unexpected production disruptions could also cause us to shut down the mill. Those disruptions could occur due to any number of circumstances, including shortages of raw materials, disruptions in the availability of transportation, labor disputes and mechanical or process failures. Specifically, the failure of our recovery boiler would result in a significant disruption to our business.

If our Pictou mill is shut down, it may experience 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. The annual pulp mill maintenance shutdown at Pictou is scheduled to occur in May 2007. The shutdown of the mill for a substantial period of time for any reason could have a material adverse effect on our financial position, cash flows and results of operations.

***The results of our pulp business will depend on our pulp supply agreement with Kimberly-Clark and our ability to supply other customers.***

The results of our pulp business prior to the Spin-Off were based almost entirely on pulp transfers to Kimberly-Clark. Kimberly-Clark is our largest customer and purchases pulp from us pursuant to the terms of a pulp supply agreement. If the pulp supply agreement were to be terminated, our financial condition, cash flows and results of operations would be materially and adversely affected.

We have begun to supply increasing quantities of pulp to customers other than Kimberly-Clark. The success of our pulp business will depend in part upon our ability to effectively market our pulp to new customers, to earn customer acceptance of our pulp and to continue to effectively supply those new customers. If we are unable to effectively market our pulp to customers other than Kimberly-Clark, our financial condition, results of operations and liquidity would be materially and adversely affected.

***Our business will suffer if we are unable to effectively respond to decreased demand for some of our products.***

We have experienced and may continue to experience decreased demand for some of our existing products. For example, our fine paper business has experienced decreased demand as a result of the growing use of digital and electronic communications media, while our technical products business must cope with a trend to replace durable papers with synthetic films. Our pulp business must compete with an increasing supply of, and in some cases customer preference for, lower priced eucalyptus pulps produced by competitors in the southern hemisphere. If we are unable to implement our business strategies to develop new sources of demand to effectively respond to decreased demand for our existing products, our financial position, cash flows and results of operations would be adversely affected.

***The terms of our pulp supply agreement with Kimberly-Clark may require us, at times, to sell pulp at prices that are lower than the prices at which we may be able to sell pulp to other customers.***

Our pulp supply agreement with Kimberly-Clark requires us to supply and Kimberly-Clark to purchase pulp from our pulp mill through 2008, subject to early termination provisions and the two year phase-down period discussed below. The prices at which we sell pulp to Kimberly-Clark under the supply agreement reflect a discount from published industry index prices that may be greater or less than the discount reflected in sales to other customers. The pulp supply agreement also contains minimum and maximum prices for northern bleached softwood kraft pulp shipped to North America prior to December 31, 2007, which may result in us charging Kimberly-Clark prices that are lower than those we could obtain from other customers.

In August 2006, the Company and Kimberly-Clark entered into an amended and restated pulp supply agreement (as amended and restated, the Pulp Supply Agreement), pursuant to which we agreed to supply and Kimberly-Clark agreed to purchase annually specified tonnages of northern bleached softwood and hardwood kraft pulp, except to the extent excused by a Force Majeure Event. For 2006, the commitment for northern bleached softwood kraft pulp was 322,000 metric tons. For 2007 and, 2008 and any subsequent years, the commitment is 365,000 metric tons and 345,000 metric tons, respectively. These tonnages have been and will be supplied to Kimberly-Clark by our Pictou Pulp mill and, on a pass-through basis, by our former Terrace Bay pulp mill (the Terrace Bay Mill) which we sold to Terrace Bay Pulp Inc. (TBPI) in August 2006. TBPI has agreed to perform substantially all of our obligations under the Pulp Supply Agreement and, together with three of its affiliated companies, to indemnify and hold the Company harmless for any claims arising from the Terrace Bay Mill's failure to so perform. In addition, our commitment to supply northern bleached hardwood kraft pulp from the Pictou Mill for 2006, 2007 and 2008 was 14,000, 20,000 and 10,000 metric tons, respectively.

The Pulp Supply Agreement may be partially terminated as to the Terrace Bay Mill portion of the pulp supply by either Kimberly-Clark or us giving a reduction notice on June 29, 2007. If either we or Kimberly-Clark gives such a notice, then the Terrace Bay portion of the contract will cease on or about June 30, 2008, unless an earlier termination date is otherwise agreed upon by the parties. A June 30, 2008 termination of the Terrace Bay portion of the Pulp Supply Agreement would cancel the pass-through sales agreement between us and TBPI with respect to the Terrace Bay Mill, but does not terminate our supply arrangements with Kimberly-Clark for pulp manufactured at the Pictou Mill.

Either party can elect a two-year phase-down period for the agreement, to begin no earlier than January 1, 2009, under which the commitments for northern bleached softwood kraft pulp in the first and second years of the phase-down period would be 225,000 and 150,000 metric tons, respectively. If either company were to choose to terminate the Terrace Bay portion of the Pulp Supply Agreement pursuant to a reduction notice, the phase-down commitments in the first and second years would be 165,000 and 101,000 metric tons, respectively. Either the Company or Kimberly-Clark may terminate the pulp supply agreement for certain events specified in the agreement, including a material breach of the agreement by the other party that is not cured after 30 days' notice, insolvency or bankruptcy of the other party, or a fundamental change in the nature of the business of the other party that may substantially affect its ability to sell or to purchase or utilize pulp under the agreement. In addition, Kimberly-Clark may terminate the agreement if the ownership or control of the Company or any of its pulp production facilities becomes vested in or is made subject to the control or direction of, any direct competitor of Kimberly-Clark or any governmental or regulatory authority or any other third party, who in Kimberly-Clark's reasonable judgment may not be able to reliably perform the Company's obligations under the agreement. Kimberly-Clark may also terminate the agreement upon one year's notice if, as a result of the Company's forestry activities, continued use of the Company's pulp by Kimberly-Clark does or, in Kimberly-Clark's reasonable judgment is likely to, result in a substantial loss of sales of Kimberly-Clark's products or to otherwise materially and adversely affect the reputation of Kimberly-Clark or its products. Kimberly-Clark may also terminate the agreement upon 180 days notice that the Company's failure to comply with United States customs requirements jeopardizes Kimberly-Clark customs certification.

The preceding description is a summary of the principal provisions of the PSA Amendment and is qualified in its entirety by the PSA Amendment.

Under the Pulp Supply Agreement, the prices for northern bleached softwood kraft pulp and northern bleached hardwood kraft pulp will be based on published industry index prices for the pulp (subject to minimum and maximum prices for northern bleached kraft softwood pulp shipped to North America prior to December 31, 2007), less agreed upon discounts. The commitments are structured as supply-or-pay and take-or-pay arrangements. Accordingly, if we do not supply the specified minimums, we must pay Kimberly-Clark for the shortfall based on the difference between the contract price and any higher price that Kimberly-Clark pays to purchase the pulp, plus 10% of that difference. If Kimberly-Clark does not purchase the specified minimums, Kimberly-Clark must pay for the shortfall based on the difference between the contract price and any lower price we obtain for the pulp, plus 10% of the difference. If such an event were to occur, our business could be materially adversely affected.

***Our activities are subject to extensive government regulation, which could increase our costs, cause us to incur liabilities and adversely affect the manufacturing and marketing of our products.***

Our operations are subject to federal, state, provincial and local laws, regulations and ordinances in both the United States and Canada relating to various environmental, health and safety matters. The nature of our operations requires that we invest capital and incur operating costs to comply with those laws, regulations and ordinances and exposes us to the risk of claims concerning non-compliance with environmental, health and safety laws or standards. We cannot assure that significant additional expenditures will not be required to maintain compliance with, or satisfy potential claims arising from, such laws, regulations and ordinances. Future events, such as changes in existing laws and regulations or contamination of sites owned, operated or used for waste disposal by us (including currently unknown contamination and contamination caused by prior owners and operators of such sites or other waste generators) may give rise to additional costs that could require significantly higher capital expenditures and operating costs, which would reduce the funds otherwise available for operations, capital expenditures, future business opportunities or other purposes. For example, the ratification of the Kyoto Protocol by Canada may result in lower limits for the emission of carbon dioxide and other greenhouse gases. The specific limitations with respect to our Canadian operations are unknown and uncertain and may result in increased costs.

***The outcome of legal actions and claims may adversely affect us.***

We are involved in legal actions and claims arising in the ordinary course of our business. The outcome of such legal actions and claims against us cannot be predicted with certainty. The legal actions and claims against us could have a material adverse effect on our financial condition, results of operations and liquidity. See Item 3 – Legal Proceedings.

***We have significant obligations for pension and other post-employment benefits.***

We have significant obligations for pension and other post-employment benefits which could require future funding beyond that which we have funded in the past or which we currently anticipate. At December 31, 2006, our projected pension benefit obligations exceeded the fair value of pension plan assets by approximately \$69 million. In 2006 total contributions to our pension trust were \$24.2 million, including \$10.8 million to purchase annuity contracts to settle pension liabilities with current retirees in our Ontario, Canada defined benefit pension plan. At December 31, 2006, our projected other post-employment benefit obligations were \$40.0 million. No assets have been set aside to satisfy our other post-employment benefit obligations. In 2006, payments for other post-employment benefits were \$2.3 million. A material increase in funding requirements or benefit payments could have a material adverse effect on our cash flows.

***Labor interruptions would adversely affect our business.***

All of our hourly paid employees are unionized. In addition, some of our key customers and suppliers are also unionized. Strikes, lockouts or other work stoppages or slow downs involving our unionized employees could have a material adverse effect on us.

***Our operating results are likely to fluctuate.***

Our operating results are subject to substantial quarterly and annual fluctuations due to a number of factors, many of which are beyond our control. Such factors may include, among others, the relative strength of the Canadian dollar and Euro versus the U.S. dollar, changes in the market price of pulp, the effects of competitive pricing pressures, changes in average selling prices of our products, production capacity levels and manufacturing yields, availability and cost of products from our suppliers, the gain or loss of significant customers, our ability to develop, introduce and market new products and technologies on a timely basis, changes in the mix of products produced and sold, seasonal customer demand and environmental costs. Operating results also could be adversely affected by increasing interest rates and other general economic conditions causing a downturn in the market for paper products. The foregoing factors are difficult to forecast, and these or other factors could materially adversely affect our quarterly or annual operating results.

***We face many competitors, several of which have greater financial and other resources.***

We face competition in each of our business segments 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. Many of our competitors have greater financial, sales and marketing, or research and development resources than we do. Greater financial resources and product development capabilities may also allow our competitors to respond more quickly to new opportunities or changes in customer requirements.

***We may fail to realize the anticipated cost savings, revenue enhancements and other benefits expected from our recent acquisitions, which could adversely affect the value of our shares of common stock.***

In October 2006, through a newly created wholly-owned subsidiary, Neenah Paper International, LLC, we acquired the outstanding interests of FiberMark Services GmbH & Co. KG ( FiberMark KG ) and the outstanding interests of FiberMark Beteiligungs GmbH (together with FiberMark KG, Neenah Germany ). In March 2007, we acquired the Fox Valley Corporation, which owns Fox River Paper Company, LLC ( Fox River ). These acquisitions require the integration of companies that have previously operated independently. We acquired Neenah Germany with the expectation that, among other things, the acquisition would provide the two companies technical products businesses with added scale in the marketplace, better prospects for growth, and the ability to offer a broader array of premium products and better service to our customers. We acquired Fox River with the expectation that, among other things, the acquisition would provide the two companies fine paper businesses with added scale in the marketplace, better prospects for growth, and the ability to offer a broader array of premium branded products and better service to our customers. We also expect to realize cost savings from combining our operations and product portfolio with Fox River and Neenah Germany.



The value of our common shares in the future may be affected by the ability of the combined company to achieve the benefits expected to result from these acquisitions. Achieving the benefits of the acquisitions will depend, in part, upon meeting the challenges inherent in the successful integration of business enterprises of the size and scope of Neenah Germany and Fox River and the possible resulting diversion of management attention for an extended period of time. There can be no assurance that we will meet these challenges and that such diversion will not negatively impact our operations.

*We have incurred expenses related to the integration of Neenah Germany and Fox River, and we expect to incur additional substantial expenses related to the continued integration of Neenah Germany and Fox River as a result of the merger.*

We have incurred, and continue to incur, expenses in connection with the integration of the businesses, policies, procedures, operations, technologies, systems and personnel of Neenah Germany and Fox River. There are a number of systems that must be integrated, including management information, purchasing, accounting and finance, sales, billing, payroll and benefits and fixed asset systems and regulatory compliance. While we have anticipated that a certain level of expenses would be incurred, there are a number of factors beyond our control that could affect the total amount or the timing of the expected integration expenses. These expenses could, particularly in the near term, exceed the savings that we expect to achieve from the elimination of duplicative expenses and the realization of economies of scale and cost savings and revenue synergies related to the integration of the businesses. These integration expenses could result in us taking both cash and non-cash charges against earnings. The amount and timing of any such charges are uncertain at present.

#### **Risks Relating to Our Indebtedness**

*We incurred significant indebtedness in connection with the Spin-Off, which subjected us to restrictive covenants relating to the operation of our business.*

As of December 31, 2006, we had \$225 million of senior notes outstanding. In addition, our borrowing base under our revolving credit agreement was \$153 million and \$57.3 million of borrowings were outstanding. Our leverage could have important consequences. For example, it could:

- make it difficult for us to satisfy our financial obligations, including making scheduled principal and interest payments on the notes and our other indebtedness;
- place us at a disadvantage to our competitors;
- require us to dedicate a substantial portion of our cash flow from operations to service payments on our indebtedness, thereby reducing funds available for other purposes;
- increase our vulnerability to a downturn in general economic conditions or the industry in which we operate;
- limit our ability to obtain additional financing for working capital, capital expenditures, acquisitions and general corporate and other purposes; and
- limit our ability to plan for and react to changes in our business and the industry in which we operate.

The terms of our indebtedness, including the revolving credit facility and the indenture governing the notes, contain covenants restricting our ability to, among other things, incur certain additional debt, make specified restricted payments and capital expenditures, authorize or issue capital stock, enter into transactions with our affiliates, consolidate or merge with or acquire another business, sell certain of our assets or liquidate, dissolve or wind-up our company. In addition, the terms of our revolving credit facility require us to achieve and maintain certain specified financial ratios. These restrictions may limit our ability to engage in activities which could expand our business, including obtaining future financing, making needed capital expenditures or taking advantage of business opportunities such as strategic acquisitions and dispositions.

Our revolving credit facility accrues interest at variable rates. As of December 31, 2006, we had \$165 million of capacity under our revolving credit facility. Availability under the credit facility will fluctuate over time depending on the value of our inventory, receivables and various capital assets. At December 31, 2006, we had \$57.3 million of borrowings outstanding, \$2.8 million in outstanding letters of credit and \$88.2 million of remaining availability. We may reduce our exposure to rising interest rates by entering into interest rate hedging arrangements, although those arrangements may result in us incurring higher interest expenses than we would incur without the arrangements. If interest rates increase in the absence of such arrangements, we will need to dedicate more of our cash flow from operations to make payments on our debt. For more information on our liquidity, see Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

***Our revolving credit agreement is secured by substantially all of our North American assets.***

Our revolving credit agreement, as amended, is secured by substantially all of our North American assets, including the capital stock of our subsidiaries and is guaranteed by Neenah Paper Company of Canada, a wholly owned subsidiary. Neenah Germany is not a borrower or guarantor with respect to the revolving credit agreement. However, we pledged 65% of our equity interest in Neenah Germany as security for our obligations under the revolving credit agreement.

Availability under our revolving credit facility will fluctuate over time depending on the value of our inventory, receivables and various capital assets. An extended work stoppage could result in a decrease in the value of the assets securing our credit facility. A reduction in availability under the revolving credit facility could have a material adverse effect on our liquidity.

***Our failure to comply with the covenants contained in our revolving credit facility or the indenture governing the notes could result in an event of default that could cause acceleration of our indebtedness.***

Our failure to comply with the covenants and other requirements contained in the indenture governing the notes, our revolving credit facility or our other debt instruments could cause an event of default under the relevant debt instrument. The occurrence of an event of default 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 or cash flows may not be sufficient to fully repay borrowings under our outstanding debt instruments, and we may be unable to refinance or restructure the payments on indebtedness on favorable terms, or at all.

***Despite our indebtedness levels, we and our subsidiaries may be able to incur substantially more indebtedness, which may increase the risks created by our substantial indebtedness.***

Because the terms of our revolving credit facility and the indenture governing the notes do not fully prohibit us or our subsidiaries from incurring additional indebtedness, we and our subsidiaries may be able to incur substantial additional indebtedness in the future, some of which may be secured. If we or any of our subsidiaries incur additional indebtedness, the related risks that we and they now face may intensify.

***We may not be able to generate a sufficient amount of cash flow to meet our debt obligations, including the notes.***

Our ability to make scheduled payments or to refinance our obligations with respect to the notes, our other debt and our other liabilities will depend on our financial and operating performance, which, in turn, is subject to prevailing economic conditions and to certain financial, business and other factors beyond our control. If our cash flow and capital resources are insufficient to fund our debt obligations and other liabilities, we could face substantial liquidity problems and may be forced to reduce or delay scheduled expansions and capital expenditures, sell material assets or operations, obtain additional capital or restructure our debt. We cannot assure that our operating performance, cash flow and capital resources will be sufficient to repay our debt in the future. In the event that we are required to dispose of material assets or operations or restructure our debt to meet our debt and other obligations, we can make no assurances as to the terms of any such transaction or how quickly any such transaction could be completed.

If we cannot make scheduled payments on our debt, we will be in default and, as a result:

- our debt holders could declare all outstanding principal and interest to be due and payable;
- our senior secured lenders could terminate their commitments and commence foreclosure proceedings against our assets; and
- we could be forced into bankruptcy or liquidation.

If our operating performance declines in the future or we breach our covenants under the revolving credit facility, we may need to obtain waivers from the required lenders under our revolving credit facility to avoid being in default. We may not be able to obtain these waivers. If this occurs, we would be in default under the revolving credit facility.

***We depend on our subsidiaries to generate cash flow to meet our debt service obligations, including payments on the notes.***

We conduct a substantial portion of our business through our subsidiaries. Consequently, our cash flow and ability to service our debt obligations, including the notes, depend upon the earnings of our subsidiaries and the distribution of those earnings to us, or upon loans, advances or other payments made by these entities to us. The ability of these entities to pay dividends or make other payments or advances to us will be subject to applicable laws and contractual restrictions contained in the instruments governing their debt, including our revolving credit facility and the indenture governing the notes. These limitations are also subject to important exceptions and qualifications.

The ability of our subsidiaries to generate sufficient cash flow from operations to allow us to make scheduled payments on our debt, including the notes, will depend upon their future financial performance, which will be affected by a range of economic, competitive and business factors, many of which are outside of our control. If our subsidiaries do not generate sufficient cash flow from operations to help us satisfy our debt obligations, including payments on the notes, we may have to undertake alternative financing plans, such as refinancing or restructuring our debt, selling assets, reducing or delaying capital expenditures or seeking to raise additional capital. Refinancing may not be possible, and any assets may not be able to be sold, or, if sold, we may not realize sufficient amounts from those sales. Additional financing may not be available on acceptable terms, if at all, or we may be prohibited from incurring it, if available, under the terms of our various debt instruments then in effect. Our inability to generate sufficient cash flow to satisfy our debt obligations or to refinance our obligations on commercially reasonable terms would have an adverse effect on our business, financial condition and results of operations, as well as on our ability to satisfy our obligations on the notes. The amount of earnings that our operating subsidiaries are able to distribute to us as dividends, or otherwise, may not be adequate for us to service our debt obligations.

**Risks Related to the Spin-Off and Our Separation from Kimberly-Clark**

***Our historical financial data, prior to the Spin-Off, is not representative of our results as a separate company and, therefore, will not be reliable as an indicator of our future performance.***

The historical combined financial data we have included in this Annual Report present the results of operations and financial position of the businesses transferred to us as they were historically operated by Kimberly-Clark. Accordingly, this data is not indicative of our future performance and does not reflect what our financial position and results of operations would have been had we operated as a separate, independent company during the periods presented. This is because, among other things:

- our pulp mill now supplies pulp to Kimberly-Clark on terms that are significantly different from the terms in place prior to the Spin-Off;
- we now supply pulp to other customers instead of supplying more than 90% of our production to Kimberly-Clark;
- for periods presented prior to the Spin-Off, we have made adjustments and allocations, primarily with respect to corporate and administrative costs, because Kimberly-Clark did not account for us as, and we were not operated as, a single, stand-alone business;
- the information does not reflect changes resulting from our separation from Kimberly-Clark, including taxes, capital spending projects, employee and transition services matters, the establishment of new offices and certain

ongoing incremental expenses such as selling, general and administrative expenses; and

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- we are incurring interest expense related to the issuance of \$225 million principal amount of 7.375% senior notes due 2014 and our entry into a credit agreement that, as amended, provides for up to \$180 million of secured borrowings.

For additional information about our past financial performance, see Selected Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited and unaudited historical consolidated and combined financial statements included elsewhere in this Annual Report.

***We could incur significant tax liabilities if the Spin-Off becomes a taxable event.***

Kimberly-Clark received a private letter ruling from the U.S. Internal Revenue Service regarding the U.S. federal income tax consequences of the Spin-Off substantially to the effect that, for U.S. federal income tax purposes, the transfer of the Pulp and Paper business to us by Kimberly-Clark and the distribution of our common stock qualified as a tax-free transaction under Sections 368(a)(1)(D) and 355 of the Internal Revenue Code of 1986, as amended. Although the private letter ruling is generally binding on the Internal Revenue Service, if the factual representations and assumptions made in the private letter ruling were incorrect in any material respect at the time of the Spin-Off, the private letter ruling could be retroactively revoked or modified by the Internal Revenue Service. If, notwithstanding the private letter ruling, the Spin-Off is determined to be a taxable transaction, our stockholders and Kimberly-Clark could be subject to significant U.S. federal income tax liability.

The Spin-Off could become taxable as a result of actions or events that occur after the Spin-Off. In that case, we and Kimberly-Clark could be liable for, and we could be required to indemnify and pay Kimberly-Clark for, taxes and resulting liabilities imposed upon Kimberly-Clark stockholders with respect to the Spin-Off. As part of the Spin-Off, we entered into a tax sharing agreement with Kimberly-Clark that allocated between Kimberly-Clark and us the taxes and liabilities relating to any failure of the Spin-Off to be tax-free.

Although the taxes described above generally would be imposed on Kimberly-Clark and its stockholders, under the tax sharing agreement, we may be required to indemnify Kimberly-Clark for all or a portion of these taxes. In addition, under U.S. federal income tax laws, we and Kimberly-Clark would both be liable for Kimberly-Clark's U.S. federal income taxes resulting from the Spin-Off being taxable even though Kimberly-Clark may be required under the tax sharing agreement to indemnify us for such taxes. If we were to be required to indemnify Kimberly-Clark for taxes incurred as a result of the Spin-Off being taxable, or were otherwise liable for and required to pay such taxes and were not indemnified for such taxes, it would have a material adverse effect on our profitability and financial condition.

***We may not realize potential benefits from our separation from Kimberly-Clark.***

We cannot assure that we will realize the potential benefits that we expected from our separation from Kimberly-Clark. In addition, we will incur significant costs, which may be greater than those for which we have planned, and we will bear the negative effects of our separation from Kimberly-Clark, including loss of access to the financial, managerial and professional resources from which we have benefited in the past.

In January 2006, we terminated substantially all of the services provided by Kimberly-Clark pursuant to a corporate services agreement under which we were dependent upon them as an outsourced service provider for certain transition services. These services included, among others, certain employee benefits administration and payroll, management information systems, purchasing and certain accounting functions. Substantially all of the services formerly provided by Kimberly-Clark are now being performed by Neenah personnel. These include, but are not limited to, management information systems, purchasing and certain accounting functions. To facilitate this transition, we acquired and implemented enterprise resource planning software. In addition, certain employee benefits administration and payroll services have been outsourced to a third party service provider. Failure to successfully transition these services from Kimberly-Clark could have a material adverse effect on our operations.

***We may not be able to fund our future capital requirements internally or obtain third-party financing.***

We may be required or choose to obtain additional debt or equity financing to meet our future working capital requirements, as well as to fund capital expenditures and acquisitions. To the extent we must obtain financing from external sources to fund our capital requirements, we cannot guarantee financing will be available on favorable terms, if at all.



*We may experience increased costs resulting from decreased purchasing power, which could decrease our overall profitability.*

Prior to our Spin-O