

Neenah Paper Inc
Form 10-Q/A
September 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **June 30, 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)

(678) 566-6500

(Registrant's telephone number, including area code)

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 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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 31, 2006, there were 14,774,831 shares of the Company's common stock outstanding.

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EXPLANATORY NOTE

This 10-Q/A is being filed for the purpose of amending Items 1 and 2 of Part I of Form 10-Q to reflect the guidance the Company received from the Office of the Chief Accountant of the Securities and Exchange Commission (the SEC Staff) with respect to the accounting for the Company's sale of woodlands in the three months ended June 30, 2006 (See Note 3. Sale of Woodlands). The guidance provided by the SEC Staff resulted in no changes to the Company's previously filed financial statements included in its Quarterly Report on Form 10-Q for the period ended June 30, 2006. As a result, the aforementioned Items have been revised to remove the discussion of the unresolved accounting question and the possible consequences thereof to the Company. Specifically, we have removed the discussion of the unresolved accounting question from Note 3 to the Financial Statements (Note 3) and from "Management's Discussion and Analysis of Financial Condition and Results of Operations - Executive Summary - Sale of Woodlands" and revised such items to reflect the guidance from the SEC Staff. Except for such revisions, the disclosure appearing in the Form 10-Q originally filed on August 9, 2006 is unchanged by this Form 10-Q/A.

All information in this Form 10-Q/A is as of June 30, 2006 and does not reflect any subsequent information or events. Except as described above, all other Items of the original filing made on August 9, 2006 are unaffected by the changes described above and have not been repeated in this Amendment.

Part I FINANCIAL INFORMATION

Item 1. Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share and per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Net sales	\$ 142.8	\$ 130.1	\$ 275.7	\$ 271.0
Cost of products sold	116.7	100.0	226.1	210.4
Gross profit	26.1	30.1	49.6	60.6
Selling, general and administrative expenses	11.8	12.6	26.9	24.5
Gain on sale of woodlands (Note 3)	(122.6)		(122.6)	
Other (income) - net	(2.0)	(1.0)	(3.6)	(1.3)
Operating income	138.9	18.5	148.9	37.4
Interest expense-net	4.1	4.6	8.6	9.3
Income from continuing operations before income taxes	134.8	13.9	140.3	28.1
Provision for income taxes	50.6	4.8	52.7	10.1
Income from continuing operations	84.2	9.1	87.6	18.0
Loss from discontinued operations (Note 4)	(10.9)	(2.3)	(13.4)	(8.5)
Net income	\$ 73.3	\$ 6.8	\$ 74.2	\$ 9.5
Earnings Per Common Share				
Basic				
Continuing operations	\$ 5.71	\$ 0.62	\$ 5.94	\$ 1.22
Discontinued operations	(0.74)	(0.16)	(0.91)	(0.58)
	\$ 4.97	\$ 0.46	\$ 5.03	\$ 0.64
Diluted				
Continuing operations	\$ 5.68	\$ 0.62	\$ 5.91	\$ 1.22
Discontinued operations	(0.74)	(0.16)	(0.90)	(0.58)
	\$ 4.94	\$ 0.46	\$ 5.01	\$ 0.64
Weighted Average Common Shares Outstanding (in thousands)				
Basic	14,747	14,739	14,745	14,738
Diluted	14,826	14,786	14,812	14,790
Cash Dividends Declared Per Share of Common Stock	\$ 0.10	\$ 0.10	\$ 0.20	\$ 0.20

See Notes to Condensed Consolidated Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)

(Unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	\$ 178.5	\$ 12.6
Accounts receivable (less allowances of \$4.0 and \$3.6, respectively)	69.9	79.1
Inventories	55.8	87.1
Other current assets	20.5	25.5
Assets held for sale - discontinued operations	14.0	
Total current assets	338.7	204.3
Property, plant and equipment, at cost	622.9	616.8
Less accumulated depreciation	407.5	398.9
Property, plant and equipment-net	215.4	217.9
Prepaid and intangible pension costs	75.0	71.7
Other assets	21.3	43.1
TOTAL ASSETS	\$ 650.4	\$ 537.0
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Debt payable within one year	\$ 1.3	\$ 1.2
Accounts payable	28.3	40.4
Income taxes payable	21.2	
Accrued expenses	40.4	38.8
Liabilities related to discontinued operations	11.6	
Total current liabilities	102.8	80.4
Long-term debt	225.6	226.3
Other noncurrent liabilities	57.5	65.0
Noncurrent liabilities related to discontinued operations	20.4	
TOTAL LIABILITIES	406.3	371.7
Commitments and contingencies (Note 11)		
STOCKHOLDERS EQUITY (Note 3)	244.1	165.3
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 650.4	\$ 537.0

See Notes to Condensed Consolidated Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Six Months Ended June 30,	
	2006	2005
OPERATING ACTIVITIES		
Net income	\$ 74.2	\$ 9.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13.7	14.2
Amortization of stock-based compensation	2.7	0.5
Asset impairment loss		0.8
Deferred income tax provision	23.0	1.3
Gain on sale of woodlands (Note 3)	(122.6)
Loss on other asset dispositions	0.2	0.1
Decrease in working capital	49.0	2.7
Pension and other post-employment benefits	3.2	
Other	1.1	(0.5
)
NET CASH PROVIDED BY OPERATING ACTIVITIES	44.5	28.6
INVESTING ACTIVITIES		
Capital expenditures	(9.9)
		(10.6
)
Net proceeds from sale of woodlands	134.8	
Other		(0.2
)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	124.9	(10.8
)
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt		3.5
Repayments of long-term debt	(0.6)
		(0.6
)
Short-term borrowings	0.3	2.3
Repayments of short-term borrowings	(0.3)
		(1.4
)
Cash dividends paid	(3.0)
		(3.0
)
Proceeds from exercise of stock options	0.1	
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(3.5) 0.8
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		(0.2
)
NET INCREASE IN CASH AND CASH EQUIVALENTS	165.9	18.4
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	12.6	19.1
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 178.5	\$ 37.5
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during period for interest	\$ 8.4	\$ 7.8
Cash (received) paid during period for income taxes	\$ (4.3)
		\$ 0.7

See Notes to Condensed Consolidated Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In millions, except as noted)

Note 1. Background and Basis of Presentation

Background

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Neenah Paper, Inc. (Neenah or the Company), 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). In November 2004, Kimberly-Clark completed the distribution of all of the shares of Neenah s common stock to the stockholders of Kimberly-Clark (the Spin-Off). Kimberly-Clark stockholders received a dividend of one share of Neenah s common stock for every 33 shares of Kimberly-Clark common stock held. As a result of the Spin-Off, Kimberly-Clark transferred all of the assets and liabilities of the Pulp and Paper Business to Neenah. Following the Spin-Off, Neenah is an independent public company and Kimberly-Clark has no continuing stock ownership.

The fine paper business is a leading producer of premium writing, text, cover and specialty papers. The technical products business is a leading producer of durable, saturated and coated base papers for a variety of end uses. At the time of the Spin-Off, the Canadian pulp business consisted of pulp mills in Terrace Bay, Ontario and Pictou, Nova Scotia and the related woodlands.

On June 29, 2006, the Company completed the sale of approximately 500,000 acres of woodlands in Nova Scotia for \$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. Approximately \$9.0 million of such gain was deferred and will be recognized in income over the term of the fiber supply agreement. See Note 3, Sale of Woodlands .

On May 9, 2006, the Company announced a tentative agreement to transfer the Terrace Bay mill to Buchanan Forest Products Ltd. (Buchanan). In August 2006, the Company and Buchanan signed a definitive agreement to transfer the mill (excluding certain working capital amounts and post-employment obligations) to Buchanan. The Terrace Bay mill is composed of a single-line pulp facility and a woodlands operation. For the three and six months ended June 30, 2006, the results of operations of the Terrace Bay mill and estimated disposal costs are reflected as discontinued operations in the condensed consolidated statements of operations. The consolidated results of operations for all prior periods have been restated to reflect the results of operations of the Terrace Bay mill as discontinued operations. See Note 4, Discontinued Operations .

Basis of Consolidation and Presentation

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These statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) and, in accordance with those rules and regulations, do not include all information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Management believes that the disclosures made are adequate for a fair presentation of the Company s results of operations, financial position and cash flows. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the results of operations, financial position and cash flows for the interim periods presented herein. The preparation of condensed consolidated financial statements

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in conformity with GAAP requires management to make extensive use of estimates and assumptions that affect the reported amounts and disclosures. Actual results may vary from these estimates.

These condensed consolidated interim financial statements should be read in conjunction with the consolidated and combined financial statements and notes thereto included in the Company's most recent Annual Report on Form 10-K. The results of operations for any interim period are not necessarily indicative of the results of operations to be expected for the full year.

The condensed consolidated interim financial statements of Neenah and its subsidiaries included herein are unaudited, except for the December 31, 2005 condensed consolidated balance sheet, which was derived from audited financial statements. The condensed consolidated financial statements include the financial statements of the Company, and its wholly owned and majority owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

Earnings per Share (EPS)

Basic EPS was computed by dividing net income by the weighted-average number of shares of common stock outstanding during the 2006 and 2005 reporting periods. Diluted EPS was calculated to give effect to all potentially dilutive common shares using the Treasury Stock method. Outstanding stock options, restricted shares, restricted stock units and restricted stock units with performance conditions represent the only potentially dilutive effects on the Company's weighted-average shares. For the three months and six months ended June 30, 2006, there were 79,000 and 67,000 dilutive shares, respectively for purposes of computing EPS. For the three months and six months ended June 30, 2005, there were 47,000 and 52,000 dilutive shares, respectively, for purposes of computing EPS. For the three and six months ended June 30, 2006, approximately 1,085,000 potentially dilutive options that were out-of-the-money were excluded from the computation of dilutive common shares. For the three and six months ended June 30, 2005, approximately 930,000 and 576,000, respectively, of such potentially dilutive options were excluded from the computation of dilutive common shares.

Note 2. New Accounting Standards

In February 2006, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140*, which resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*. The Company does not have hybrid financial instruments.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140*, which amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Company does not service financial assets.

In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is recognition: the enterprise determines whether it is more likely than not that a tax position will be sustained upon examination. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is evaluating FIN 48 and is currently unable to predict the effect of adoption on the Company's financial position, results of operations or cash flows.

Note 3. Sale of Woodlands

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On June 29, 2006, the Company completed the sale of approximately 500,000 acres of woodlands in Nova Scotia to Atlantic Star Forestry LTD and Nova Star Forestry LTD (the Purchaser) for \$139.1 million. The Company received the total proceeds from the sale in cash at closing. The Company also entered into a fiber supply agreement (the FSA) with the Purchaser to secure a source of fiber for the Company's Pictou pulp mill. Following the sale, the Company has approximately 500,000 acres of owned and 200,000 acres of licensed or managed woodlands in Nova Scotia.

Pursuant to the terms of the FSA, the Purchaser is required to make available to the Company sufficient woodlands acreage to yield 200,000 metric tons of softwood timber annually. The Company is required to bear all costs associated with harvesting the timber, and title to the timber transfers to the Company when the timber is cut. Timber purchases under the FSA are at market-based prices subject to semi-annual adjustment. The FSA expires on December 31, 2010 and can be extended for an additional five years at the Company's discretion. The FSA can be extended for a subsequent five years upon the mutual agreement of the Company and the Purchaser. The FSA does not give the Company the option or right to reacquire the woodlands that were sold.

The Company has determined that the sale qualifies for gain recognition under Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate* (FAS 66). The Company has also concluded that its commitment to accept acreage offered by the Purchaser to satisfy the timber requirements for the first 18 months of the FSA represents a constructive obligation . As a result, the Company recognized a net pre-tax gain on the sale of approximately \$122.6 million in the three months ended June 30, 2006 and deferred approximately \$9.0 million, which represents its estimated maximum exposure to loss of profit due to its constructive obligation under the FSA. The deferral related to the constructive obligation will be amortized over the 18-month term of such obligation.

Note 4. Discontinued Operations

Transfer of the Terrace Bay mill

Manufacturing operations at the Terrace Bay mill have been suspended since February 2006 due to a lack of wood fiber for its operations. The mill's fiber supply was exhausted as a result of a strike by the approximately 250 workers employed by the Longlac woodlands operations that supplies wood fiber to the mill. Most of the approximately 400 hourly and salaried workers employed at the mill were laid off for an indefinite period during the two weeks following the suspension of manufacturing activities. In 2005, the Terrace Bay mill produced approximately 375,000 metric tons of pulp.

On May 9, 2006, the Company announced a tentative agreement to transfer the Terrace Bay mill to Buchanan. In August 2006, the Company and Buchanan signed a definitive agreement to transfer the mill (excluding certain working capital amounts and post-employment obligations) to Buchanan. The Terrace Bay mill is composed of a single-line pulp facility, which primarily produces softwood pulp, and a woodlands operation. The Terrace Bay mill holds non-exclusive rights under a sustainable forest license to harvest wood off approximately 4.6 million acres of land owned by the Province of Ontario. Pursuant to the terms of the agreement, Buchanan will assume responsibility for substantially all liabilities related to the future operation of the mill in exchange for a payment from the Company of approximately \$18 million.

At closing, the Company will retain certain working capital amounts, primarily consisting of trade accounts receivable, finished goods inventory and trade accounts payable. In addition, the Company will retain long-term disability obligations for current and former mill employees and post-employment medical and life insurance liabilities for current retirees.

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In conjunction with the transfer of mill employees to Buchanan and as a closing condition of the agreement, the Company will initiate plans to curtail and settle its Ontario, Canada defined benefit pension plan. The Company expects to record a loss of approximately \$22 million in the third quarter of 2006 related to the settlement of pension obligations for current retirees. The Company will make a payment to the pension trust of approximately \$11 million for the purchase of annuity contracts to settle the liability for current retirees. In addition, the Company expects to record a loss of approximately \$50 million and make a payment of approximately \$7 million related to the settlement of pension obligations for active employees. The timing and amount of the payment and recognition of the loss to settle the liability for active employees is dependent upon, among other things, an actuarial determination of the value of the obligations being settled, the cost of annuity contracts, regulatory approval to settle the plan and employee elections. The transfer is subject to normal closing conditions.

The results of operations of the Terrace Bay mill and estimated disposal costs are reflected as discontinued operations in the condensed consolidated statements of operations for each period presented. The following table presents the results of discontinued operations:

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Net sales, net of intersegment sales	\$ 11.5	\$ 59.2	\$ 43.8	\$ 114.9
Discontinued Operations:				
Loss from operations	\$ (11.6)	\$ (3.7)	\$ (15.7)	\$ (13.7)
Loss on disposal	(6.0)		(6.0)	
Loss before income taxes	(17.6)	(3.7)	(21.7)	(13.7)
Benefit for income taxes	6.7	1.4	8.3	5.2
Loss from discontinued operations	\$ (10.9)	\$ (2.3)	\$ (13.4)	\$ (8.5)

The following table presents assets held for sale and liabilities related to discontinued operations:

	June 30, 2006
Inventories	\$ 11.4
Other current assets	2.6
Assets held for sale - discontinued operations	\$ 14.0
Accrued expenses	\$ 11.6
Other noncurrent liabilities	20.4
Liabilities related to discontinued operations	\$ 32.0

Note 5. Comprehensive Income

Comprehensive income includes, in addition to net income, unrealized gains and losses recorded directly to stockholders' equity. These unrealized gains and losses are referred to as other comprehensive income items. Accumulated other comprehensive income (loss) consists of unrealized foreign currency translation gains (losses), deferred gains (losses) on cash flow hedges and minimum pension liability adjustments. Unrealized foreign currency translation gains (losses) that relate to indefinite investments in the Company's Canadian pulp operations are not adjusted for income taxes. At June 30, 2006 and December 31, 2005, accumulated other comprehensive income was \$58.7 million and \$53.9 million, respectively.

The components of comprehensive income are as follows.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net income	\$ 73.3	\$ 6.8	\$ 74.2	\$ 9.5
Other comprehensive income:				
Change in unrealized foreign currency translation losses	10.0	(3.7)	8.5	(6.4)
Change in unrealized gains (losses) on cash flow hedges	(0.3)	4.9	(3.7)	6.9
Comprehensive income	\$ 83.0	\$ 8.0	\$ 79.0	\$ 10.0

Note 6. Risk Management

The Company is exposed to risks such as changes in foreign currency exchange rates and pulp prices. A variety of practices are employed to manage these risks, including operating and financing activities and, where deemed appropriate, the use of derivative instruments. Derivative instruments are used only for risk management purposes and not for speculation or trading. All foreign currency derivative instruments are either exchange traded or entered into with major financial institutions. Credit risk with respect to the counterparties is considered minimal in view of the financial strength of the counterparties. The notional amounts of the Company's derivative instruments do not represent amounts exchanged by the parties and, as such, are not a measure of exposure to credit loss. The amounts exchanged are determined by reference to the notional amounts and the other terms of the contracts.

In accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the Company records all derivative instruments as assets (included in Other current assets and Other assets) or liabilities (included in Accrued expenses or Other noncurrent liabilities) on the condensed consolidated balance sheets at fair value. Changes in the fair value of derivative instruments are recorded in either income or other comprehensive income, as appropriate. Unrealized gains or losses from changes in the fair value of highly effective derivatives designated as cash flow hedges are recorded in accumulated other comprehensive income (loss) in the period that changes in fair value occur and are reclassified to income in the same period that the hedged item affects income.

Pulp Price and Foreign Currency Risk

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The operating results, cash flows and financial condition of the Company are subject to pulp price risk. The profitability of the Company's pulp operations is subject to foreign currency risk because the price of pulp is established in U.S. dollars and the Company's cost of producing pulp is incurred principally in Canadian dollars. The Company uses foreign currency forward and pulp futures

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contracts to manage its foreign currency and pulp price risks. The use of these instruments allows management of this transactional exposure to exchange rate and pulp price fluctuations because the gains or losses incurred on the derivative instruments are intended to offset, in whole or in part, losses or gains on the underlying transactional exposure. (See Cash Flow Hedges below). The translation exposure related to the Company's net investment in its Canadian subsidiaries is not hedged.

Cash Flow Hedges

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At June 30, 2006, the Company had outstanding foreign currency forward exchange contracts designated as cash flow hedges of U.S dollar denominated pulp sales in a notional amount of \$91 million Canadian dollars. The fair value of the contracts was \$7.9 million U.S. dollars and was reflected on the balance sheet as a current asset. The weighted-average exchange rate for the foreign currency contracts at June 30, 2006 was \$0.812 U.S. dollars per Canadian dollar. The contracts extend through May 2007 with the highest value of contracts maturing in July 2006. The Company recorded net pre-tax gains of \$3.2 million and \$6.3 million on foreign currency contracts as the forecasted transactions occurred in the three and six months ended June 30, 2006, respectively. The Company recorded net pre-tax losses of \$1.0 million and \$0.9 million on foreign currency contracts as the forecasted transactions occurred in the three and six months ended June 30, 2005, respectively. Realized gains and losses on currency derivatives are recorded in Other (income) expense - net on the condensed consolidated statements of operations.

Gains and losses on foreign currency forward exchange contracts related to the operations of the Terrace Bay mill have been reclassified from Other (income) expense - net on the condensed consolidated statements of operations and recorded in Loss from discontinued operations. For the three and six months ended June 30, 2006, \$0.8 million and \$2.4 million, respectively, of such gains have been reclassified. Losses of \$0.8 million and \$0.7 million for the three and six months ended June 30, 2005, have been reclassified to Loss from discontinued operations.

At June 30, 2006, the Company had outstanding pulp future contracts, to hedge fluctuations in pulp prices, for 72,000 metric tons of pulp with a notional amount of approximately \$45 million. The fair value of the contracts was \$7.8 million and was reflected on the balance sheet as a current liability. The weighted-average price for the pulp futures contracts at June 30, 2006 was \$631 per metric ton. The contracts extend through December 2006 and expire at the rate of 12,000 metric tons per month. The Company recorded net pre-tax losses of \$2.6 million and \$4.0 million on pulp futures contracts as the forecasted transactions occurred in the three and six months ended June 30, 2006, respectively. The Company recorded net pre-tax losses of \$0.1 million and \$1.1 million on pulp futures contracts as the forecasted transactions occurred in the three and six months ended June 30, 2005, respectively. Realized gains and losses on pulp derivatives are recorded in Net sales on the condensed consolidated statements of operations.

Gains and losses on pulp futures contracts related to the operations of the Terrace Bay mill have been reclassified from Net sales on the condensed consolidated statements of operations and recorded in Loss from discontinued operations. For the three and six months ended June 30, 2006, \$0.8 million and \$1.5 million, respectively, of such losses have been reclassified. Losses of \$23 thousand and \$0.7 million for the three and six months ended June 30, 2005, have been reclassified to Loss from discontinued operations.

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For the three months ended June 30, 2006, the Company's cash flow hedges were highly effective and changes in the fair value of the derivative instruments were reflected in other comprehensive income. If future market rates are consistent with the rates assumed at June 30, 2006, a net pretax gain of approximately \$75 thousand (or \$48 thousand after-tax) is expected to be recognized in earnings during the next 12 months.

Foreign Currency Transactions

In May 2006, the Company entered into a foreign currency forward contract to eliminate variability in the U.S. dollar proceeds from the sale of woodlands in Nova Scotia, Canada (See Note 3 - Sale of Woodlands). The Company settled the contract on June 30, 2006 and had no realized gain or loss on settlement. The foreign currency forward contract had a notional value of \$155 million Canadian dollars and an exchange rate of \$0.902 U.S. dollars per Canadian dollar. Realized gains and losses on the foreign currency forward contract are recorded in Other (income) expense - net on the condensed consolidated statements of operations.

Gains and losses resulting from foreign currency transactions (transactions denominated in a currency other than the entity's functional currency) are included in Other (income) net in the condensed consolidated statements of operations. Net foreign currency transaction losses for the three and six months ended June 30, 2006 were \$0.9 million and \$0.8 million, respectively. Net foreign currency transaction gains for the three and six months ended June 30, 2005 were \$1.2 million and \$1.9 million, respectively.

Note 7. Inventories

The following presents inventories by major class as of June 30, 2006 and December 31, 2005.

	June 30, 2006	December 31, 2005
Raw materials	\$ 14.8	\$ 30.5
Work in progress	8.8	8.2
Finished goods	33.3	47.8
Supplies and other	6.2	7.6
	63.1	94.1
Excess of FIFO over LIFO cost	(7.3)	(7.0)
Total	\$ 55.8	\$ 87.1

At June 30, 2006, \$11.4 million of inventories at the Terrace Bay mill were classified as Assets held for sale - discontinued operations. The FIFO values of total inventories valued on the LIFO method were \$39.3 million and \$35.2 million at June 30, 2006 and December 31, 2005, respectively.

Note 8. Debt

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The following debt was incurred either as a result of or since the Spin-Off. The Company did not have debt prior to November 30, 2004.

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Senior Unsecured Notes

On November 30, 2004, the Company completed an underwritten offering of 10-year senior unsecured notes (the Senior Notes) at face amount of \$225 million. The Senior Notes bear interest at a rate of 7.375%, payable May 15 and November 15 of each year and mature on November 15, 2014. The Senior Notes are fully and unconditionally guaranteed by all of the Company's subsidiaries.

Secured Revolving Credit Facility

On November 30, 2004, the Company entered into a Credit Agreement by and among Neenah, certain of its subsidiaries, the lenders listed in the Credit Agreement and JP Morgan Chase Bank, N.A. as agent for the lenders, as amended, (the Credit Agreement). Under the Credit Agreement, the Company has a secured revolving credit facility (the Revolver) that provides for borrowings of up to \$150 million. Availability under the Credit Agreement will fluctuate over time depending on the value of the Company's inventory, receivables and various capital assets. The Credit Agreement is secured by substantially all of the Company's assets, including the capital stock of its subsidiaries and is guaranteed by Neenah Paper Company of Canada, a wholly-owned subsidiary. The Credit Agreement will terminate on November 30, 2008.

At June 30, 2006, approximately \$67 thousand was outstanding under the Revolver. Borrowing availability under the Revolver is reduced by outstanding letters of credit. At June 30, 2006, the Company had approximately \$2.8 million of letters of credit outstanding and \$132.3 million of borrowing availability under the Revolver.

The Credit Agreement and the indenture governing the Senior Notes contain, among other provisions, covenants with which the Company must comply during the term of the agreements. Such covenants restrict the Company's 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 affiliates, consolidate or merge with or acquire another business, sell certain of its assets or liquidate, dissolve or wind-up. In addition, the terms of the Revolver require the Company to achieve and maintain certain specified financial ratios. As of June 30, 2006, the Company was in compliance with all such covenants.

Other Financing

During the first quarter of 2005, the Company obtained third-party financing to fund its purchase of enterprise resource planning (ERP) software. At inception, the present value of the financing agreement was \$3.6 million (discounted at 7.375%) payable in quarterly installments through January 2008. At June 30, 2006, \$1.9 million of such third-party financing was outstanding of which \$1.3 million was due in the next 12 months. In the first quarter of 2005, the Company issued a short-term note for \$2.3 million to finance insurance premiums.

Note 9. Pension and Other Post-employment Benefits***Pension Plans***

Substantially all active employees of the Pulp and Paper Business participated in Kimberly-Clark's defined benefit pension plans and defined contribution retirement plans. On November 30, 2004, the Company assumed responsibility for pension and post-employment benefit obligations for active employees of the Pulp and Paper Business and retired employees of the Canadian pulp operations. Pension and post-employment benefit obligations related to retired employees of the U.S. paper operations were retained by Kimberly-Clark.

The following table presents the components of net periodic benefit cost:

Components of Net Periodic Benefit Cost

	Pension Benefits		Post-Employment Benefits	
	Three Months Ended June 30,		Other than Pensions	
	2006	2005	2006	2005
Service cost	\$ 1.9	\$ 2.6	\$ 0.5	\$ 0.4
Interest cost	5.9	5.2	1.1	0.8
Expected return on plan assets (a)	(8.0)	(6.8)		
Recognized net actuarial loss	2.0	1.7	0.5	0.1
Amortization of unrecognized transition asset				
Amortization of prior service cost	0.4	0.3	0.1	
Net periodic benefit cost	\$ 2.2	\$ 3.0	\$ 2.2	\$ 1.3

	Pension Benefits		Post-Employment Benefits	
	Six Months Ended June 30,		Other than Pensions	
	2006	2005	2006	2005
Service cost	\$ 4.4	\$ 5.3	\$ 1.1	\$ 0.8
Interest cost	11.7	10.6	2.1	1.5
Expected return on plan assets (a)	(15.9)	(13.6)		
Recognized net actuarial loss	4.1	3.5	0.9	0.3
Amortization of unrecognized transition asset	(0.1)	(0.1)		
Amortization of prior service cost	0.8	0.5	0.2	
Net periodic benefit cost	\$ 5.0	\$ 6.2	\$ 4.3	\$ 2.6

(a) The expected return on plan assets is determined by multiplying the fair value of plan assets at the prior year-end (adjusted for estimated current year cash benefit payments and contributions) by the expected long-term rate of return.

As a condition of closing and directly related to the transfer of the Terrace Bay mill to Buchanan, the Company will initiate plans to curtail and settle its Ontario, Canada defined benefit pension plan. The Company expects to record a loss of approximately \$22 million in the third quarter of 2006 related to the settlement of pension obligations for current retirees. The Company will make a payment to the pension trust of approximately \$11 million for the purchase of annuity contracts to settle the liability for current retirees. In addition, the Company expects to record a loss of approximately \$50 million and make a payment of approximately \$7 million related to the settlement of pension obligations for

active employees. The timing and amount of the payment and recognition of the loss to settle the liability for active employees is dependent upon, among other things, an actuarial determination of the value of the obligations being settled, the cost of annuity contracts, regulatory approval to settle the plan and employee elections. For the three and six months ended June 30, 2006, \$(42) thousand and \$0.6 million, respectively, of the pension (income) expense described above related to the operations of the Terrace Bay mill and have been classified as Loss from discontinued operations on the condensed consolidated statements of operations. Such amounts for the three and six months ended June 30, 2005 were \$1.3 million and \$2.8 million, respectively.

Pursuant to the terms of the transfer agreement, upon closing Buchanan will assume responsibility for post-employment medical and life insurance benefits for active employees at the Terrace Bay mill. At June 30, the Company's liability for such benefits was \$20.4 million. As a result, \$0.9 million and \$1.8 million of post-employment benefits other than pensions (described above) for the three and six months ended June 30, 2006, respectively, have been classified as Loss from discontinued operations on the condensed consolidated statements of operations. Such amounts for the three and six months ended June 30, 2005 were \$0.6 million and \$1.2 million, respectively.

Based on June 30, 2006 exchange rates, the Company expects to contribute approximately \$25 million to its pension trusts in 2006, including approximately \$11 million to purchase annuity contracts to settle pension liabilities under the Company's Ontario, Canada defined benefit pension plan for current retirees. For the six months ended June 30, 2006, the Company made contributions to its pension trusts of approximately \$5.4 million.

Note 10. Stock Compensation Plan

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The Company adopted and established the 2004 Omnibus Stock and Incentive Plan (the Omnibus Plan) under unanimous written consent of its Board of Directors on December 1, 2004. The Company reserved 3,500,000 shares of \$0.01 par value common stock (Common Stock) for issuance under the Omnibus Plan. Pursuant to the terms of the Omnibus Plan, the compensation committee of the Company s Board of Directors may grant various types of equity-based compensation awards, including incentive and nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units (RSUs), restricted stock units with performance conditions (Performance Shares) and performance units, in addition to certain cash-based awards. All grants under the Omnibus Plan will be made at fair market value and no grant may be repriced. In general, the options expire ten years from the date of grant and vest over a three-year service period. At June 30, 2006, a total of 2,033,186 shares of Common Stock were reserved for future issuance under the Omnibus Plan.

On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share Based Payment* (FAS 123R) using the modified-prospective transition method. The restatement of prior year periods for the adoption of FAS 123R is not permitted under the modified-prospective transition method. Stock-based compensation cost recognized under FAS 123R in the three and six months ended June 30, 2006 consisted of (a) compensation cost for all unvested stock-based grants outstanding as of January 1, 2006, based on the grant date fair value estimated in accordance with the pro forma provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (FAS 123) and (b) compensation cost for all stock-based awards granted subsequent to adoption based on the grant date fair value estimated in accordance with the provisions of FAS 123R. The amount of stock-based compensation cost recognized is based on the fair value of grants that are ultimately expected to vest and is recognized pro-rata over the requisite service period for the entire award.

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FAS 123R amends Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows*, to require the reporting of excess tax benefits related to the exercise or vesting of stock-based awards as cash provided by financing activities rather than as a reduction in income taxes paid and reported as cash provided by operations. The Company did not recognize any excess tax benefits related to the exercise or vesting of stock-based awards for the six months ended June 30, 2006 and 2005.

Valuation and Expense Information Under FAS 123R

The following table summarizes stock-based compensation costs and related income tax benefits.

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Selling, general and administrative expenses	\$ 1.3	\$ 0.3	\$ 2.7	\$ 0.5
Income tax benefit	(0.5)	(0.1)	(1.0)	(0.2)
Stock-based compensation, net of income tax benefits	\$ 0.8	\$ 0.2	\$ 1.7	\$ 0.3

The adoption of FAS 123R resulted in additional stock-based compensation expense of \$0.9 million and income tax benefits of \$0.3 million and reduced EPS by \$0.04 for the three months ended June 30, 2006. For the six months ended June 30, 2006 additional stock-based compensation and related income tax benefits were \$2.1 million and \$0.8 million and reduced EPS by \$0.09.

The following table summarizes total compensation costs related to the Company's equity awards and amounts recognized in the six months ended June 30, 2006.

	Stock Options	Restricted Stock
Unrecognized compensation cost December 31, 2005	\$ 4.8	\$ 1.8
Add: Grant date fair value current year grants	1.0	1.5
Less: Compensation expense recognized	1.7	1.0
Unrecognized compensation cost June 30, 2006	\$ 4.1	\$ 2.3
Expected amortization period (in years)	1.7	2.4

Stock Options

In February 2006, the Company informed participants in its Long-Term Incentive Plan (the LTIP) of its intention to award nonqualified stock options to purchase a total of 151,332 shares of common stock (subject to forfeitures due to termination of employment and other conditions) during 2006. During the first six months of 2006, the Company granted options to purchase 80,182 shares of common stock to LTIP participants, options to purchase 11,220 shares of common stock to members of the board of directors and options to purchase 5,000 shares to other employees. The options expire in ten years and the exercise price of the options was equal to the market price of the Company's common stock on the date of grant. Except for options awarded to members of the board of directors, one-third of the options vest on each of the first three anniversaries of the date of grant. Options granted to members of the board of directors vest one year from the date of grant. For the six months ended June 30, 2006, the weighted average exercise price for options granted was \$28.47 per share. For the six months ended June 30, 2005, the Company granted options to purchase 63,050 shares and 11,250 shares of common stock to LTIP participants and members of the board of directors, respectively. The weighted average exercise price and grant date fair value of such options was \$33.21 and \$13.31, respectively (see Pro Forma Information Under FAS 123 for Periods Prior to January 1, 2006).

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The weighted-average grant date fair value for stock options granted during the six months ended June 30, 2006 was \$10.47 and was estimated using the Black-Scholes option valuation model with the following assumptions:

	Six Months Ended June 30, 2006	
Expected life in years	5.9	
Interest rate	4.7	%
Volatility	37.7	%
Dividend yield	1.4	%

The expected term was estimated based upon historical data for Kimberly-Clark stock option awards and the expected volatility was estimated by reference to the historical stock price performance of a peer group of companies. The risk-free interest rate was based on the yield on U.S. Treasury bonds with a remaining term approximately equivalent to the expected term of the stock option award. Forfeitures were estimated at the date of grant.

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The following table summarizes stock option activity under the Omnibus Plan for the six months ended June 30, 2006:

	Number of Stock Options	Weighted-Average Exercise Price
Options outstanding December 31, 2005	1,284,428	\$ 31.90
Add: Options granted	96,402	\$ 28.47
Less: Options exercised	5,694	\$ 25.35
Less: Option forfeited/cancelled	900	\$ 32.60
Options outstanding June 30, 2006	1,374,236	\$ 31.69

The status of outstanding and exercisable stock options as of June 30, 2006, summarized by exercise price follows:

Exercise Price	Options Outstanding			Options Exercisable			
	Number of Options	Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Aggregate Intrinsic Value(a)	Number of Options	Weighted- Average Exercise Price	Aggregate Intrinsic Value(a)
\$24.01 - \$26.04	199,901	6.2	\$ 24.24	\$ 1.2	199,901	\$ 24.24	\$ 1.2
\$26.95 - \$31.70	222,570	6.9	\$ 29.26	0.4	79,738	\$ 29.04	0.1
\$32.60 - \$37.59	951,765	7.1	\$ 33.82		581,993	\$ 34.52	
	1,374,236	6.9	\$ 31.69	\$ 1.6	861,632	\$ 31.63	\$ 1.3

(a) Represents the total pre-tax intrinsic value as of June 30, 2006 that option holders would have received had they exercised their options as of such date. The pre-tax intrinsic value is based on the closing market price for the Company's common stock of \$30.45 on June 30, 2006.

The total pre-tax intrinsic value of stock options exercised during the six months ended June 30, 2006 was \$38,000. No stock options were exercised during the six months ended June 30, 2005.

The following table summarizes the status of the Company's unvested stock options as of June 30, 2006 and activity for the six months then ended:

	Number of Stock Options	Weighted-Average Grant Date Fair Value
Outstanding December 31, 2005	544,144	\$ 12.98
Add: Options granted	96,402	\$ 10.93
Less: Options vested	158,044	\$ 13.62
Less: Options forfeited/cancelled	630	\$ 12.60
Outstanding June 30, 2006	481,872	\$ 12.37

For the six months ended June 30, 2006, the aggregate grant date fair value of options vested was \$1.8 million. As of June 30, 2006, certain participants met age and service requirements that allowed their options to qualify for accelerated vesting upon retirement. For the six months ended June 30, 2006, there were 30,732 stock options subject to accelerated vesting that such participants would have been eligible to exercise if they had retired as of June 30, 2006. The aggregate grant date fair value of options subject to accelerated vesting was \$0.3 million. Stock options that reflect accelerated vesting for expense recognition become exercisable according to the contract terms of the stock option grant.

Restricted Stock and RSUs

In February 2006, the Company granted 48,100 Performance Shares to LTIP participants. The measurement period for the Performance Shares is January 1, 2006 through December 31, 2006. Based on Company performance compared to revenue growth and return on invested capital targets, RSUs equal to between 30% and 225% of the performance award will be issued. The RSUs carry a promise to pay out in Common Stock at a future date. In general, the RSUs issued will become 100% vested two years from the end of the performance period. During the vesting period, the holders of RSUs are entitled to dividends, but are not permitted to vote such shares and the RSUs are forfeited in the event of termination of employment (as defined). The grant date fair value for the performance shares was \$27.58 per share and was equal to the market price of the Company's common stock on the date of grant. Compensation cost is recognized pro rata over the vesting period.

During the first six months of 2006, the Company awarded 3,510 RSUs to members of the board of directors. The RSUs vest one year from the date of grant. During the vesting period, the holders of RSUs are entitled to dividends, but are not permitted to vote such shares and the RSUs are forfeited in the event holder does not continue to serve as a member of the board of directors (as defined). The grant date fair value for the RSUs was \$32.84 per share and was equal to the market price of the Company's common stock on the date of grant. Compensation cost is recognized pro rata over the vesting period.

In December 2004, the Company awarded 40,800 and 3,450 RSUs (Fresh Start Grants) to LTIP participants and non-employee members of the Company's Board of Directors, respectively. The RSUs carry a promise to pay out in Common Stock at a future date. The Fresh Start Grants awarded to LTIP participants vest over a five year period, with one-third vesting on the third anniversary of the date of grant, one-third vesting on the fourth anniversary, and the balance vesting on the fifth anniversary. The RSUs awarded to non-employee members of the Board of Directors vest on the first anniversary of the date of grant. At June 30, 2006, 55,706 RSUs were outstanding, with 18,876 shares, 23,380 shares and 13,450 shares vesting in 2007, 2008 and 2009, respectively.

At the time of the Spin-Off, the vesting schedule of Kimberly-Clark restricted stock awards for employees of the Pulp and Paper Business were adjusted so that the awards vested on a prorated basis determined by the number of full years of employment with Kimberly-Clark during the restriction period. Unvested restricted shares of Kimberly-Clark common stock were forfeited. In December 2004, the Company awarded 25,360 replacement restricted shares to employees whose restricted shares of Kimberly-Clark common stock were forfeited. The number of restricted shares was calculated using a ratio conversion methodology approved under FASB Interpretation No. 44 based on the fair market value of the Company's common stock on the date of grant. At June 30, 2006, 22,871 of such restricted shares were outstanding, with 3,681 shares, 2,025 shares, 16,591 shares and 574 shares vesting in 2006, 2007, 2008 and 2009, respectively.

The following table summarizes the activity of the Company's unvested stock-based awards (other than stock options) for the six months ended June 30, 2006:

	Restricted Stock	Weighted- Average Grant Date Fair Value	Performance Shares/RSUs	Weighted- Average Grant Date Fair Value
Outstanding December 31, 2005	22,871	\$ 34.28	55,193	\$ 31.68
Add: Shares granted(a)		\$ 0.00	51,647	\$ 27.94
Less: Shares vested		\$ 0.00	2,934	\$ 33.31
Less: Shares expired or cancelled		\$ 0.00	100	\$ 32.60
Outstanding June 30, 2006(b)	22,871	\$ 34.28	103,806	\$ 29.77

(a) Includes the grant of 37 RSUs to Canadian employees and directors in lieu of cash dividends. Such dividends-in-kind vest concurrently with the underlying RSU.

(b) The aggregate pre-tax intrinsic value of restricted stock and RSUs/Performance Shares at June 30, 2006 was \$0.7 million and \$3.2 million, respectively.

Pro Forma Information Under FAS No. 123 for Periods Prior to January 1, 2006

Prior to January 1, 2006, the Company applied the intrinsic value method permitted by Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations to account for stock option grants as permitted by FAS 123. No employee compensation expense related to stock options has been charged to earnings because the exercise prices of all stock options granted were equal to the market value of the Company or Kimberly-Clark's common stock on the date of grant. FAS 123R requires the recognition of compensation costs for stock-based awards subject to accelerated vesting upon retirement over a service period ending no later than the earliest date the employee becomes eligible for retirement, generally age 55 with five years of vested service. Prior to the adoption of FAS 123R, the Company recognized compensation cost over the explicit service period for restricted stock and RSU awards subject to accelerated vesting upon retirement. For such awards and other stock-based awards granted prior to, but unvested as of, January 1, 2006, compensation cost will be recognized pro-rata over the explicit service period for the award and any remaining unamortized compensation cost will be recognized upon the employees' retirement.

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The following table presents the effects on net income and earnings per share if the Company had adopted the fair value recognition provisions of FAS No. 123 for options granted in the three and six months ended June 30, 2005.

(In millions, except per share)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Reported net income	\$ 6.8	\$ 9.5
Add:		
Stock-based compensation expense, net of tax effects, included in net income as reported	0.2	0.3
Less:		
Pro forma compensation expense, net of tax	(0.6)	(1.3)
Pro forma net income	\$ 6.4	\$ 8.5
Reported earnings per share:		
Basic	\$ 0.46	\$ 0.64
Diluted	\$ 0.46	\$ 0.64
Pro forma earnings per share:		
Basic	\$ 0.43	\$ 0.58
Diluted	\$ 0.43	\$ 0.58

The weighted-average grant date fair value for stock options granted during the six months ended June 30, 2005 was estimated using the Black-Scholes option valuation model with the following assumptions:

	Six Months Ended June 30, 2005
Expected life in years	5.9
Interest rate	3.8 %
Volatility	39.4 %
Dividend yield	1.2 %

The expected term was estimated based upon historical data for Kimberly-Clark stock option awards and expected volatility was estimated by reference to the historical stock price performance of a peer group of companies. The grant date fair market value of stock options awarded during the six months ended June 30, 2005 was \$13.31. Forfeitures were estimated at the date of grant.

Note 11. Contingencies and Legal Matters

Litigation

The Company is involved in certain legal actions and claims arising in the ordinary course of business. While the outcome of these legal actions and claims cannot be predicted with certainty, it is the opinion of management that the outcome of any claim which is pending or threatened, either individually or on a combined basis, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

Indemnifications

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Pursuant to the Distribution Agreement, the Pulp Supply Agreement, the Employee Matters Agreement and the Tax Sharing Agreement, the Company has agreed to indemnify Kimberly-Clark for certain liabilities or risks related to the Spin-Off. Many of the potential indemnification liabilities

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under these agreements are unknown, remote or highly contingent. Furthermore, even in the event that an indemnification claim is asserted, liability for indemnification is subject to determination under the terms of the applicable agreement. For these reasons, the Company is unable to estimate the maximum potential amount of the possible future liability under the indemnity provisions of these agreements. However, the Company accrues for any potentially indemnifiable liability or risk under these agreements for which it believes a future payment is probable and a range of loss can be reasonably estimated. As of June 30, 2006, management believes the Company's liability under such indemnification obligations was not material to the consolidated financial statements.

Employees and Labor Relations

Hourly employees at the Terrace Bay pulp mill are represented by locals of the United Steelworkers (the USW) and the International Brotherhood of Electrical Workers with each collective bargaining agreement expiring on May 1, 2007. Hourly employees at the Pictou pulp mill are represented by Local 440 of the Communications, Energy and Paperworkers Union of Canada pursuant to a collective bargaining agreement expiring on May 31, 2009.

The collective bargaining agreement covering approximately 250 hourly employees at the Longlac, Ontario operations represented by Local 1-2693 of the USW expired on September 1, 2005. The hourly employees working in the Longlac woodlands operations commenced a strike on January 30, 2006. In February 2006, the Company suspended pulp manufacturing activities at the Terrace Bay mill as a result of a lack of wood fiber for its operations.

Most of the approximately 400 hourly and salaried workers employed at the mill were laid off for an indefinite period during the two weeks following the commencement of closure activities. Pursuant to certain of the Company's labor agreements and Canadian laws, the Company made required payments to laid-off employees of approximately \$6.4 million in the three months ended June 30, 2006. In conjunction with the transfer of the Terrace Bay mill, the unions representing hourly workers at the mill have agreed to new labor agreements with Buchanan which will become effective upon closing the transaction.

In December 2005, hourly employees at the Munising paper mill, represented by Locals 7-0087 and 7-0096 of the USW and the Company executed a new collective bargaining agreement expiring on July 15, 2009. In January 2006, hourly employees at the Whiting paper mill, represented by Local 7-370 of the USW and the Company executed a new collective bargaining agreement expiring on February 1, 2009. In February 2006, hourly employees at the Neenah paper mill, represented by Local 7-1170 of the USW and the Company executed a new collective bargaining agreement expiring on July 1, 2009. Additionally, these mills have bargained jointly with the union on pension matters. The agreements on pension matters for these mills expire June 30, 2007.

Note 12. Restructuring Costs and Asset Impairment Loss

The Company closed the smaller of the two single-line pulp mills at the Terrace Bay facility (the No. 1 Mill) on May 1, 2005. The No. 1 Mill was originally constructed in 1948 and had annual capacity of approximately 125,000 metric tons of bleached kraft pulp. In conjunction with the closure, approximately 150 employees accepted early retirement and severance packages.

During 2005, the Company recorded approximately \$5.0 million for one-time termination benefits related to early retirement, severance and defined benefit pension plans in connection with the closure of the No.1 Mill and approximately \$0.3 million for other exit costs. Approximately \$1.7 million and \$5.2 million of such early retirement and severance costs were recognized in the three and six months

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ended June 30, 2005. As of June 30, 2006, termination benefits of approximately \$4.9 million had been paid to 147 employees and approximately \$55 thousand was accrued but unpaid.

During the first six months of 2005, the Company recorded a pre-tax, non-cash asset impairment loss of approximately \$0.8 million related to the remaining value of the long-lived assets of the No. 1 Mill. As a result of the transfer of the Terrace Bay mill to Buchanan, costs associated with the closure were reclassified to Loss from discontinued operations on the condensed consolidated statements of operations.

Note 13. Business Segment Information

The Company reports its operations in three segments: Fine Paper, Technical Products and Pulp. The Fine Paper business is a leading producer of premium writing, text, cover and specialty papers. The Technical Products business is a leading producer of durable, saturated and coated base papers for a variety of end uses. The Pulp business consists of a pulp mill in Nova Scotia, Canada and related woodlands, which produce northern bleached softwood and hardwood kraft pulp. The results of operations of the Terrace Bay mill were previously reported in the Pulp business segment. As a result of the agreement to the transfer of the Terrace Bay mill to Buchanan, the results of operations of the Terrace Bay mill have been reclassified to discontinued operations and the results of Pulp business segment have been restated for all periods presented. Each segment requires different technologies and marketing strategies. Corporate expenses that are identifiable as directly supporting the operations of the business segments are allocated to the business segments. General corporate expenses that do not directly support the operations of the business segments are shown as Unallocated corporate costs. Disclosure of segment information is on the same basis that management uses internally for evaluating segment performance and allocating resources.

The following table summarizes the net sales and income before interest and taxes (Operating income) for each of the Company's business segments.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net sales				
Fine Paper	\$ 57.3	\$ 56.8	\$ 115.4	\$ 114.7
Technical Products	33.8	34.4	66.8	70.3
Pulp	52.1	39.1	95.2	86.2
Intersegment sales	(0.4)	(0.2)	(1.7)	(0.2)
Consolidated	\$ 142.8	\$ 130.1	\$ 275.7	\$ 271.0

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Operating income				
Fine Paper	\$ 15.5	\$ 16.0	\$ 31.1	\$ 33.0
Technical Products	2.9	3.1	4.9	7.8
Pulp	123.1	1.1	119.5	
Unallocated corporate costs	(2.6)	(1.7)	(6.6)	(3.4)
Consolidated	\$ 138.9	\$ 18.5	\$ 148.9	\$ 37.4

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Note 14. Condensed Consolidating Financial Information

Neenah Paper Company of Canada, Neenah Paper Michigan, Inc. and Neenah Paper Sales, Inc. (the **Subsidiary Guarantors**) guarantee the Company's Senior Notes. The Subsidiary Guarantors are 100% owned by the Company and all guarantees are full and unconditional. The following condensed consolidating financial information is presented in lieu of consolidated financial statements for the Subsidiary Guarantors as of June 30, 2006 and December 31, 2005 and for the three and six months ended June 30, 2006 and 2005.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**For the Three Months Ended June 30, 2006**

	Neenah Paper, Inc	Subsidiary Guarantors	Consolidating Adjustments	Consolidated Amounts
Net sales	\$ 22.9	\$ 148.4	\$ (28.5)	\$ 142.8
Cost of products sold	17.7	127.5	(28.5)	116.7
Gross profit	5.2	20.9		26.1
Selling, general and administrative expenses	1.6	10.2		11.8
Gain on sale of woodlands (Note 3)		(122.6)		