

Neenah Paper Inc
Form 10-K
March 13, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2005

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15() 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)

3460 Preston Ridge Road

Alpharetta, Georgia

(Address of principal executive offices)

20-1308307

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

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	Name of Each Exchange on Which Registered
Common Stock \$0.01 Par Value	New York Stock Exchange
Preferred Stock Purchase Rights	

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 o No x

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 o No x

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 x No o

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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, 2005 (based on the closing stock price on the New York Stock Exchange) on such date was \$457 million.

As of February 28, 2006, there were 14,766,203 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 3, 2006 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 Canadian pulp business and its fine paper and technical products businesses in the United States (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 North American producer of premium fine papers and technical products. We also produce bleached kraft market pulp in Canada, where we own approximately one million acres of timberlands and have non-exclusive rights to harvest wood off approximately 4.8 million 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 durable, saturated and coated base papers and films for a variety of end uses. We sell our technical products globally into 15 product categories, and we focus on categories where we believe we are a market leader or have a competitive advantage, which include, among others, the 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 and include 3M Company, Perfecseal, Avery Dennison Corporation and Saint-Gobain Group. Our technical products manufacturing facility is located in Munising, Michigan.

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 mills located in Pictou, Nova Scotia and Terrace Bay, Ontario, 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 one million 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 2005, the Pictou mill produced approximately 265,000 metric tons of bleached kraft pulp.

On May 1, 2005, we closed the smaller of two single-line pulp mills at the Terrace Bay facility (the No. 1 Mill). The No. 1 Mill was originally constructed in 1948 and had annual capacity of approximately 125,000 tons of bleached kraft pulp. Following the closure of the No. 1 Mill, the Terrace Bay mill is comprised of a single-line pulp facility, which produces primarily softwood pulp, and a timberlands

operation. Terrace Bay 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. In 2005, the Terrace Bay mill produced approximately 375,000 metric tons of pulp, including approximately 45,000 metric tons at the No. 1 Mill.

Recent Developments

In February 2006, we suspended pulp manufacturing activities at our Terrace Bay pulp mill as a result of a lack of wood fiber for its operations. The mill's fiber supply has been exhausted as a result of a strike by the approximately 250 woodlands workers employed by our forestry operations that supply wood fiber to the mill (See Employee and Labor Relations). Pulp shipments will continue until the mill's finished goods inventory is exhausted.

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. A small group of hourly and salaried employees will remain at the facility for security operations, boiler and related equipment operation and maintenance during the warm shutdown. An extended work stoppage at the mill could have a material impact on our liquidity and results of operations.

Company Structure

Our corporate structure consists of Neenah Paper, Inc., and three wholly owned subsidiaries.

Neenah Paper, Inc. Neenah Paper is a Delaware corporation that holds our trademarks and patents related to all of our businesses, the real estate, the mills and the manufacturing assets associated with our fine paper business, and all of the equity in our subsidiaries which are listed below. The common stock of Neenah Paper is publicly traded on the New York Stock Exchange under the symbol NP.

Neenah Paper Sales, Inc. Neenah Paper Sales is a Delaware corporation that owns all of our U.S. inventory and certain other assets.

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

Neenah Paper Company of Canada. Neenah Paper Company of Canada is a Nova Scotia unlimited liability company and wholly owned subsidiary of Neenah Paper. It owns the real estate, the mills and the manufacturing assets associated with our pulp business operations in Pictou, Nova Scotia and Terrace Bay, Ontario. It also conducts timberlands operations in the Provinces of Ontario and Nova Scotia.

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.

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.

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 on the north shore of Lake Superior in Ontario, Canada. In the mid-1970s, Kimberly-Clark added a second pulp mill at Terrace Bay and in the early 1980s rebuilt other portions of the pulp mill. The Terrace Bay operation includes the Longlac timberlands operation, in existence since 1937, which harvests wood from land owned by the Ontario government for pulp production at the Terrace Bay mill. In May 2005, we closed the No. 1 Mill (See Overview).

Business Strategy

Increase the Size of our Paper Businesses relative to our overall Product Mix. 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 on Capital. Return on capital is an important metric and we believe 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 have achieved improvements in both our supply chain and management of working capital through the integration of these efforts within the Company and expect to achieve additional gains through the full implementation of our enterprise resource planning system and other tools. We also expect to provide returns to investors by paying dividends in line with peer companies.

Transition to a Market Pulp Producer. We are continuing to transition from an internal supplier of pulp as a part of Kimberly-Clark to a producer of market pulp. As part of this effort, we have developed an external pulp sales function, and are making appropriate improvements in bale quality, customer support and technical support to establish a broader market pulp customer base.

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 \$222 million in 2005, \$221 million in 2004 and \$210 million in 2003.

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 2005, we successfully introduced the EAMES Paper Collection which leveraged processes from both our Fine Paper and Technical Product Business to create three unique finishes and 16 new colors inspired by the work of the designers Charles and Ray Eames. 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 base papers and films for a variety of end uses, including tapes, premask, abrasives, labels, medical packaging, decorative components and heat transfer papers. Net sales of our technical products business were approximately \$131 million in 2005, \$132 million in 2004 and \$122 million in 2003. KIMDURA®, MUNISING LP®, PREVAIL and NEENAH® 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 five major market segments—tape, premask, abrasives, label and medical packaging—and ten other 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, industrial general purpose, transportation, manufacturing and building construction 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 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.

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.

Heat 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 heat transfer papers for use in digital printing applications. Heat 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, clean room paper and release paper.

Pulp Business. Our pulp mills produce 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 2005, more than 75% of our mills' output was consumed by Kimberly-Clark and approximately 5% was used by our fine paper and technical products businesses. The Pictou pulp mill's major products are Pictou HARMONY® Softwood (northern bleached softwood kraft pulp) and Pictou Hardwood (northern bleached hardwood kraft pulp). The Terrace Bay mill's major product is a fully bleached northern softwood kraft pulp used to manufacture publication, printing and writing, specialty papers and tissue grades. The Terrace Bay operation also sells softwood and hardwood logs from its timberlands operations to sawmills and veneer manufacturers who, in turn, sell wood chips and sawdust to Terrace Bay.

Net sales of our pulp business were approximately \$401 million in 2005, \$449 million in 2004 and \$405 million in 2003.

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. 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 annual corporate 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 2005 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 35% of its total sales in 2005. 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 into 15 separate market segments in the U.S. and more than 35 export markets. Such segments, broadly defined as polymer impregnated and synthetic paper, include papers used as components in the following applications: 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.

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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 2005 was approximately 70% in North America, 15% in Europe and 15% in Latin America and Asia. 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.

Several of the smaller customers of the technical products business are large multinational corporations with multiple manufacturing locations. The primary global customers of the technical products business are 3M Company, Perfecseal, Avery Dennison Corporation and Saint-Gobain Group.

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 2005, Terrace Bay and Pictou produced about 335,000 metric tons and 225,000 metric tons, respectively, of northern bleached softwood kraft pulp. In 2005, approximately 80% of our pulp mills' northern bleached softwood kraft pulp production was transferred to Kimberly-Clark. Our pulp mills have historically transferred more than 90% of their 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 2005, both our Terrace Bay and Pictou mills produced about 40,000 metric tons of northern bleached hardwood kraft pulp. In 2005, our pulp mills transferred approximately 50,000 metric tons of northern bleached hardwood kraft pulp to Kimberly-Clark and less than 10,000 metric tons to our fine paper business. The balance of the pulp mills' output of northern bleached hardwood kraft pulp was sold to 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 pulp mills have transferred their pulp directly to Kimberly-Clark and used brokers for sales to external customers. We will utilize our internal sales team to generate sales to external customers.

For the years ended December 31, 2005, 2004 and 2003, we had pulp sales to Kimberly-Clark of \$309 million, \$351 million and \$305 million, respectively. No single customer, other than Kimberly-Clark, accounted for more than 10% of our net sales in those years.

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 63,000, 54,000 and 48,000 metric tons of hardwood pulp in 2005, 2004 and 2003, 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 cotton could adversely affect our fine paper sales. Except for pulp, the fine paper business purchases 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 is the other main raw material consumed, approximately two-thirds of which is supplied by the Terrace Bay pulp mill. Except for pulp, the technical products business purchases all of its other raw material requirements externally. We believe that all of the raw materials that must be purchased for our technical products operations, except for certain specialty latex grades, 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, 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 Terrace Bay mill obtains approximately 50% of its wood chip needs from pulpwood and logs harvested from timberlands licensed to us by the Province of Ontario. The balance of the mill's fiber requirements are met through wood chips purchased from local sawmills. In February 2006, we suspended pulp manufacturing activities at our Terrace Bay pulp mill as a result of a lack of wood fiber for its operations. The mill's fiber supply has been exhausted as a result of a strike by the woodlands workers who are employed by our forestry operations that supply wood fiber to the mill (See Recent Developments). The 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. 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 mills are chemicals and supplies. Our pulp mills purchase all of these other raw materials externally.

Except for wood chips used by our pulp mills and certain specialty latex grades 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 2005, two suppliers provided over 70% of the wood chips used by the Pictou mill and three suppliers provided approximately 50% of the wood chips used by the Terrace Bay mill. During 2005, scheduled downtime at our Terrace Bay mill was extended, in part, to allow us to replenish the inventory of wood chips. 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 to our technical products business, which we currently obtain from a single source, could disrupt and eventually cause a shutdown of production of certain technical products.

Energy

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 million tons 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 one-half of the electrical energy at the Terrace Bay mill. We also purchase electrical energy from external sources.

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. In February 2006, the Ontario Minister of Energy extended revenue limits on certain of Ontario Power Generation's unregulated assets through 2008. The revenue limits are intended to provide more stable and predictable pricing for large electricity consumers. We anticipate that, despite the revenue limits, our cost of energy at the Terrace Bay mill will increase in 2006 due to the expiration on December 31, 2005 of a fixed price contract for electricity. 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 emission limitations in respect of our Canadian operations are unknown and uncertain and may increase costs.

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 20 to 22 days of raw material inventories to support its paper making operations and about 30 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, the technical products business maintains approximately 10 to 12 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 up to 60 days are typically offered to customers located in export markets. On average supplier invoices are paid in approximately 20 days.

Pulp Business. The pulp mills maintain 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 mills typically carry 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 that 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., Fox River Paper Company, Wausau Paper Corp. and other smaller companies. We believe that the primary bases of competition for premium writing, text and cover

papers are brand recognition, product quality, service, availability and promotional support, with price being a less 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, medical packaging, label and decorative components segments, our technical products business competes in North American and global markets with a number of large multinational competitors, including Arjo Wiggins USA, Inc., FiberMark, Inc., MeadWestvaco Corporation, 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. 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 and customer service and price. We believe that 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 retain and to grow its customer base in recent years.

Pulp Business. The principal competitors of our pulp mills 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. The 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. We have continually invested in product research and development with spending of \$2.3 million in 2005, \$1.7 million in 2004 and \$2.1 million in 2003.

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®, The 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.

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 that our heat transfer patents have contributed to establishing the technical products business as a leading supplier of heat transfer papers.

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, 2005 and December 31, 2004 were \$4.1 million and \$4.3 million, respectively, representing six and five days, respectively, of sales. We expect to fill these orders within the current fiscal year.

Technical Products Business. **Historically, the technical products business has had a steady quarter to quarter shipments flow with small reductions in the third and fourth quarters due to international customer vacations and other downtime in the third quarter and a reduction in inventory levels by our customers in the fourth quarter. 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 customers accounting for approximately 35% of its annual sales 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 backlogs in the technical products business on December 31, 2005 and December 31, 2004 were approximately \$17 million and \$32 million, respectively, representing approximately 12 percent and 24 percent of prior year sales, respectively. We expect to fill these orders within the current fiscal year.**

Pulp Business. Each of our pulp mills has historically taken a 10 to 14-day shutdown each year for major maintenance, typically in either May or September, thereby reducing pulp shipments in the second and third quarters. Shutdowns for maintenance and capital projects are sometimes taken in other quarters, resulting in a variation in quarter-to-quarter pulp shipments. In 2005, the Terrace Bay mill maintenance shutdown occurred in September and was shortened to four days while the maintenance shutdown at the Pictou mill was taken in the fourth quarter. With the closure of the No.1 Mill, we would expect that future maintenance shutdowns at our Terrace Bay mill would be shorter than the historical norm. 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, 2005, we had approximately 1,900 regular full time employees of whom 620 hourly and 280 salaried employees were located in the United States and 780 hourly and 220 salaried employees were located in Canada.

On June 1, 2005, hourly employees at the Pictou pulp mill, represented by Local 440 of the Communications, Energy and Paperworkers Union of Canada and the Company executed a new collective bargaining agreement expiring on May 31, 2009. 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 Longlac, Ontario operations are represented by Local 1-2693 of the USW with a collective bargaining agreement which expired on September 1, 2005. On January 30, 2006, the hourly employees working in the Company's Longlac, Ontario woodlands operations commenced a strike. In February 2006, we suspended pulp manufacturing activities at our Terrace Bay pulp mill as a result of a lack of wood fiber for its operations. An extended work stoppage at the Terrace Bay mill could have a material impact on the liquidity and results of operations of the Company (See Recent Developments).

Hourly employees at the Munising, Neenah and Whiting paper mills are represented by locals of the USW. On December 23, 2005, hourly employees at the Munising paper mill, represented by Locals 7-0087 and 7-0096 of the USW voted to accept a new collective bargaining agreement expiring on July 15, 2009. On January 8, 2006, hourly employees at the Whiting paper mill, represented by Local 7-370 of the USW voted to accept a new collective bargaining agreement expiring on February 1, 2009. On February 21, 2006, hourly employees at the Neenah paper mill, represented by Local 7-1170 of the USW voted to accept 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.

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 Canada. For these purposes, we have capital expenditure programs for which we incurred approximately \$1 million of spending in 2005 of which no material amount is the result of environmental fines or settlements. We anticipate expenditures for major environmental projects during the period 2006 through 2010 will include approximately \$20 million to reconfigure the effluent treatment system at the Pictou mill and between \$15 million and \$25 million for equipment and engineering to abate total sulphur emissions and for other environmental matters at the Pictou and Terrace Bay mills, to remove and replace transformers containing polychlorinated biphenyls at the Terrace Bay mill, to improve stream crossings in the timberlands licensed from the Province of Ontario. The timing and amount of such expenditures will depend on the outcome of negotiations with regulatory authorities, the results of engineering studies and the remediation methods

ultimately selected. These capital expenditures 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. 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. 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 by writing 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 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 idled capacity until the cycle is repeated.

The following chart shows price information for northern bleached softwood kraft pulp from 1980 to 2005 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 and results of operations 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, particularly at our Terrace Bay mill, and other factors.

Because our pulp business competes primarily on the basis of price and availability, the financial success of our pulp mills depends on their ability to produce pulp at a competitive cost. Our ability to contain or reduce costs at our pulp mills is significant to our business. We believe that our Terrace Bay mill currently has an unfavorable cost structure, with the cost of wood at Terrace Bay being the single most important contributing factor.

In February 2006, we suspended pulp manufacturing activities at our Terrace Bay pulp mill as a result of a lack of wood fiber for its operations. The mill's fiber supply has been exhausted as a result of a strike

by the approximately 250 woodlands workers who are employed by our forestry operations that supply wood fiber to the mill (See Employee and Labor Relations).

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. A small group of hourly and salaried employees are expected to remain at the facility for security operations, boiler and related equipment operation and maintenance during the warm shutdown. An extended work stoppage at the mill could have a material impact on our liquidity and results of operations.

If our pulp business had been operated on a stand-alone basis during 2004 (prior to the Spin-Off) and 2003 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 gross profit (losses) of approximately \$19 million and \$21 million in 2004 and 2003, respectively. Those pro forma gross profit (losses) would have represented in 2004 and 2003 a decrease in our gross profit of about \$26 million and about \$25 million, respectively. The decrease in gross profit would have resulted primarily from lower market prices for pulp during those years, the resulting prices at which we would have transferred pulp to Kimberly-Clark during those years, the high costs at our Terrace Bay mill and the impact of a weakening U.S. dollar relative to the Canadian dollar in 2004 and 2003. For our pulp business to be profitable, we must reduce costs at our Terrace Bay mill even if pulp prices increase. Although we are attempting to implement strategies to reduce costs at the mill, we can give no assurance that we will be able to reduce those costs to a level at which we can profitably sell pulp produced by our Terrace Bay mill.

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 can have a material impact on our financial results because substantially all of our pulp mills' expenses are incurred in Canadian dollars and our pulp revenues are denominated in U.S. dollars. For example, in 2005, 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 \$5 million, excluding additional currency remeasurement losses. We anticipate continued strength for the Canadian dollar relative to the U.S. dollar.

We use hedging arrangements to reduce our exposure to 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 2005:

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 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 most of the wood fiber we require for our Terrace Bay pulp mill and a portion of the wood fiber required for our Pictou pulp mill from timberland areas licensed by the Ontario and Nova Scotia provincial governments, respectively. These governments have granted us non-exclusive licenses for substantial timberland areas from which