

Neenah Paper Inc
Form 10-Q
August 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(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, 2007

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.

Edgar Filing: Neenah Paper Inc - Form 10-Q

(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

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, 2007, there were 14,943,081 shares of the Company's common stock outstanding.

TABLE OF CONTENTS

Part I Financial Information

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Item 4. Controls and Procedures

Part II Other Information

Item 1. Legal Proceedings

Item 1a. Risk Factors

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 4. Submission of Matters to a Vote of Security Holders

Item 6. Exhibits

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 June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net sales	\$ 258.1	\$ 142.8	\$ 482.8	\$ 275.7
Cost of products sold	227.4	116.7	408.6	226.1
Gross profit	30.7	26.1	74.2	49.6
Selling, general and administrative expenses	21.9	11.8	39.8	26.9
Gain on sale of woodlands	(1.5)	(122.6)	(2.9)	(122.6)
Other income - net	(1.1)	(2.0)	(1.7)	(3.6)
Operating income	11.4	138.9	39.0	148.9
Interest expense - net	6.5	4.1	12.5	8.6
Income from continuing operations before income taxes	4.9	134.8	26.5	140.3
Provision for income taxes	1.6	50.6	8.0	52.7
Income from continuing operations	3.3	84.2	18.5	87.6
Loss from discontinued operations	(0.7)	(10.9)	(1.2)	(13.4)
Net income	\$ 2.6	\$ 73.3	\$ 17.3	\$ 74.2
Earnings Per Common Share				
Basic				
Continuing operations	\$ 0.22	\$ 5.71	\$ 1.25	\$ 5.94
Discontinued operations	(0.04)	(0.74)	(0.08)	(0.91)
	\$ 0.18	\$ 4.97	\$ 1.17	\$ 5.03
Diluted				
Continuing operations	\$ 0.22	\$ 5.68	\$ 1.22	\$ 5.91
Discontinued operations	(0.05)	(0.74)	(0.08)	(0.90)
	\$ 0.17	\$ 4.94	\$ 1.14	\$ 5.01
Weighted Average Common Shares Outstanding (in thousands)				
Basic	14,857	14,747	14,835	14,745
Diluted	15,221	14,826	15,124	14,812
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, 2007	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 1.1	\$ 1.6
Restricted cash	5.8	
Accounts receivable (less allowances of \$5.3 million and \$4.4 million)	157.9	112.5
Inventories	113.5	74.9
Other receivables	13.7	13.6
Prepaid and other current assets	27.6	19.8
Total Current Assets	319.6	222.4
Property, Plant and Equipment, at cost	849.1	768.1
Less accumulated depreciation	454.4	412.5
Property, plant and equipment net	394.7	355.6
Deferred Income Taxes	54.5	32.7
Goodwill	95.6	92.0
Intangible Assets, net	33.2	29.5
Other Assets	13.4	12.5
TOTAL ASSETS	\$ 911.0	\$ 744.7
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Debt payable within one year	\$ 6.7	\$ 1.3
Accounts payable	91.6	74.7
Accrued salaries and employee benefits	28.0	26.6
Accrued income taxes	14.5	10.2
Accrued expenses	24.6	16.7
Total Current Liabilities	165.4	129.5
Long-term Debt	340.2	282.3
Deferred Income Taxes	36.0	35.8
Noncurrent Employee Benefits	129.9	109.2
Other Noncurrent Obligations	14.1	3.0
TOTAL LIABILITIES	685.6	559.8
Commitments and Contingencies (Note 13)		
TOTAL STOCKHOLDERS EQUITY	225.4	184.9
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 911.0	\$ 744.7

See Notes to Condensed Consolidated Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES

Edgar Filing: Neenah Paper Inc - Form 10-Q

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Six Months Ended June 30,	
	2007	2006
OPERATING ACTIVITIES		
Net income	\$ 17.3	\$ 74.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	22.0	13.7
Stock-based compensation	3.5	2.7
Excess tax benefit from stock-based compensation	(0.6))
Deferred income tax (benefit) provision	(1.1)	) 23.0
Gain on sale of woodlands	(2.9)	) (122.6)
Loss on asset dispositions	0.1	0.2
Decrease (increase) in working capital, net of effects of acquisitions	(16.8)	) 49.0
Pension and other post-employment benefits	0.1	3.2
Other		1.1
NET CASH PROVIDED BY OPERATING ACTIVITIES	21.6	44.5
INVESTING ACTIVITIES		
Capital expenditures	(23.6)	) (9.9)
Increase in restricted cash	(5.6))
Acquisition cost of Fox River, net of cash acquired	(55.3))
Additional acquisition cost of Neenah Germany	(1.5))
Net proceeds from sale of woodlands		134.8
Other	0.3	
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(85.7)	) 124.9
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	74.8	
Debt issuance costs	(0.7))
Repayments of long-term debt	(11.9)	) (0.6)
Short-term borrowings	4.8	0.3
Repayments of short-term debt	(4.7)	) (0.3)
Cash dividends paid	(3.0)	) (3.0)
Proceeds from exercise of stock options	3.6	0.1
Excess tax benefit from stock-based compensation	0.6	
Other	(0.1))
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	63.4	(3.5)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	0.2	
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(0.5)	) 165.9
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1.6	12.6
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 1.1	\$ 178.5
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during period for interest, net of interest expense capitalized	\$ 11.9	\$ 8.4
Cash paid (received) during period for income taxes	\$ 3.8	\$ (4.3)
Non-cash investing activities:		
Decrease in liability for equipment acquired	\$ (3.8)	\$

See Notes to Condensed Consolidated Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions, except as noted)

Note 1. Background and Basis of Presentation

Background

Edgar Filing: Neenah Paper Inc - Form 10-Q

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). 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 transportation and other filter media, and durable, saturated and coated base papers for a variety of end uses. The pulp business primarily produces northern bleached softwood kraft pulp used by paper mills to manufacture tissue and printing and writing papers. At the time of the Spin-Off, the pulp business consisted of pulp mills in Terrace Bay, Ontario and Pictou, Nova Scotia and the related woodlands (including 1,000,000 acres in Nova Scotia).

In June 2006, the Company s wholly owned subsidiary, Neenah Paper Company of Canada (Neenah Canada) completed the sale of approximately 500,000 acres of woodlands in Nova Scotia for \$139.1 million (proceeds net of transaction costs were \$134.8 million). The woodlands sale agreement included a fiber supply agreement to secure a source of fiber for Neenah Canada 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 is being recognized in income pro-rata through December 2007. See Note 6, Sale of Woodlands.

In August 2006, Neenah Canada completed the transfer of the Terrace Bay, Ontario pulp mill and related woodlands operations (Terrace Bay) to certain affiliates of Buchanan Forest Products Ltd. (Buchanan). Pursuant to the terms of the sale agreement, Buchanan assumed responsibility for substantially all liabilities related to the future operation of Terrace Bay in exchange for a payment of \$18.6 million. For the three and six months ended June 30, 2007, discontinued operations in the condensed consolidated statements of operations primarily reflect costs associated with Terrace Bay s defined benefit pension plan. The condensed consolidated statements of operations for the three and six months ended June 30, 2006 have been restated to reflect the results of operations of Terrace Bay as discontinued operations. See Note 5, Discontinued Operations.

In October 2006, the Company completed the purchase of the stock of FiberMark Services GmbH & Co. KG and the stock of FiberMark Beteiligungs GmbH (collectively Neenah Germany). Neenah Germany was acquired from FiberMark, Inc. (FiberMark) and FiberMark International Holdings LLC for approximately \$220 million in cash (net of cash acquired). The transaction was financed from available cash and debt drawn against the Company s existing revolving credit facility. The assets acquired as a result of the acquisition of Neenah Germany consist of two mills located near Munich, Germany and a third mill near Frankfurt, Germany, that produce a wide range of products, including transportation and other filter media, nonwoven wall coverings, masking and other tapes, abrasive backings, and specialized printing and coating substrates. The results of Neenah Germany are being reported as part of the Company s Technical Products segment and have been included in the Company s consolidated financial results since the acquisition date. See Note 4, Acquisitions.

In March 2007, the Company acquired the stock of Fox Valley Corporation and its subsidiary, Fox River Paper Company, LLC (collectively, Fox River). The Company paid \$55.3 million in cash for Fox River and financed the acquisition through a combination of cash and debt drawn against its existing revolving credit facility. The assets acquired as a result of the acquisition of Fox River consist of four U.S. paper mills and various related assets. The results of Fox River are being reported as part of the Company s Fine Paper segment and have been included in the Company s consolidated financial results since the acquisition date. See Note 4, Acquisitions, for a summary of the preliminary allocation of the purchase price and a description of certain post-acquisition restructuring activities.

Basis of Consolidation and Presentation

Edgar Filing: Neenah Paper Inc - Form 10-Q

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 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, 2006 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 intercompany balances and transactions have been eliminated in consolidation.

Earnings per Share (EPS)

Edgar Filing: Neenah Paper Inc - Form 10-Q

Basic EPS was computed by dividing net income by the weighted-average number of shares of common stock outstanding during the three and six months ended June 30, 2007 and 2006. 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 and six months ended June 30, 2007, approximately 85,000 and 195,000 potentially dilutive stock options, respectively, were excluded from the computation of dilutive common shares. For the three and six months ended June 30, 2006, approximately 1,085,000 potentially dilutive options were excluded from the computation of dilutive common shares.

The following table presents the computation of basic and diluted shares of common stock used in the computation of EPS (amounts in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Weighted-average basic shares outstanding	14,857	14,747	14,835	14,745
Add: Assumed incremental shares under stock compensation plans	364	79	289	67
Assuming dilution	15,221	14,826	15,124	14,812

Note 2. Accounting Standard Changes

On January 1, 2007, the Company adopted FASB Interpretation No. 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*.

The Company is liable for taxes due for tax returns filed by Neenah Germany for periods prior to the acquisition (see Note 4, Acquisitions). Pursuant to the terms of the purchase agreement, FiberMark has agreed to indemnify the Company for such taxes and a portion of the purchase price has been reserved in an escrow account to fund the indemnification. The Company believes it is probable that Neenah Germany is liable for approximately \$5.5 million in additional taxes and recognized a liability for the benefit of this uncertain income tax position at the acquisition date. The Company has also recognized a receivable in an equal amount in Other receivables on the consolidated balance sheet for the value of the indemnification. The Company does not believe its liability for such taxes is in excess of the escrow amount.

Edgar Filing: Neenah Paper Inc - Form 10-Q

The Company's adoption of FIN 48 resulted in a \$1.0 million increase in its liability for uncertain income tax positions. As of June 30, 2007, the Company's liability for uncertain income tax positions was \$6.5 million. If recognized, approximately \$0.7 million of such income tax benefits would favorably affect the Company's effective tax rate in future periods. The Company does not anticipate that the expiration of the statute of limitations or the settlement of audits in the next 12 months will result in liabilities for uncertain income tax positions that are materially different than the amounts accrued as of June 30, 2007.

Tax years 2004 through 2006 are subject to examination by federal and state tax authorities in the United States, federal and provincial tax authorities in Canada and federal and municipal tax authorities in Germany. Currently, the 2004 tax year is being audited by German tax authorities.

The Company recognizes accrued interest and penalties related to uncertain income tax positions in Provision for income taxes on the condensed consolidated statements of operations. As of June 30, 2007, the Company had no amounts accrued for interest related to uncertain income tax positions.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. SFAS 157 does not require any new fair value measurements.

The definition of fair value in SFAS 157 retains the exchange price notion in earlier definitions of fair value and emphasizes that fair value is a market-based measurement, not an entity-specific measurement. SFAS 157 expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Adoption of SFAS 157 is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Most of the provisions of SFAS 159 apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, applies to all entities with available-for-sale and trading securities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, *Fair Value Measurements*. The Company does not expect the adoption of SFAS 159 to have a material effect on its financial position or results of operations.

Note 3. Comprehensive Income

Edgar Filing: Neenah Paper Inc - Form 10-Q

Comprehensive income includes, in addition to net income, unrealized gains and losses recorded directly into a separate section of stockholders equity on the condensed consolidated balance sheets. 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 adjustments to pension and other post-employment benefit obligations. Unrealized foreign currency translation gains (losses) that relate to indefinite investments in international operations are not adjusted for income taxes. As of June 30, 2007 and December 31, 2006, accumulated other comprehensive income was \$28.5 million and \$9.9 million, respectively.

8

Edgar Filing: Neenah Paper Inc - Form 10-Q

The following table presents the components of comprehensive income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income	\$ 2.6	\$ 73.3	\$ 17.3	\$ 74.2
Other comprehensive income:				
Unrealized foreign currency translation gain	12.5	10.0	16.3	8.5
Adjustments to pension and other post-employment benefit liabilities	0.6		1.0	
Deferred gain (loss) on cash flow hedges	1.5	(0.3)	1.3	(3.7)
Total other comprehensive income	14.6	9.7	18.6	4.8
Comprehensive income	\$ 17.2	\$ 83.0	\$ 35.9	\$ 79.0

Note 4. Acquisitions

Fox River

Edgar Filing: Neenah Paper Inc - Form 10-Q

In March 2007, the Company acquired the stock of Fox River for \$55.3 million in cash (net of cash acquired). Included in such acquisition costs were amounts for the repayment of debt, the payoff of deferred employee compensation obligations of the acquired companies and fees and expenses directly related to the acquisition. The Company financed the acquisition through a combination of cash and debt drawn against its existing revolving credit facility. The assets acquired as a result of the acquisition of Fox River consist of four U.S. paper mills and various related assets, producing premium fine papers with well-known brands including STARWHITE®, SUNDANCE®, ESSE® and OXFORD®. The results of Fox River are being reported as part of the Company's Fine Paper segment and have been included in the Company's consolidated financial results since the acquisition date.

During the second quarter of 2007, the Company completed the previously announced permanent closure of the Housatonic mill, located near Great Barrington, Massachusetts. In June 2007, the Company also announced plans to permanently close the fine paper mill located in Urbana, Ohio (the Urbana mill). Operations at the Urbana mill are expected to be phased out in an orderly manner over the next 12 months. The closure of the Housatonic and Urbana mills will allow the Company to maximize cost efficiencies by shifting fine paper manufacturing to utilize existing available capacity at its other high quality fine paper mills. In addition, the Company has substantially completed the process of identifying and notifying certain Fox River sales and administrative employees who will be terminated as the acquired business is integrated with its existing fine paper business.

The total cost of the acquisition has been allocated to the assets acquired and liabilities assumed in accordance with Statement of Financial Accounting Standards No. 141, *Business Combinations* (SFAS 141). The values of certain assets and liabilities are based on preliminary valuations and are subject to adjustment as additional information is obtained. Such additional information includes, but is not limited to, the valuation of property, plant and equipment, gains or losses related to the settlement of post-retirement obligations at closed facilities and the liability for post-acquisition restructuring activities. The Company is in the process of finalizing its valuations which will be complete no later than one year from the acquisition date. Changes to the valuation of assets and liabilities acquired may result in adjustments to the carrying value of property, plant and equipment acquired. The Company did not acquire any in-process research and development assets as part of the acquisition.

Edgar Filing: Neenah Paper Inc - Form 10-Q

The following table summarizes the preliminary allocation of the purchase price to the estimated fair value of the assets acquired and liabilities assumed as of March 1, 2007:

Assets Acquired	
Accounts receivable	\$ 18.7
Inventories	36.0
Other receivables	1.0
Prepaid and other current assets	2.2
Property, plant and equipment	28.5
Unamortizable intangible assets	3.7
Amortizable intangible assets	0.3
Deferred income taxes	18.5
Other noncurrent assets	0.1
Total assets acquired	109.0
Liabilities Assumed	
Accounts payable	13.3
Accrued salaries and employee benefits	5.5
Accrued expenses	11.6
Noncurrent employee benefits	17.5
Other noncurrent obligations	5.8
Total liabilities assumed	53.7
Net assets acquired	\$ 55.3

The preceding table includes approximately \$10.4 million for the cost of post-acquisition restructuring activities that the Company recognized in accordance with Emerging Issues Task Force Issue 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*. The following table presents the status of such post-acquisition restructuring activities as of and for the six months ended June 30, 2007. The Company expects the payment of severance benefits to be substantially complete within one year.

	Post-Acquisition Restructuring Costs	Payments through June 30, 2007	June 30, 2007
Number of employees	375	(160)	215
Severance benefits	\$ 6.3	\$ (1.6)	\$ 4.7
Contract termination costs	2.6		2.6
Environmental clean-up and monitoring	1.5		1.5
Total	\$ 10.4	\$ (1.6)	\$ 8.8

Edgar Filing: Neenah Paper Inc - Form 10-Q

The following selected unaudited pro forma consolidated statements of operations data for the three and six months ended June 30, 2007 and 2006 was prepared as though the acquisition of Fox River had occurred on January 1, 2007 and 2006 (in millions, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net sales	\$ 258.1	\$ 191.7	\$ 515.6	\$ 379.2
Operating income (a)	11.4	140.6	39.1	152.9
Income from continuing operations (a)	3.3	84.6	18.1	88.7
Loss from discontinued operations	(0.7)	(10.9)	(1.2)	(13.4)
Net income	2.6	73.7	16.9	75.3
Earnings (Loss) Per Common Share:				
Basic				
Continuing operations	\$ 0.22	\$ 5.74	\$ 1.22	\$ 6.02
Discontinued operations	(0.04)	(0.74)	(0.08)	(0.91)
	\$ 0.18	\$ 5.00	\$ 1.14	\$ 5.11
Diluted				
Continuing operations	\$ 0.22	\$ 5.71	\$ 1.20	\$ 5.99
Discontinued operations	(0.05)	(0.74)	(0.08)	(0.90)
	\$ 0.17	\$ 4.97	\$ 1.12	\$ 5.09

(a) Results for the three and six months ended June 30, 2006, include \$122.6 million (\$75.7 million after-tax) for the gain on sale of woodlands. See Note 6, Sale of Woodlands.

Neenah Germany

In October 2006, the Company completed the purchase of the stock of Neenah Germany. Neenah Germany was acquired from FiberMark and FiberMark International Holdings LLC for approximately \$220 million in cash, including \$1.5 million paid in the first quarter of 2007 primarily for the adjusted value of working capital at the acquisition date. The Company also incurred approximately \$5.1 million of transaction costs directly related to the acquisition of Neenah Germany. The acquisition of Neenah Germany was financed through \$160 million of available cash and \$58 million of debt drawn against the Company's revolving credit facility. The primary source of available cash used to finance the acquisition was proceeds from the sale of woodlands in June 2006. See Note 6, Sale of Woodlands. The results of Neenah Germany are being reported as part of the Company's Technical Products segment and have been included in the Company's consolidated financial results since the acquisition date.

Note 5. Discontinued Operations

Transfer of Terrace Bay

Manufacturing operations at Terrace Bay were suspended in February 2006 due to a lack of wood fiber for its operations as the result of a strike initiated in January 2006 by workers employed by the woodlands operations that supplied wood fiber to the mill. Most of the hourly and salaried workers employed at the mill were laid off during the two weeks following the suspension of manufacturing activities.

In August 2006, Neenah Canada transferred Terrace Bay to Buchanan. Buchanan assumed responsibility for substantially all liabilities related to the future operation of Terrace Bay in exchange for a payment of \$18.6 million. At closing, Neenah Canada retained certain working capital amounts, primarily trade accounts receivable, finished goods inventory and trade accounts payable. In addition, Neenah Canada retained certain long-term disability obligations for current and former mill employees and post-employment medical and life insurance liabilities for current retirees.

Edgar Filing: Neenah Paper Inc - Form 10-Q

In conjunction with the transfer of Terrace Bay to Buchanan and as a closing condition of the agreement, Neenah Canada initiated plans to curtail and settle its Ontario, Canada defined benefit pension plan (the Ontario Plan). In August 2006, Neenah Canada made a payment to the pension trust of approximately \$10.8 million for the purchase of annuity contracts to settle its pension liability for current retirees. As a result, Neenah Canada recognized a pension curtailment and settlement loss of approximately \$26.4 million in the year ended December 31, 2006.

In July 2007, the Financial Services Commission of Ontario approved the Company s request to settle its pension obligations for active employees and terminate the Ontario Plan. The Company expects termination of the Ontario plan to be completed in the fourth quarter of 2007. Neenah Canada expects to record a settlement loss of approximately \$40 million upon termination of the Ontario Plan. The amount of any funds that Neenah Canada may pay or receive upon settlement of the Ontario Plan is dependent upon, among other things, an actuarial determination of the value of the obligations being settled, the cost of annuity contracts and employee elections.

For the three and six months ended June 30, 2007, discontinued operations in the condensed consolidated statements of operations primarily reflect costs associated with Terrace Bay s defined benefit pension plan. The results of operations of Terrace Bay are reflected as discontinued operations in the condensed consolidated statements of operations for the three and six months ended June 30, 2006. The following table presents the results of discontinued operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net sales, net of intersegment sales	\$	\$ 11.5	\$	\$ 43.8
Discontinued Operations:				
Loss from operations	\$ (1.2)	\$ (11.6)	\$ (2.0)	\$ (15.7)
Loss on disposal		(6.0)		(6.0)
Loss before income taxes	(1.2)	(17.6)	(2.0)	(21.7)
Benefit for income taxes	0.5	6.7	0.8	8.3
Loss from discontinued operations	\$ (0.7)	\$ (10.9)	\$ (1.2)	\$ (13.4)

Note 6. Sale of Woodlands

Edgar Filing: Neenah Paper Inc - Form 10-Q

In June 2006, Neenah Canada completed the sale of approximately 500,000 acres of woodlands in Nova Scotia to Atlantic Star Forestry LTD and Nova Star Forestry LTD (collectively, the Purchaser) for \$139.1 million (proceeds net of transaction costs were \$134.8 million). Neenah Canada received the total proceeds from the sale in cash at closing. Neenah Canada also entered into a fiber supply agreement (the FSA) with the Purchaser to secure a source of fiber for the Pictou pulp mill. Following the sale, Neenah Canada 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 Pictou mill sufficient woodlands acreage to yield 200,000 metric tons of softwood timber annually. The Pictou mill is required to bear all costs associated with harvesting the timber. Timber purchases under the FSA are at market-based prices subject to semi-annual adjustment. The FSA expires in December 2010 and the Pictou mill has the option to unilaterally extend the contract for an additional five years. Also, the FSA can be extended for an additional five years upon the mutual agreement of Neenah Canada and the Purchaser.

The sale qualified for gain recognition under the full accrual method described in Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate* (SFAS 66). The Pictou mill's 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, Neenah Canada recognized a net pre-tax gain on the sale of approximately \$122.6 million in June 2006 and deferred approximately \$9.0 million, which represents Neenah Canada's estimated maximum exposure to loss of profit due to the constructive obligation under the FSA. The deferral related to the constructive obligation will be amortized through December 2007. For the three and six months ended June 30, 2007, Neenah Canada recognized approximately \$1.5 million and \$2.9 million, respectively of such deferred gain.

Note 7. Risk Management

Edgar Filing: Neenah Paper Inc - Form 10-Q

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 Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the Company records all derivative instruments as assets (included in Prepaid and other current assets and Other Assets) or liabilities (included in Accrued expenses or Other Noncurrent Obligations) on the condensed consolidated balance sheet at fair value. Changes in the fair value of derivative instruments are either recorded in 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

Edgar Filing: Neenah Paper Inc - Form 10-Q

The operating results, cash flows and financial condition of the Company are subject to pulp price 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 profitability of the Company's pulp operations is subject to foreign currency risk. The Company uses foreign currency forward contracts to manage its foreign currency risks. In addition, the Company has used, from time-to-time, pulp futures contracts to manage its 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 and German subsidiaries is not hedged. In addition, the Company's reported operating results are affected by changes in the Euro exchange rate relative to the U.S. dollar. The Company's exposure to such Euro risk is not hedged.

Cash Flow Hedges

Edgar Filing: Neenah Paper Inc - Form 10-Q

As of June 30, 2007, 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 \$42 million Canadian dollars. The fair value of the contracts was a current asset of \$2.9 million U.S. dollars. The weighted-average exchange rate for the foreign currency contracts at June 30, 2007 was \$0.877 U.S. dollars per Canadian dollar. The contracts extend through February 2008 with the highest value of contracts maturing in July 2007. The Company recorded net pre-tax gains of \$2.0 million and \$2.6 million on foreign currency contracts as the forecasted transactions occurred in the three and six months ended June 30, 2007, respectively. 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. Realized gains and losses on foreign currency forward exchange contracts are recorded in Other (income) expense - net on the condensed consolidated statements of operations. Gains of \$0.8 million and \$2.4 million on foreign currency forward exchange contracts related to the operations of Terrace Bay were recorded in Loss from discontinued operations for the three and six months ended June 30, 2006.

During 2006 and 2005, the Company entered into a series of pulp futures contracts to hedge fluctuations in pulp prices through December 2006. Subsequent to December 31, 2006, the Company had no outstanding pulp future contracts. For the three and six months ended June 30, 2006, the Company recorded net pre-tax losses of \$2.6 million and \$4.0 million on pulp futures contracts as the forecasted transactions occurred. Realized gains and losses on pulp derivatives are recorded in Net sales on the condensed consolidated statements of operations. Losses of \$0.8 million and \$1.5 million on pulp futures contracts related to the operations of Terrace Bay were recorded in Loss from discontinued operations for the three and six months ended June 30, 2006.

For the three months and six months ended June 30, 2007, changes in the fair value of the Company's derivative instruments were reflected in other comprehensive income. If future market rates are consistent with the rates assumed at June 30, 2007, a net pre-tax gain of approximately \$2.9 million (or \$1.8 million after-tax) is expected to be recognized in earnings during the next 12 months.

Foreign Currency Transactions

Edgar Filing: Neenah Paper Inc - Form 10-Q

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 gains for the three and six months ended June 30, 2007 and 2006 were \$1.4 million and \$1.3 million, respectively. Net foreign currency transaction losses for the three and six months ended June 30, 2006 were \$0.9 million and \$0.8 million, respectively. Losses of \$0.5 million and \$0.4 million on foreign currency transactions related to the operations of Terrace Bay were recorded in Loss from discontinued operations in the condensed consolidated statements of operations for the three and six months ended June 30, 2006.

Note 8. Inventories

Edgar Filing: Neenah Paper Inc - Form 10-Q

The following presents inventories by major class:

	June 30, 2007	December 31, 2006
Inventories by Major Class:		
Raw materials	\$ 25.5	\$ 24.2
Work in progress	21.0	11.1
Finished goods	70.7	44.5
Supplies and other	4.6	3.4
	121.8	83.2
Excess of FIFO over LIFO cost	(8.3	) (8.3
Total	\$ 113.5	\$ 74.9

The FIFO values of total inventories valued on the LIFO method were \$83.6 million and \$37.9 million at June 30, 2007 and December 31, 2006, respectively.

Note 9. Debt

Edgar Filing: Neenah Paper Inc - Form 10-Q

Long-term debt is as follows:

	June 30, 2007	December 31, 2006
Senior Notes (7.375% fixed rate) due 2014	\$ 225.0	\$ 225.0
Revolving bank credit facility (variable rates) due 2010	82.5	57.3
Term Loan (variable rates) due in 13 equal quarterly installments beginning November 2007	25.0	
Third-party financing (7.375% fixed rate) due in quarterly installments through December 2007	0.6	1.3
Neenah Germany project financing (3.8% fixed rate) due in 16 equal semi-annual installments beginning June 2009	13.5	
Neenah Germany revolving line of credit (variable rates)	0.3	
Total debt	346.9	283.6
Less: Debt payable within one year	6.7	1.3
Long-term debt	\$ 340.2	\$ 282.3

Principal Payments

Edgar Filing: Neenah Paper Inc - Form 10-Q

The following table presents the Company's required debt payments:

	2007	2008	2009	2010	2011	Thereafter	Total
Debt payments	\$ 2.8	\$ 7.7	\$ 9.4	\$ 91.9	\$ 1.7	\$ 233.4	\$ 346.9

Senior Unsecured Notes

In November 2004, the Company completed an underwritten offering of ten-year senior unsecured notes (the Senior Notes) at an aggregate face amount of \$225 million. The Senior Notes bear interest at a rate of 7.375 percent, payable in May and November of each year and mature in November 2014. The Senior Notes are fully and unconditionally guaranteed by all of the Company's subsidiaries, with the exception of Neenah Germany.

Secured Revolving Credit Facility

In November 2004, the Company entered into a Credit Agreement by and among the Company, certain of its subsidiaries, the lenders listed in the Credit Agreement and JP Morgan Chase Bank, N.A. as agent for the lenders (the Initial Credit Agreement). Under the Initial Credit Agreement, the Company had a secured revolving credit facility (the Revolver) that provided for borrowings of up to \$150 million. Amounts outstanding under the Revolver may be repaid, in whole or in part, at any time without premium or penalty except for specified make-whole payments on LIBOR-based loans. All principal amounts outstanding under the Revolver are due and payable on the date of termination of the Revolver.

Borrowings under the Initial Credit Agreement were secured by substantially all of the Company's assets, including the capital stock of its subsidiaries and were guaranteed by Neenah Paper Company of Canada, a wholly-owned subsidiary. The Initial Credit Agreement was scheduled to terminate in November 2008.

The interest rate applicable to borrowings under the Revolver was either (1) the applicable base rate plus 0.25 percent to 0.75 percent or (2) a LIBOR-based rate ranging from LIBOR plus 1.75 percent to LIBOR plus 2.25 percent. Interest was computed bas