Neenah Paper Inc
Form 10-Q
May 10, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from to

Commission File Number: 001-32240

NEENAH PAPER, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**20-1308307** (I.R.S. Employer Identification No.)
3460 Preston Ridge Road **Alpharetta, Georgia** (Address of principal executive offices)	**30005** (Zip Code)

(678) 566-6500

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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 o Accelerated filer x Non-accelerated filer o

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

Yes o No x

As of April 30, 2007, there were 14,812,020 shares of the Company s common stock outstanding.

TABLE OF CONTENTS

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 March 31, 2007	2006
Net sales	$ 224.7	$ 132.9
Cost of products sold	181.2	109.4
Gross profit	43.5	23.5
Selling, general and administrative expenses	17.9	15.1
Gain on sale of woodlands	(1.4)	
Other income net	(0.6)	(1.6)
Operating income	27.6	10.0
Interest expense net	6.0	4.5
Income from continuing operations before income taxes	21.6	5.5
Provision for income taxes	6.4	2.1
Income from continuing operations	15.2	3.4
Loss from discontinued operations	(0.5)	(2.5)
Net income	$ 14.7	$ 0.9
Earnings Per Common Share		
Basic		
Continuing operations	$ 1.03	$ 0.23
Discontinued operations	(0.04)	(0.17)
	$ 0.99	$ 0.06
Diluted		
Continuing operations	$ 1.01	$ 0.23
Discontinued operations	(0.03)	(0.17)
	$ 0.98	$ 0.06
Weighted Average Common Shares Outstanding (in thousands)		
Basic	14,790	14,743
Diluted	15,005	14,796
Cash Dividends Declared Per Share of Common Stock	$ 0.10	$ 0.10

See Notes to Condensed Consolidated Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions)
(Unaudited)

	March 31, 2007	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	$ 3.5	$ 1.6
Restricted cash	10.1	
Accounts receivable (less allowances of $4.8 and $4.4 million)	148.9	112.5
Inventories	117.0	74.9
Other receivables	13.9	13.6
Prepaid and other current assets	21.1	19.8
Total Current Assets	314.5	222.4
Property, plant and equipment, at cost	801.4	768.1
Less accumulated depreciation	424.1	412.5
Property, plant and equipment net	377.3	355.6
Deferred Income Taxes	57.5	32.7
Goodwill	94.4	92.0
Intangible Assets, net	33.3	29.5
Other Assets	13.7	12.5
TOTAL ASSETS	$ 890.7	$ 744.7
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Debt payable within one year	$ 4.3	$ 1.3
Accounts payable	79.2	74.7
Accrued salaries and employee benefits	25.2	26.6
Accrued income taxes	17.6	10.2
Accrued expenses	29.0	16.7
Total Current Liabilities	155.3	129.5
Long-term Debt	355.6	282.3
Deferred Income Taxes	35.9	35.8
Noncurrent Employee Benefits	127.1	109.2
Other Noncurrent Obligations	13.1	3.0
TOTAL LIABILITIES	687.0	559.8
Commitments and Contingencies (Note 13)		
TOTAL STOCKHOLDERS EQUITY	203.7	184.9
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 890.7	$ 744.7

See Notes to Condensed Consolidated Financial Statements

NEENAH PAPER, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Three Months Ended March 31, 2007	2006
OPERATING ACTIVITIES		
Net income	$ 14.7	$ 0.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11.0	6.7
Stock-based compensation	1.7	1.4
Deferred income tax benefit	(0.8)	(0.7)
Gain on sale of woodlands	(1.4)	
Loss on asset dispositions	(0.3)	0.1
Decrease (increase) in working capital, net of effects of acquisition	(23.6)	3.5
Pension and other post-employment benefits	(0.8)	2.8
Other	(0.1)	1.6
NET CASH PROVIDED BY OPERATING ACTIVITIES	0.4	16.3
INVESTING ACTIVITIES		
Capital expenditures	(6.2)	(3.4)
Increase in restricted cash	(10.1)	
Acquisition cost of Fox River, net of cash acquired	(55.1)	
Additional acquisition cost of Neenah Germany	(1.5)	
Other	(0.4)	(0.5)
NET CASH USED IN INVESTING ACTIVITIES	(73.3)	(3.9)
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	73.3	
Debt issuance costs	(0.1)	
Repayments of long-term debt	(0.4)	(0.3)
Short-term borrowings	3.4	0.2
Repayments of short-term debt		(0.1)
Cash dividends paid	(1.5)	(1.5)
Other	(0.1)	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	74.6	(1.7)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	0.2	
NET INCREASE IN CASH AND CASH EQUIVALENTS	1.9	10.7
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1.6	12.6
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 3.5	$ 23.3
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during period for interest, net of interest expense capitalized	$ 1.5	$
Cash paid (received) during period for income taxes	$ 0.1	$ (4.6)
Non-cash investing activities: Liability for equipment acquired	$ 1.0	$ 0.6

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

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 manufacturer 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 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 the Company s Pictou pulp mill. The transaction resulted in a net pretax 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, the Company s wholly-owned subsidiary, Neenah Paper Company of Canada (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 months ended March 31, 2007, discontinued operations in the condensed consolidated statement of operations primarily reflect costs associated with Terrace Bay s defined benefit pension. The condensed consolidated statement of operations for the three months ended March 31, 2006 has 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 million in cash. 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 three mills located near Munich and 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.

On March 1, 2007, the Company acquired the stock of Fox Valley Corporation and its subsidiary, Fox River Paper Company, LLC (collectively Fox River). The Company paid $55.1 million in cash for Fox River (including fees and expenses directly related to the acquisition) 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, selected pro forma financial data and certain mill restructuring activities.

Basis of Consolidation and Presentation

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)

Basic earnings per share (EPS) was computed by dividing net income by the weighted-average number of shares of common stock outstanding during the three months ended March 31, 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 months ended March 31, 2007 and 2006, approximately 390,000 and 1,080,000 potentially dilutive options, respectively, 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 March 31,	
	2007	**2006**
Weighted-average basic shares outstanding	14,790	14,743
Add: Assumed incremental shares under stock compensation plans	215	53
Assuming dilution	15,005	14,796

Note 2. Accounting Standard Changes

In January 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*.

Pursuant to the terms of the purchase agreement with FiberMark (see Note 4, Acquisitions), the Company is liable for potential additional taxes due for tax returns filed for periods prior to the acquisition. FiberMark has agreed to indemnify the Company for such additional 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. 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.

In addition to the amounts described above, the Company s adoption of FIN 48 on January 1, 2007 resulted in a $1.0 million increase in its liability for uncertain income tax positions. As of March 31, 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 any changes in its liability for uncertain income tax positions due to the settlement of audits or the expiration of the statute of limitations prior to March 31, 2008.

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 Income tax expense on the condensed consolidated statements of operations. As of March 31, 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

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 March 31, 2007 and December 31, 2006, accumulated other comprehensive income was $13.9 million and $9.9 million, respectively.

The following table presents the components of comprehensive income (loss):

	Three Months Ended March 31, 2007	2006
Net income	$14.7	$0.9
Other comprehensive income:		
Unrealized foreign currency translation gains/(losses)	3.8	(1.5)
Adjustments to pension and other post-employment benefit liabilities	0.4	
Deferred losses on cash flow hedges	(0.2)	(3.4)
Total other comprehensive income/(loss)	4.0	(4.9)
Comprehensive income/(loss)	$18.7	$(4.0)

Note 4. Acquisitions

Fox River

On March 1, 2007, the Company acquired the stock of Fox River for $55.1 million in cash. Included in such acquisition costs were amounts for the repayment of debt, the payoff of deferred employee compensation obligations of the acquired companies and approximately $1.8 million for 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.

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). Due to the proximity of the Fox River acquisition to March 31, 2007, 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, intangible assets and the liability for employee severance benefits. In addition, the allocation of the purchase price to the fair value of assets acquired has not been completed pending payment for certain working capital amounts acquired in the acquisition. The Company has up to 12 months from the closing of the acquisition to finalize its valuations. Changes to the valuation of assets and liabilities acquired may result in adjustments to the carrying value of property, plant and equipment acquired or goodwill. The Company has not identified any material unrecorded pre-acquisition contingencies. Prior to the end of the one-year purchase price allocation period, if information becomes available which would indicate it is probable that such events had occurred as of the acquisition date and the amounts can be reasonably estimated, such items will be included in the final purchase price allocation and may result in an adjustment to the carrying value of property, plant and equipment acquired or goodwill. The Company did not acquire any in-process research and development assets as part of the acquisition.

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	37.0