

Neenah Paper Inc
Form 10-K
March 16, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from to

Commission file number 001-32240

NEENAH PAPER, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

20-1308307

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

**3460 Preston Ridge Road
Alpharetta, Georgia**

(Address of principal executive offices)

30005

(Zip Code)

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

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

Title of Each Class

Common Stock \$0.01 Par Value
Preferred Stock Purchase Rights

Name of Each Exchange on Which Registered

New York Stock Exchange

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

TABLE OF CONTENTS

Part I

<u>Item 1.</u>	<u>Business</u>
<u>Item 1A.</u>	<u>Risk Factors</u>
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>
<u>Item 2.</u>	<u>Properties</u>
<u>Item 3.</u>	<u>Legal Proceedings</u>
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>
<u>Item 4A.</u>	<u>Executive Officers of the Registrant</u>

Part II

<u>Item 5.</u>	<u>Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>
<u>Item 6.</u>	<u>Selected Financial Data</u>
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>
<u>Item 9A.</u>	<u>Controls and Procedures</u>
<u>Item 9B.</u>	<u>Other Information</u>

Part III

<u>Item 10.</u>	<u>Directors and Executive Officers of the Registrant</u>
<u>Item 11.</u>	<u>Executive Compensation</u>
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions</u>
<u>Item 14.</u>	<u>Principal Accounting Fees and Services</u>

Part IV

<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>
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Signatures

PART I

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

Item 1. Business

Overview

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

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

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

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

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

Recent Developments

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

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

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

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

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

Company Structure

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

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

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

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

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

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

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

3

History of the Businesses

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

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

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

Business Strategy

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

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

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

Products

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Markets and Customers

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Year Ended December 31,
2006**