How do you make a great

first impression?

NEENAH PAPER INC

2004 Annual Report

1.

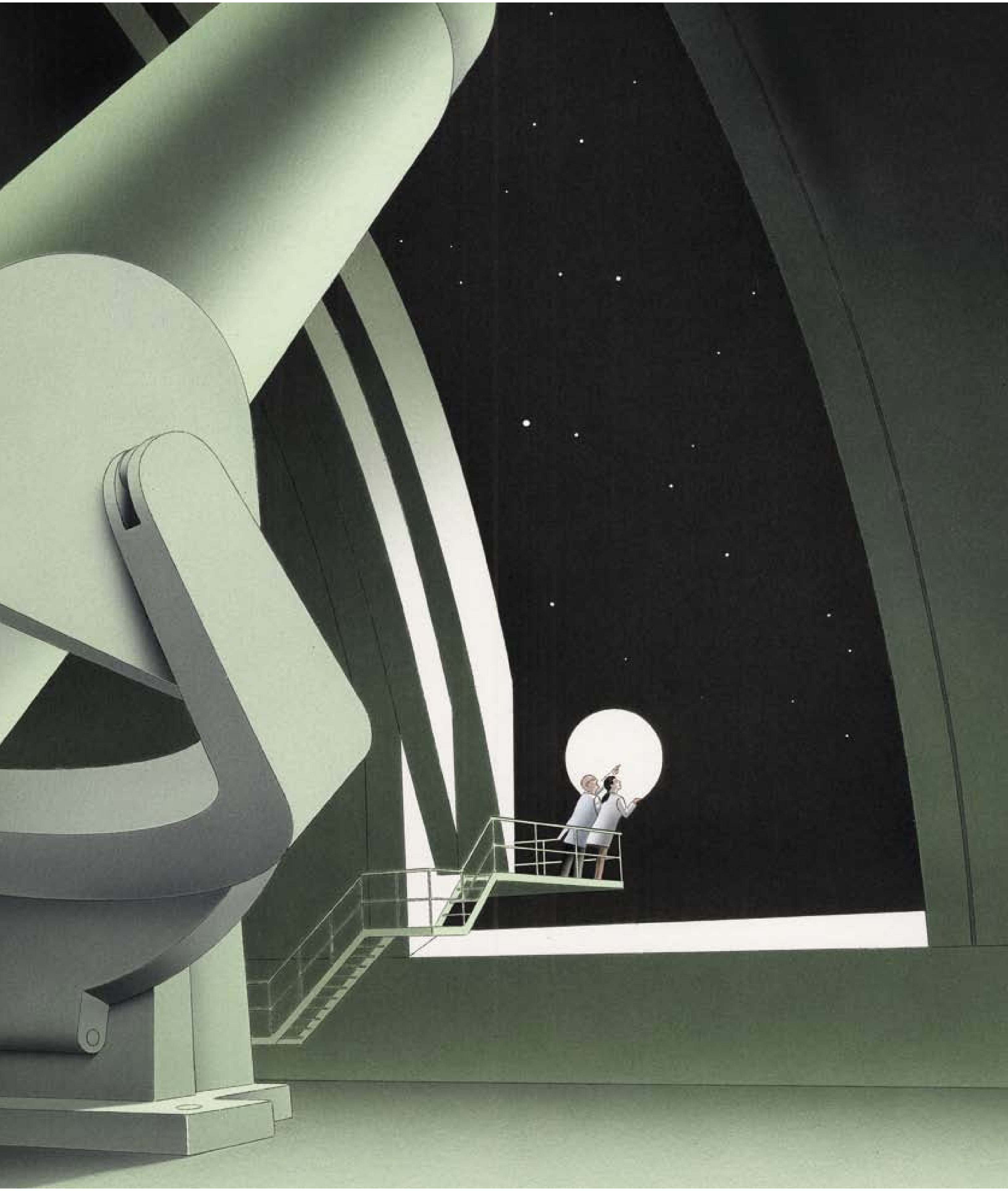
start with a *blank sheet of paper*

Every new beginning brings with it a multitude of new possibilities – new opportunities. Such is the case with Neenah Paper. We’re a new stand-alone company created from Kimberly-Clark’s fine paper, technical paper and pulp operations. And while our heritage goes back to the founding of the first Neenah Mill in 1873, our future is now what we make of it. For us, it’s a blank sheet of paper – a place to leave an indelible mark.

2.

share a *strong vision*

What unites a company also makes it stronger. At Neenah Paper, our shared values connect us. We believe in a commitment to quality and service, one driven by constant innovation. We believe in achieving outstanding results by promoting safe operations, involvement and accountability. And we believe in serving our owners and communities by being good stewards of both our natural and financial resources. These are not just credos that we trot out at company meetings. It's how we run our business every single day – helping us to be the first choice for branded and customized paper and pulp products.



Sean T. Erwin

Chairman, President and
Chief Executive Officer

To our *shareholders:*

"You don't create value by talking about it. Only execution produces results."

Right size, right time, right market

Neenah Paper was created from three stand-alone businesses. Yet today we function as one integrated and independent company. We've taken the strengths and resources from each business and used them to create a strong foundation for our future.

A large piece of that foundation is the Neenah Paper brand. It has tremendous equity in the marketplace. It is synonymous with outstanding quality, customer service and support. Those qualities are being applied equally to all three of our pulp and paper markets. Our focus now is on growing our individual paper businesses – fine paper and technical paper. To facilitate that process and strengthen our structure, we are making a significant investment in an integrated ERP (Enterprise Resource Planning) system, which will help align production planning, supply chain management and inventory management with the needs of our customers.

Our spin-off from Kimberly-Clark allows us to explore new growth opportunities and reinvest in our business in ways that were not open to us before. The math is in our favor.

We're an $800 million company now, as opposed to being a small part of a $15 billion company. A $20 to $30 million sales opportunity in our context is not only reachable; it's significant.

A culture of accountability

Neenah Paper may be a new company, but our heritage extends back more than a half century. Under Kimberly-Clark, Neenah Paper established a leadership role in fine paper, technical paper and pulp. We're not about to let that go. Our first priority is safety. Our responsibility is to create value for customers and shareholders alike through innovation, service and excellence. It is our employees who will create this value and drive our success. Together, we are a team of smart, engaged, results-oriented people who are committed to making this company a success. For the first time ever, we are in control of our own destiny. The decisions we make now have more impact on us than they did when we were part of Kimberly-Clark. Bottom line, we are accountable for everything we do.

The power of people

On the morning of December 2, 2004, we celebrated our spin-off by ringing The Opening Bell℠ at the New York Stock Exchange. It was an exciting occasion for all of us and the fruition of many months of hard work. The honor of ringing the bell went to Bill Platt, Operations Manager for our fine paper mill in Neenah, Wisconsin. During the spin-off process, we decided to establish a "Ring the Bell" contest to recognize the employees who were creating and driving value for the new company – not talking about what they would do, but making things happen. In all, 45 different teams, comprised of employees from all functions and locations submitted their successes. The winning team then selected Bill as their representative to ring the bell in New York. We are keeping the "Ring the Bell" program alive and using it as a means to capture savings and celebrate creating real value for our new company.

It's all about execution

Execution is what drives us forward. But to keep us on a steady course, we are tracking all of the financial and

Vision:

To be the first choice for branded and customized paper and pulp products.

Mission:

To create value for our customers and shareholders through innovation, service and excellence.

It is our employees who will create this value and drive our success.

non-financial metrics that shape our business. Our mission is to provide shareholders with a return that's greater than the cost of capital as we grow our business. That means we intend to reinvest our capital and cash wisely to achieve growth. As a whole, the paper and forest products industry has not provided attractive returns to shareholders in recent years. Neenah Paper's specialty papers business is different. Strategically, we expect these types of higher return businesses to become a larger part of the Neenah Paper portfolio as we continue to grow.

Reorganizing R&D – Energizing innovation

Ours is a customer-centric business. One of the key ways we help our customers is to provide innovative solutions for their needs. Often, that means we are developmental partners with our customers. Many of our products, especially our technical papers, are customized for specific applications. Naturally, research and development plays a vital role in that process. For that reason, we have combined our disparate R&D operations under one roof and are investing to improve our capabilities. We consider it an investment not only in our future, but in the future of our customers. By adding value to our customer relationships, we demonstrate our strong commitment to helping them achieve success.

Developing a market for pulp

For Kimberly-Clark, pulp was a cost center. For us, our pulp operation is an opportunity to become a world-class competitive supplier in this industry. Of course, this will only happen with a sound strategy and execution. We intend to bring the same premium performance and value to pulp that we bring to our fine paper and technical paper businesses. That includes enhancing the quality and usability of our pulp. Our new, unique wireless bale is an excellent example of that.

We will have a strong market presence in pulp. We have hired an outstanding sales and marketing team for our pulp business that brings to the table more than 20 years of experience and strong relationships with customers and the mills.

At both Terrace Bay and Pictou, we stand committed to managing the natural resources under our protection in

(left to right)

James R. Piedmonte Vice President – Operations

Bonnie C. Lind Vice President, Chief Financial Officer and Treasurer

Steven S. Heinrichs Vice President, General Counsel and Secretary

Sean T. Erwin Chairman of the Board, President and Chief Executive Officer

William K. O'Connor Vice President – Sales and Marketing

a sustainable and productive manner to maximize their long-term viability. We are on track for both pulp mills to be certified shortly to the American Forest & Paper Association's (AF&PA) Sustainable Forestry Initiative (SFI).

Strengthening our competitive position in pulp also requires making some tough decisions. One example is the closing of the No. 1 mill at our Terrace Bay plant in Ontario, Canada. As the smaller and older of the two mills at Terrace Bay, the No. 1 mill did not justify the investment necessary to compete successfully in today's global pulp market. Also, this move improved the profit-generating ability of the facility and allowed the teams to focus on improving the larger No. 2 mill and our wood costs, both necessary steps to achieve long-term viability of the plant.

The first of many annual reports

Launching a new company the size of Neenah Paper isn't something that we could do by ourselves. It took the combined efforts and support of our employees, customers and investors to make it happen. For that, and for your continued support, I extend my deepest thanks.

I hope this will be the first of a long line of Neenah Paper annual reports that you will read with interest. Actually, you can do more than just read this one; you can experience it. It's printed on a variety of some of our best-selling fine paper brands. Run your fingers across the page. That's the feel of quality paper.

The business segment and financial sections of this report cover the full year's activities in more detail. However, this report for 2004 includes only one month as an independent company. Our job is now to get to work, begin executing our strategies as a new company, and deliver the results you expect from us.

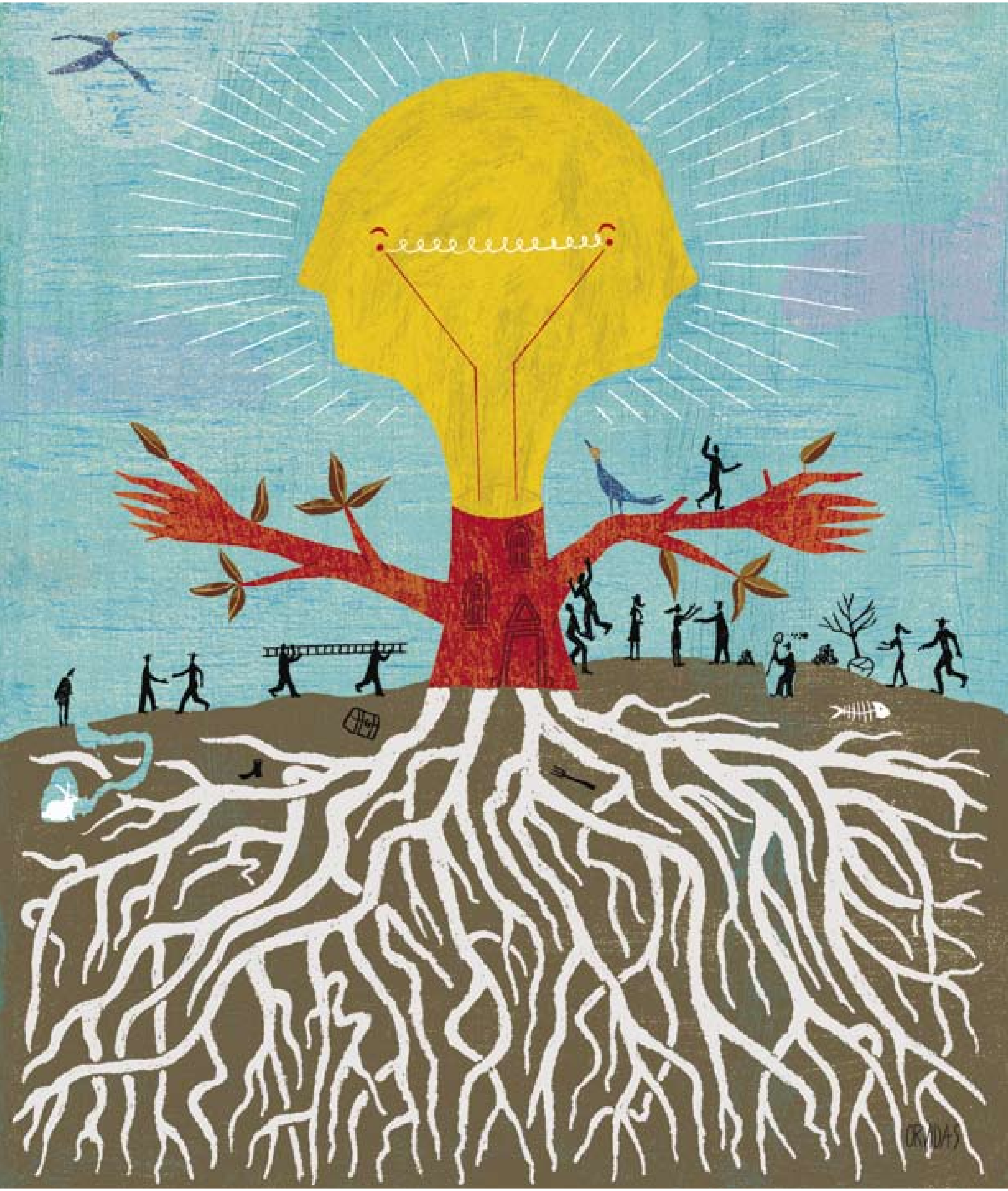
We have our work ahead of us, but we are both ready and anxious to get going.

Sean T. Erwin
Chairman, President and
Chief Executive Officer

3.

[*empower* 2,100 employees]

Innovation doesn't exist in a vacuum. So at Neenah Paper, we're creating a collaborative environment that gives Neenah Paper employees the tools and support they need to be creative. Today, employees are encouraged to cross divisional boundaries, to think innovatively, to explore new ideas and processes that add value and efficiency for customers and our company. At Neenah Paper, we believe in the power of our people and their ability to meet the challenges of this business.



250 days and counting

Watching out for the other person is part of human nature. It's also the basis of a new safety initiative, EAGLES (Employees Assessing Gaining Learning Educating Safety), at our Whiting Fine Paper mill. The plant manager at Whiting sought a safety program that mill employees could "own," rather than a program imposed on them from the top. EAGLES is employee-driven and observation-based. In short, it's employees watching out for the well-being of each other. It works, too. As of mid-March, Whiting has gone 250 days without a reportable safety accident – a significant achievement in the paper industry. On the pulp side of our business, our Terrace Bay mill in Ontario was ranked as the safest mill in Canada in 2004.

Team members (left to right)

Bonnie Vander Zanden Finishing Utility / **Duane Johnson** Shipper / **Don Jisko** EAGLES Facilitator / **Pete Sepeda** Winder Operator

Sampling made easier

In 1999, we were the first in the industry to launch a comprehensive e-Commerce site (neenahpaper.com) that allowed us to reach a whole new audience for our products. In 2004, Renee, Michelle and Eric took this service to a new level by significantly expanding options for samples and promotions, integrating all aspects of inventory and order fulfillment and compressing average shipment times by over a day. This has allowed us to promote our brands to new customers in new markets, an important driver in our future growth. This is one more example of how employee-driven teams can enhance our customers' experience.

Team members (left to right)
Eric Leicht Systems Analyst / **Michelle Turner** Customer Service Analyst / **Renee Schwartz-Johnson** Customer Service Manager

Doing more in less time

At our Pictou pulp mill in Canada, we had scheduled a 10-day maintenance shutdown, including the complicated replacement of the mill's steam vessel. But once the shutdown planning was underway, it became clear that replacing the steam vessel would take at least 12 days. Our people collaborated on a quick solution. A planning team of engineers, operators, maintenance personnel and outside contractors devised a way to do the job in eight days – allowing the mill to start up on schedule.

Team members (left to right)
Angus Pellerin Pipefitter / **Fred Anderson** Millwright

Keeping fit the Neenah Paper way

Wellness at Neenah Paper is more than just employee health screenings. At our Pictou mill, for example, our wellness program focuses on changing employees' attitudes and behavior regarding health and fitness. One of the most popular ways of doing that is through walking. Not solitary strolls, but a walking program called Beat The Feet, in which teams challenge each other to meet health-related goals.

Team members (left to right)
Anne Melanson Administrative Assistant / **Mike Pittoello** Safety and Loss Control Coordinator / **Bob Findlay** Information Services Supervisor

Polar Bear Plunge

The expression "go jump in the lake" takes on new meaning at Neenah Paper. Every winter, Ron Ebben from our Neenah, Wisconsin, mill participates in the Polar Bear Plunge. It's a jump into a frozen lake. But it's all for a good cause – The Special Olympics. This past winter, as always, there were plenty of Neenah Paper sponsors on hand to cheer him on.

Ron Ebben Warehouse Helper

A team solution

An alternative sourcing plan for premask was developed as part of a plan to alleviate capacity constraints on Munising assets. Through an inter-mill team effort, Erika and Ray in the Specialties area made it a priority to provide expertise on saturation, expedite machine trials and provide detailed feedback to the team on product performance. Consequently, the team was able to deliver commercially accepted product 25 percent ahead of the aggressive timeline.

Team members (left to right)
Erika Anderson Specialties Operations / Ray Hagman Asset Leader

4.

listen to our customers

When our customers speak, Neenah Paper aims to hear every word. This is why we have structured a strong customer service program, one that's as critical to meeting our customers' needs as the innovative solutions and the quality of the products we provide.

A new image

Working closely with Bank of America's minority partner, American Product Distributors, Neenah Paper helped enhance the look and feel of the bank's letterhead and business card – creating a private watermark with greater recycled content (40 percent). The letterhead was developed on a 25 percent CLASSIC COTTON® Papers base sheet, while the business card stock was developed using CLASSIC CREST® Papers.

Meeting the challenge

In November 2003, the scrapbook industry was in a virtual panic. Its annual tradeshow was looming and its main paper supplier had gone out of business. Although the quantities were small by Neenah Paper's standards, we viewed this as an opportunity to enter one of the fastest growing segments of the hobby market. Neenah's No. 8 machine ran all of January 2004, changing colors and finishes 5–6 times a day. The result: 40 new deep colors for the tradeshow and several new customers for us.

Keeping up with customer needs

How do you react when a customer calls requesting a paper that matches the color of his beloved alma mater? Or when a customer is looking for a product with years of longevity, high strength and a slow cure thermo set coating? If you're a Neenah Paper Customer Service Analyst, you immediately recognize an opportunity to solve a customer's problem. In 2004, Fine Paper recognized the need for improved freight service to several Midwestern markets and offered overnight delivery to these customers. Technical Paper found ways to address our customers' needs for lower-cost products by improving production processes and offering a selection of alternative raw materials. We also set up a new world-class customer service measurement system called the "perfect order." This is a more comprehensive and stringent analysis of how we are striving to exceed all facets of our customers' service expectations.

5.

utilize the best in all our businesses

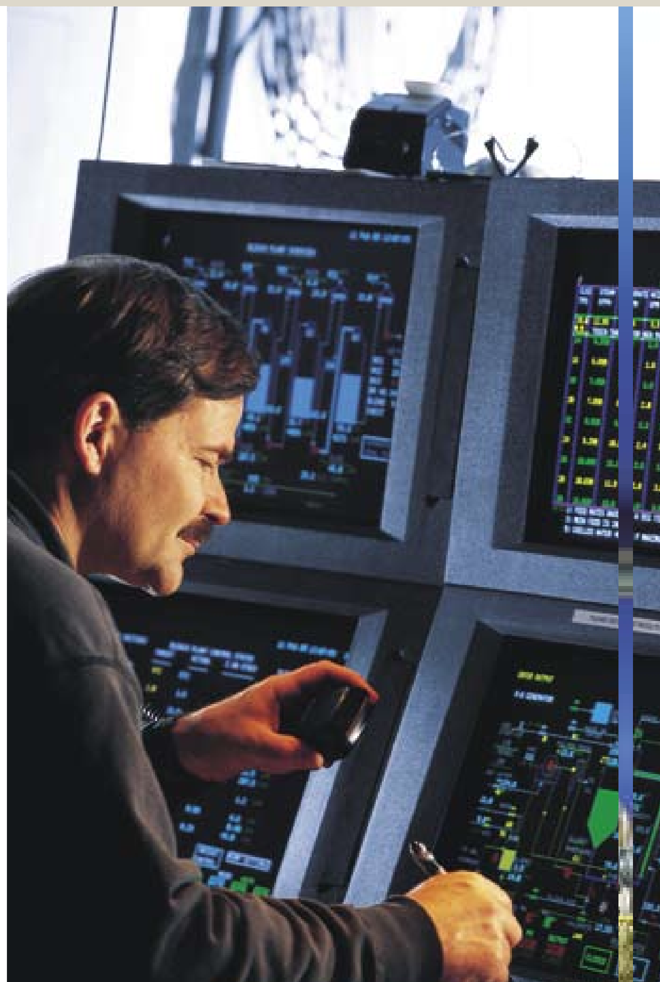
Neenah Paper is driven by quality, innovation and customer service. Operating as an integrated, cohesive company enables us to better leverage all three. All functions, including R&D and customer service, now cut across our three business lines. And we continue to invest in new technology that supports our high quality standards.

Putting quality in place

At Neenah Paper, we see quality in a variety of ways – as process improvement, as enhancements to customer service, as exceeding customers' expectations as well as our own.

Right now, process improvement is underway at the Munising mill, where we produce our technical paper. Improvements include the installation of a new headbox, a major piece of equipment used to control sheet formation; a stock screen; and a defect detector. Collectively, those represent the most significant process upgrades to the mill in decades.

We are sharpening our focus on customer service, too. Our online Fine Paper Customer Service System is operational, ensuring that customers receive the right samples at the right time. And when our ERP system goes online later this year, it will add efficiency and support to everything from customer service to manufacturing.



Exceeding our customers' expectations is key to our success. Our Munising facility saw a 34 percent reduction in the number of customer complaints. Our Fine Paper facilities experienced a 41 percent reduction in the cost of claims.

(from left to right)

Recently installed high-speed defect detector scans rolls of paper at our Munising mill.

In the process control room at our Pictou mill, where operators monitor the entire process from one central control station.

Saturated paper machine at the Munising mill.

Safety process inspector watches sheeting operation at our Whiting mill.

6.

invest in *creative thinking*

Research and development play a pivotal role in Neenah Paper's success. Today, our cross-divisional team of wood and paper scientists and engineers are housed together in our new R&D facility in Roswell, Georgia, near Neenah Paper's corporate headquarters. The team mission: to exploit the unique characteristics of our raw materials and processes to create differentiators across all three of our product segments: Fine Paper, Technical Paper and Pulp. New ideas that lead to greater value – that's the Neenah Paper way.


ORVIDAS

Solving problems the Neenah Paper way

At Neenah Paper, our R&D process is a collaborative one. A good example of that is the recent development of the EAMES™ Paper Collection, our new, innovative paper line. Creating these papers involved a dedicated team of people, from R&D, Marketing and Operations and cut across both our Fine Paper and Technical Paper facilities. The resultant EAMES Paper Collection, a collaboration with the Eames Office Foundation, represents a new approach to paper making based on the design and color principles of renowned designers Charles and Ray Eames. The EAMES Paper Collection also represents something else: how Neenah Paper's previous stand-alone businesses are now working together to produce results.

The major focus of our R&D activity is developing solutions that meet our customers' needs – both current and prospective customers. In one case, a prospective Technical Paper customer encountered a costly manufacturing glitch in developing a new product. Fixing the problem would

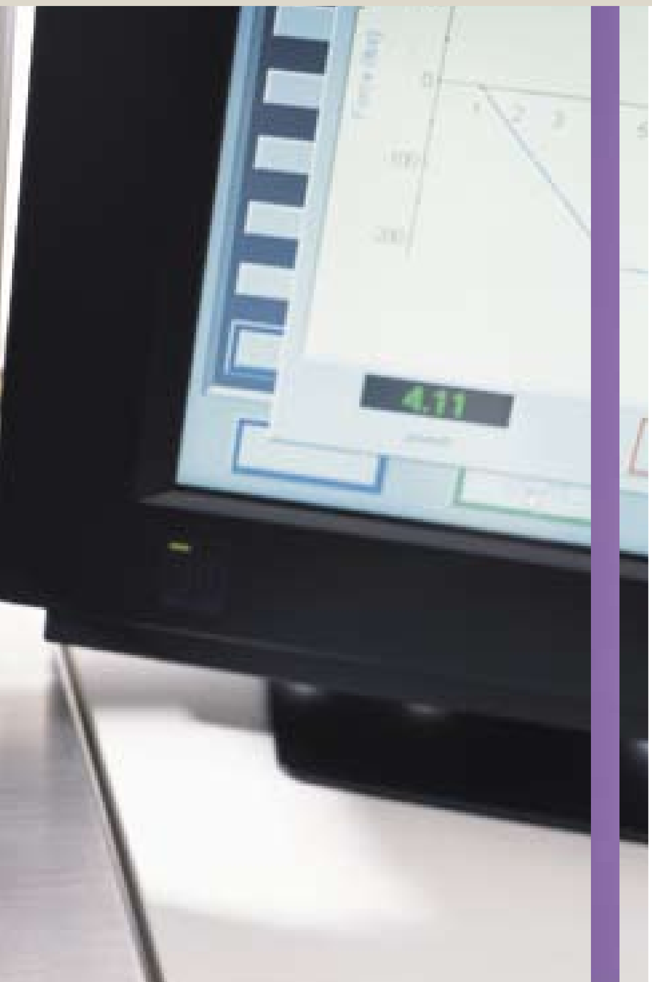
have required a sizeable investment in new equipment and an expensive change to their production processes. Neenah Paper's R&D team came to the rescue and developed a more cost-effective solution, one that involved only the addition of a simple step. Consequently, this prospective customer became a new customer for Neenah Paper!

(from left to right)

Mike Lindquist at our Munising mill: his innovative solution to a customer's problem helped us keep the business.

A battery of quality tests, like this one for internal strength, ensures a quality sheet.

Dave Winger at our Neenah mill: one of the team members who developed our new EAMES™ Brand of papers.



7.

[*respect* and *protect* the environment]

Neenah Paper's respect for the environment is part of our corporate DNA and is apparent from our strong record in environmental performance. Today, Neenah Paper is building on that foundation. So it should be no surprise that the water treatment systems in all our mills surpass regulatory standards. Or that our stewardship program protects several unique areas in both Ontario and Nova Scotia. Or that our ENVIRONMENT® Brand of premium 100 percent recycled paper is immensely popular with both designers and customers.

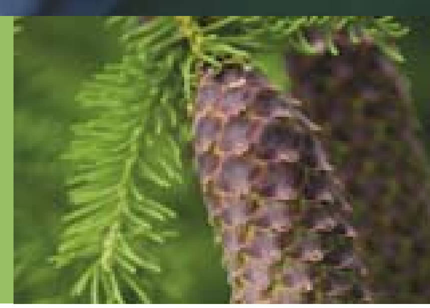
Doing our part

As part of Neenah Paper's stewardship program, many unique areas have been permanently protected, including old growth forests, seabird sanctuaries, and areas of geological, cultural and historic significance. These areas were identified through collaboration with government agencies and conservation groups such as the Nature Conservancy of Canada. In addition, Neenah Paper has made available thousands of acres of company owned and leased lands for public enjoyment through the creation of over 30 parks and wilderness areas in Ontario and Nova Scotia.

The Pictou woodlands facilities encompass approximately 1.2 million acres of combined owned and licensed or managed land in Nova Scotia. As part of this operation, we own and operate a tree nursery which produces and ships 8.5 million seedlings annually that are used in the reforestation of lands harvested by Neenah Paper as well as other designated areas.

Neenah Paper is a leader in the manufacturing of environmentally friendly papers. As part of our sustainability program, we use post-consumer and recycled fiber as well as alternate fibers, like sugar cane bagasse. Since its debut

Neenah Paper's forest tree nursery in Nova Scotia supplies millions of softwood seedlings for the company's extensive reforestation programs. The seedlings are also playing an important role in helping children at the IWK Hospital for Children in Halifax. In a unique partnership with students at Prince Andrew High School over the past three years, more than 60,000 seedlings have been distributed to city residents in return for donations to the hospital. The result: over $40,000 raised for the kids and a greener city!



in 1990, the ENVIRONMENT® Brand of premium papers from Neenah Paper has led the industry in this category and has been one of our fastest-growing brands. Two colors of ENVIRONMENT Brand – White and Ultra Bright White – have received certification from SmartWood, a representative of the Forest Stewardship Council (FSC), an international non-profit organization devoted to encouraging the responsible management and sustainability of the world's forests.

In another important step in our history of managing our forestlands responsibly, we are in the process of having our woodlands operations in Ontario and Nova Scotia third-party certified by the standards of the Sustainable Forestry Initiative (SFI). Similar to ISO 14001, SFI is a comprehensive system of principles and performance measures that provides a means of assuring the public, our customers and our employees that we are following environmentally sound forestry practices. While our woodlands currently operate in a manner designed to ensure stakeholder involvement and considerations for all forest values, obtaining certification to the strict standards of SFI provides yet another level of assurance.

Neenah Paper At-a-Glance

Neenah Paper is recognized as a world-class manufacturer of fine paper, technical paper and pulp.

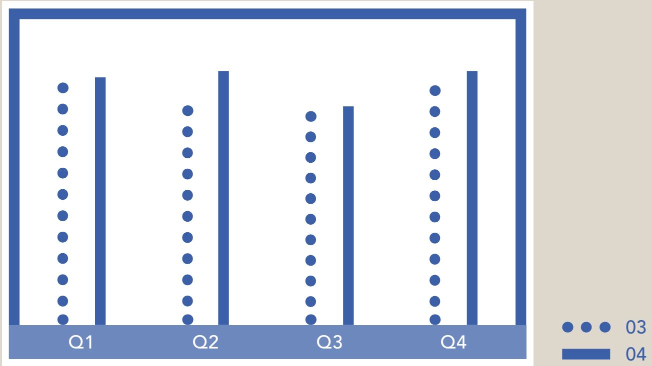
Our Fine Paper division produces premium writing, text, cover, specialty and private watermark papers that are used in corporate annual reports, corporate identity packages, invitations, personal stationery and high-end packaging. Our premium paper brands are some of the most recognized and preferred in the industry, including CLASSIC®, CLASSIC CREST®, ENVIRONMENT®, NEENAH® and UV/ULTRA® II Papers.

Our Technical Paper division is regarded as an industry leader in research, technology and problem solving, focused on durable, saturated and coated base papers for a variety of end uses. For more than half a century, our innovative paper products have replaced those made from wood, plastic, cloth and leather. Our technical papers are used in a wide array of applications – from labels and tape to heat transfer and medical packaging – and our customers are located in 39 countries around the world.

Our pulp business consists of mills in Pictou, Nova Scotia and Terrace Bay, Ontario, together with related timberlands. These mills produce northern softwood kraft pulp and northern hardwood kraft pulp, which are used in the manufacture of tissue, publication, premium writing, printing and other specialty papers.

Fine Paper

In 2004, our Fine Paper business achieved four consecutive quarters of year-on-year volume growth.



Change in Volume 2003 vs. 2004

Our Brands

- CLASSIC CREST®
- CLASSIC COTTON®
- CLASSIC® Linen
- CLASSIC® Laid
- CLASSIC COLUMNS®
- NEENAH® Bond
- UV/ULTRA® II
- ATLAS™ Bond
- ENVIRONMENT® Papers
- EAMES™ Paper Collection
- OLD COUNCIL TREE® Bond

Market Opportunities

Today, Neenah Paper participates in the premium text and cover market segment which represents only 3 percent of the total uncoated printing and writing market. The opportunity to move more customers up to using premium papers to enhance their message is enormous. As a stand-alone company and market leader, Neenah Paper now has the opportunity to drive growth in this segment, as well as explore new distribution channels, products and geographies.

2004 Highlights

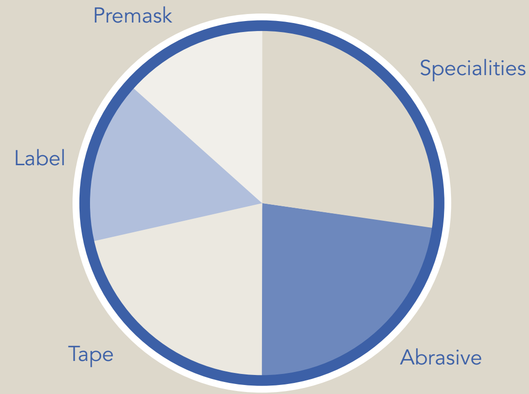
- Total volumes grew 7 percent, driving 5 percent growth in net sales.
- Operating income grew 6 percent, with operating margins maintained over 30 percent.
- Our ENVIRONMENT® Papers gradeline was revised to meet evolving customer needs and continues as our fastest-growing Fine Paper brand.
- Fine Paper branded print advertising campaign rated number one in awareness and believability in several graphic design industry publications.
- Fine Paper assets successfully qualified and began manufacturing base paper for Technical Paper to meet demand in this segment.

Key Strengths

Neenah Paper's strong brands and focus on customer service and quality, coupled with the newest and most efficient asset base in the premium papers segment, have led paper distributors, printers and designers to specify Neenah Paper for their premium paper needs.

Technical Paper

Our innovative technical papers provide performance and value to a wide variety of customers and end uses.



2004 Net Sales

Our Brands

KIMDURA®
EPIC II®
DURAFORM®
DURAFLEX®
BUCKSKIN®
PREVAIL®
TEXOPRINT®
MUNISING LP®
TECHNI-PRINT®
KIMLON®
PHOTO-TRANS®
HEIRLOOM®
NEENAH™

Key Strengths

Our years of experience and significant intellectual capital in the production of specialty substrate materials – combining fibers, a variety of synthetic lattices and multiple coating materials – make many products in Neenah Paper's Technical Paper division unique. This expertise is combined with a R&D group that is passionate in their work in driving innovation and working closely with customers in finding new and improved uses and products.

2004 Highlights

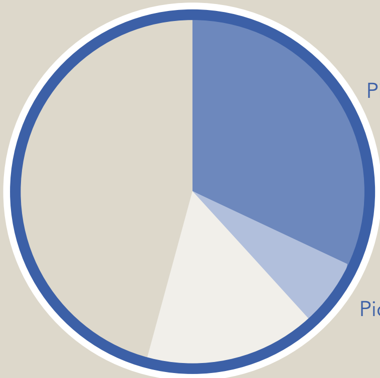
- Volume grew 7 percent, with contributions across 15 product segments and in U.S., European, Asian and Latin American markets.
- Net sales and operating income increased 9 and 32 percent, respectively.
- The Munising Mill celebrated 100 years of operation.
- Successful launch of EPIC II® Graphic Materials line of text book covers complemented our Decorative Component product line.

Market Opportunities

Technical Paper is positioned to further grow both in the U.S. and overseas. The additional focus and resources in R&D are also expected to result in additional growth opportunities with new and improved products.

Pulp

The Terrace Bay and Pictou mills produce more than 700,000 metric tons of pulp annually. The majority of Neenah Paper's pulp production goes into Kimberly-Clark products.



2004 Production *(metric tons)*

2004 Highlights

- Neenah Paper's net sales grew 11 percent in 2004.
- Terrace Bay was again named the safest paper mill in Canada by *Pulp and Paper Canada* magazine.
- The Terrace Bay mill began producing "wireless bales" for its hardwood pulp production.
- Neenah Paper's Pictou mill set the highest productivity level in its 58-year-old history, with over 264,000 metric tons.

Key Strengths

Both the hardwood and softwood pulp produced at the mills have been noted for their many important quality and product characteristics. Neenah Paper's background as a paper company and as part of Kimberly-Clark's tissue operations also give us unique insights into what characteristics are important to our customers.

Market Opportunities

As a new entry to the market pulp industry, Neenah Paper has many opportunities to develop new customers. Pictou's location in Nova Scotia makes it an ideal shipping point for delivery to Europe.

Board of Directors







Sean T. Erwin
Chairman of the Board, President and Chief Executive Officer
Neenah Paper, Inc.

Timothy S. Lucas, CPA
Independent Consultant
Lucas Financial Reporting

Philip C. Moore
Partner
McCarthy Tétrault, L.L.P.

Stephen M. Wood, Ph.D.
Former Chief Executive Officer
Kraton Polymers LLC

Mary Ann Leeper, Ph.D.
President and
Chief Operating Officer
Female Health Company

James G. Grosklaus
Retired Executive Vice President
Kimberly-Clark Corporation

Edward Grzedzinski
Former Chief Executive Officer
NOVA Information Systems

Financials

The following discussion and analysis presents the factors that had a material effect on our results of operations during the years ended December 31, 2004, 2003 and 2002. Also discussed is our financial position as of the end of those periods. You should read this discussion in conjunction with our consolidated and combined financial statements and the notes to those consolidated and combined financial statements included elsewhere in this Annual Report. This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. See "Forward-Looking Statements" for a discussion of the uncertainties, risks and assumptions associated with these statements.

INTRODUCTION

As more fully described in the "Business Outlook" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations, the results of operations of our business after the Spin-Off are and will continue to be significantly different than the results of operations of our business prior to the Spin-Off. This difference results from, among other things, the prices at which we sell pulp to Kimberly-Clark after the Spin-Off, which are significantly different than the prices reflected in transfers of pulp to other Kimberly-Clark operations prior to the Spin-Off, interest expense of new long-term debt and incremental selling, general and administrative expenses related primarily to reduced economies of scale as a result of operating on a stand-alone basis. To understand how the terms of our pulp supply agreement with Kimberly-Clark would have affected our historical results, you should see the "Business Outlook" section.

This Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to provide investors with an understanding of the historical performance of our business, its financial condition and its prospects. We will discuss and provide our analysis of the following:

- Overview of Business;
- Business Segments;
- Separation from Kimberly-Clark;
- Results of Operations and Related Information;
- Liquidity and Capital Resources;
- Critical Accounting Policies and Use of Estimates; and
- Business Outlook.

OVERVIEW OF BUSINESS

We are a leading North American producer of premium fine papers and technical papers. We also produce bleached kraft market pulp in Canada, where we own approximately one million acres of timberlands and have non-exclusive rights to harvest wood from approximately 4.8 million acres of other timberlands. We have three primary operations: our fine paper business, our technical paper business and our pulp business.

In managing this diverse pulp and paper business, management believes that achieving and maintaining a leadership position for its fine paper and technical paper businesses, responding effectively to competitive challenges, employing capital optimally, controlling costs and managing currency and commodity risks are important to the long-term success of the business. The pulp cycle and general economic conditions also impact our results. In this discussion and analysis, we will refer to these factors.

Market Leadership. Achieving and maintaining leadership for our fine paper and technical paper businesses have been an important part of our past performance. We have long been recognized as a leading manufacturer of world-class premium writing, text and cover papers used in corporate annual reports, corporate identity packages, invitations, personal stationery and high-end packaging. Maintaining our leadership is important to our results, particularly in light of the competitive environment in which we operate.

Competitive Environment. Our past results have been and future prospects will be significantly affected by the competitive environment in which we operate. We experience intense competition for sales of our principal products in our major markets. Our paper business competes directly with well-known competitors, some of which are larger and more diversified in most of our markets. In our pulp business, we have experienced, and will continue to experience, intense competition from suppliers of softwood pulps and southern hemisphere suppliers of hardwood pulps. We expect our competitors to continue to be aggressive in the future.

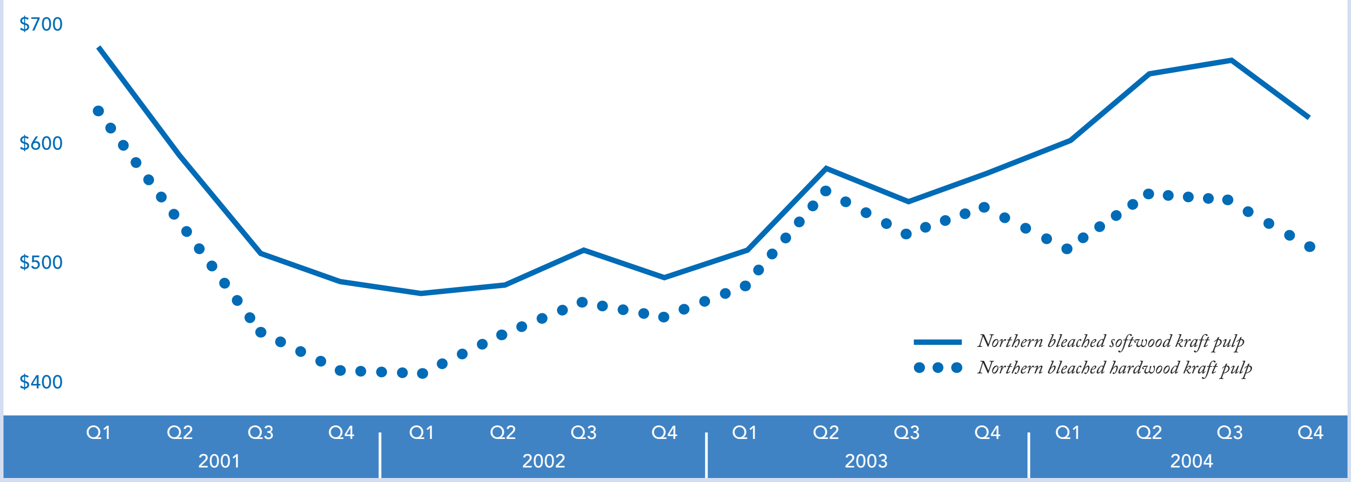
Cost Control. To improve and maintain our competitive position, we must control our raw material, manufacturing, distribution and other costs. A major share of our investments in capital improvements are intended to achieve cost savings and improvements in productivity.

Cyclical Nature of the Pulp Industry. Revenues in the pulp industry and our pulp business tend to be cyclical, with periods of shortage and rapidly rising market prices, leading to increased production and increased industry investment until supply exceeds demand. Those periods are then typically followed by periods of reduced market prices and excess and idled capacity until the cycle is repeated.

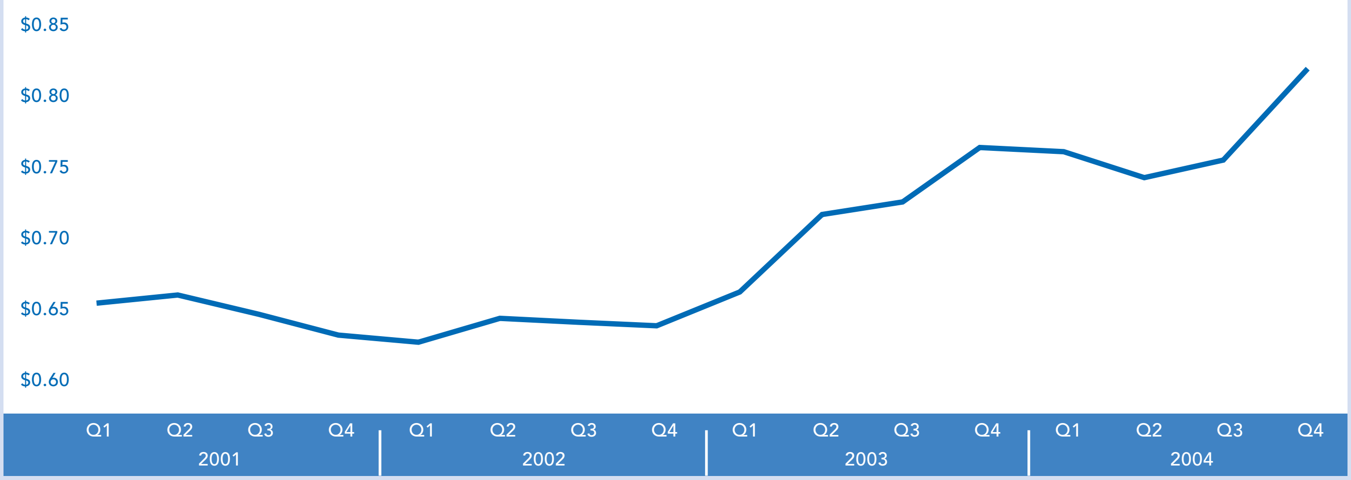
General Economic Conditions. The markets for all of our products are affected to a significant degree by general economic conditions. Downturns and improvements in the U.S. economy or in our export markets affect the demand for our products.

Foreign Currency and Commodity Risk. Sales of pulp by our Canadian manufacturing facilities are invoiced in U.S. dollars in accordance with industry practice; therefore, no currency effects are presented in our analysis of the change in net sales for our pulp operations. However, we are exposed to changes in foreign currency exchange rates because most of the costs relating to our pulp business are incurred in Canadian dollars. These risks could have a material impact on our results of operations if not effectively managed. The following charts illustrate changes in currency and pulp prices that occurred during the periods covered by this Management's Discussion and Analysis of Financial Condition and Results of Operations:

Pulp Price History: Average Quarterly Prices *U.S. dollars per metric ton*



Exchange Rate History: Average Quarterly Exchange Rates *Canadian dollar per U.S. dollar*



Source: Resource Information Systems, Inc.

BUSINESS SEGMENTS

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, with sales to distributors and distributor-owned paper stores accounting for approximately 85% of our sales. We believe that our fine paper manufacturing facilities located in Neenah and Whiting, Wisconsin are among the most efficient in their markets and make us one of the lowest cost producers.

Our technical paper business is a leading producer of durable, saturated and coated base papers for a variety of end uses. We sell our technical paper globally into 15 product categories, and we focus on nine categories where we believe we are a market leader, which include, among others, the tape, label, abrasive, medical packaging and heat transfer technical paper 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 39 countries and include 3M Company, Perfecseal, Avery Dennison Corporation and Saint-Gobain Group. Our technical paper manufacturing facility is located in Munising, Michigan.

Our pulp business consists of two mills located in Pictou, Nova Scotia and Terrace Bay, Ontario, together with related timberlands. The Pictou mill is comprised of a single-line pulp facility which produces primarily softwood pulp, as well as timberlands encompassing approximately one million acres of owned and 200,000 acres of licensed or managed land in Nova Scotia. In 2004, the Pictou mill produced approximately 260,000 metric tons of bleached kraft pulp. The Terrace Bay mill is comprised of two single-line pulp facilities which produce both softwood and hardwood pulp and a timberlands operation. Terrace Bay holds non-exclusive rights under a sustainable forest license to harvest wood from approximately 4.6 million acres of land owned by the Province of Ontario. In 2004, the Terrace Bay mill produced approximately 450,000 metric tons of pulp. As described in "Business Outlook – Recent Developments" below, on March 1, 2005, we announced our intention to close one of the two single-line pulp facilities at Terrace Bay in early May 2005.

SEPARATION FROM KIMBERLY-CLARK

Neenah Paper, Inc. was incorporated under the laws of the state of Delaware in April 2004, as a wholly owned subsidiary of Kimberly-Clark. We had no material assets or activities until the transfer to us by Kimberly-Clark of the businesses described in this Annual Report, which occurred immediately prior to the Spin-Off. Prior to the Spin-Off, Kimberly-Clark had conducted such businesses through various divisions and subsidiaries. Following the Spin-Off, we became an independent, public company, and Kimberly-Clark has no continuing ownership interest in us.

Prior to the Spin-Off, we entered into several agreements with Kimberly-Clark in connection with the separation of our business from Kimberly-Clark's businesses. These agreements included a distribution agreement, a pulp supply agreement, a corporate services agreement, an employee matters agreement and a tax-sharing agreement. The distribution agreement provided for the transfer to us of the assets relating to Kimberly-Clark's Canadian pulp business and its fine paper and technical paper business in the United States, and the assumption by us of the liabilities relating to these businesses. The pulp supply agreement supports our transition from a captive pulp producer to a market supplier of pulp. The corporate services agreement facilitates an orderly transition from being a part of a larger company to a stand-alone company. The employee matters agreement allocates responsibilities relating to employee compensation and benefit plans and programs and other related matters. The tax-sharing agreement governs tax obligations arising out of our business both before and after the Spin-Off.

RESULTS OF OPERATIONS AND RELATED INFORMATION

In this section, we discuss and analyze our net sales, income before interest and income taxes (which we refer to as "operating income" in this Management's Discussion and Analysis of Financial Condition and Results of Operations) and other information relevant to an understanding of our results of operations for the years ended December 31, 2004, 2003 and 2002.

Analysis of Net Sales – Years Ended December 31, 2004, 2003 and 2002

The following table presents net sales by segment, expressed as a percentage of total net sales before intersegment eliminations:

Year Ended December 31,	2004	2003	2002
Fine Paper	28%	29%	31%
Technical Paper	16	16	17
Pulp	56	55	52
Total	100%	100%	100%

The following table presents our net sales by segment for the periods indicated:

Year Ended December 31,[(a)]	2004	2003	2002
(in millions)			
Fine Paper	$ 220.8	$ 210.4	$ 224.7
Technical Paper	132.3	121.6	120.7
Pulp	448.6	405.1	380.0
Eliminations	(29.6)	(26.8)	(23.4)
Total	$ 772.1	$ 710.3	$ 702.0

(a) The above amounts of Net sales for the years ended December 31, 2003 and 2002 have been increased from the amounts previously reported by $44.5 million and $44.0 million, respectively, to be in conformity with EITF 00-10, which prohibits the netting of shipping and handling costs against revenues.

Commentary:

Year 2004 versus 2003

	Percent Change in Net Sales Versus Prior Year				
		Change Due to			
	Total Change	Volume	Net Price	Product Mix	Currency
Combined	9	2	7	–	–
Fine paper	5	7	–	(2)	–
Technical paper	9	7	–	1	1
Pulp[(a)]	11	(2)	13	–	–

(a) Sales of pulp by our Canadian manufacturing facilities are invoiced in U.S. dollars in accordance with industry practice; therefore, no currency effects are presented in our analysis of the change in net sales for our pulp operations.

Total net sales increased $61.8 million, or 8.7%, in 2004 compared with 2003 primarily due to higher average market prices for softwood and hardwood pulp and unit volume growth in the fine and technical paper businesses.

Our fine paper business net sales increased $10.4 million, or 4.9%, primarily due to 7% growth in unit volumes. Unit volumes increased due to a strengthening U.S. economy that boosted market demand for premium papers, new product introductions and higher promotional spending. Product mix was unfavorable as sales volumes shifted to a higher proportion of lower-priced grades.

Our technical paper business net sales increased $10.7 million, or 8.8%, primarily due to 7% growth in unit volumes. The volume growth reflected increased market demand as a result of an improving global economy and new product introductions. Product mix was favorable as sales volumes shifted to a higher proportion of higher-priced grades.

Our pulp business net sales increased $43.5 million, or 10.7%, primarily due to higher softwood pulp prices. Average market prices for softwood and hardwood pulp increased 15% and 2%, respectively. The higher prices in 2004, particularly for softwood pulp, reflected increased global demand. Net sales subsequent to the Spin-Off (in December 2004) were reduced by $12.9 million or 3.2% lower compared to total 2003 pulp revenues, reflecting the one-time effect resulting from the new pulp supply agreement with Kimberly-Clark which transfers title at product delivery rather than shipment date.

Year 2003 versus 2002

	Percent Change in Net Sales Versus Prior Year			
		Change Due to		
	Total Change	Volume	Net Price	Product Mix
Combined	1	(5)	6	–
Fine paper	(6)	(6)	1	(1)
Technical paper	1	(2)	1	2
Pulp[(a)]	7	(5)	12	–

(a) Sales of pulp by our Canadian manufacturing facilities are invoiced in U.S. dollars in accordance with industry practice; therefore, no currency effects are presented in our analysis of the change in net sales for our pulp operations.

Total net sales increased $8.3 million, or 1.2%, in 2003 compared with 2002.

Our fine paper business net sales decreased $14.3 million, or 6.4%, primarily due to 6% lower sales volumes. Weakness in the U.S. economy and trends toward increased use of lower-priced papers reduced demand for premium papers. Slightly higher net selling prices due to a May 2003 price increase were offset by additional discounts and a less favorable product mix, as sales volumes shifted to a higher proportion of lower-priced grades.

Our technical paper business net sales increased $0.9 million, or 0.7%. Unit sales volumes in total were flat while selling prices were slightly higher, following a 1.8% average price increase in the second quarter of 2003.

Our pulp business net sales increased $25.1 million, or 6.6%, primarily due to price increases. Average market prices for softwood and hardwood pulp increased 13% and 18%, respectively. These improvements were tempered by a 5% decline in volume primarily due to unusually high sales in 2002, as Kimberly-Clark increased consumption of hardwood pulp in order to reduce hardwood pulp inventory levels. Hardwood pulp inventories increased in 2001 as Kimberly-Clark substituted softwood pulp consumption for hardwood pulp and also due to reduced hardwood pulp sales to external customers.

The following table sets forth line items from our consolidated and combined statements of operations as a percentage of net sales for the periods indicated and is intended to provide a perspective of trends in our historical results:

Year Ended December 31,	**2004**	2003	2002
Net sales	**100.0 %**	100.0 %	100.0 %
Cost of products sold	**83.9**	84.8	81.3
Gross profit	**16.1**	15.2	18.7
Selling, general and administrative expenses	**5.9**	4.9	4.8
Asset impairment loss	**14.6**	–	–
Other (income) and expense – net	**0.7**	1.4	(0.2)
Operating income (loss)	**(5.1)**	8.9	14.1
Interest expense	**0.2**	–	–
Income (loss) before income taxes	**(5.3)**	8.9	14.1
Provision (benefit) for income taxes	**(1.9)**	3.4	5.2
Net income (loss)	**(3.4)%**	5.5 %	8.9 %

Analysis of Operating Income (Loss) – Years Ended December 31, 2004, 2003 and 2002

The following table sets forth our pre-tax income (loss) by segment for the periods indicated:

Year Ended December 31,	**2004**	2003	2002
(in millions)			
Fine Paper	**$ 67.0**	$ 63.2	$ 77.2
Technical Paper	**21.9**	16.6	18.4
Pulp	**(120.5)**	(16.5)	3.7
Corporate costs	**(8.3)**	–	–
Total	**$ (39.9)**	$ 63.3	$ 99.3

Asset Impairment Loss

Our Terrace Bay, Ontario pulp mill incurred operating losses in 2002, 2003 and 2004. We anticipate that the facility will continue to incur operating losses in 2005, 2006 and 2007. The principal causes of these projected losses are:

- continued high operating costs at this facility;
- prices for pulp sold to Kimberly-Clark under the new pulp supply agreement, which will be at substantially higher discounts than those at which pulp was transferred to Kimberly-Clark prior to the Spin-Off;
- anticipated lower market prices for pulp in the second half of 2005 and forward as a result of an expected downturn in the pulp cycle; and
- continued strength of the Canadian dollar relative to the U.S. dollar.

Because projected extended periods of operating losses are indicators of impairment under Statement of Financial Accounting Standards ("SFAS") 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"), we performed an asset impairment test on the facility under the guidance of SFAS 144, which indicated that the carrying amount of the Terrace Bay facility would not be recoverable from estimated future cash flows. Accordingly, in December 2004, we recorded a pre-tax, non-cash impairment loss of approximately $110.0 million to reduce the carrying amount of the Terrace Bay facility. In addition, in December 2004, in recognition of the probability that the No. 1 mill would be closed (see "Business Outlook–Recent Developments" below), we recorded an additional impairment loss of approximately $2.8 million related to the long-lived assets of the Terrace Bay facility. A deferred tax benefit of approximately $40.8 million was also recorded as a result of the impairment losses, resulting in a net after-tax charge of approximately $72.0 million.

In determining the impairment losses, the estimated fair value of the Terrace Bay facility was based on probability-weighted pre-tax cash flows from operating the facility, discounted at a risk-free interest rate. The significant assumptions used to determine fair value of the facility included our long-term projections of the market price of pulp, the projected cost structure of the facility and the long-term relationship of the Canadian dollar and the U.S. dollar. We also considered our plans to improve the cost structure at Terrace Bay, primarily through future capital projects and a plan for a cogeneration arrangement that would lower the cost of electricity, when determining the fair value of the facility used to determine the impairment losses. This estimate of the fair value of the Terrace Bay facility reflects these assumed improvements to the facility's cost structure.

Prior to the Spin-Off, Kimberly-Clark's management also performed an impairment test of the Terrace Bay facility under the guidance of SFAS 144. The purpose of that analysis was to determine if the Terrace Bay facility was impaired when held by Kimberly-Clark prior to the Spin-Off. As operated by Kimberly-Clark, the Terrace Bay facility supplied more than 90% of the pulp it produced to other Kimberly-Clark businesses where it was used to produce tissue and other products. Kimberly-Clark's management concluded that the facility was not impaired prior to the Spin-Off because, as used by Kimberly-Clark, it was an integrated part of Kimberly-Clark's tissue and other businesses and the estimated undiscounted future cash flows of the businesses consuming such pulp were sufficient to recover the carrying amounts of their long-lived assets, including the Terrace Bay facility.

Commentary:

Year 2004 versus 2003

	Percent Change in Operating Income Versus Prior Year					
		Change Due to				
	Total Change	Volume	Net Price	Fiber/ Wood Mix	Currency	Other[b]
Combined[c]	–	–	–	–	–	–
Fine paper	6	9	(2)	(3)	–	2
Technical paper	32	12	(3)	(12)	9	26
Pulp[a][c]	–	–	–	–	–	–

(a) The operating loss for our pulp business in 2004 includes an impairment loss of $112.8 million for our Terrace Bay facility.

(b) Includes distribution, pension, energy and other costs.

(c) Percentage changes from prior period have been omitted from this table for Combined and Pulp because percentage changes are not meaningful when there is operating income in one period and an operating loss in the other.

Overall operating income decreased $103.2 million and we incurred an operating loss of $39.9 million in 2004 primarily due to the impairment loss for Terrace Bay ($112.8 million pre-tax).

Our fine paper business operating income increased $3.8 million primarily due to the higher sales volumes and improved manufacturing operations and the benefits of cost reduction programs. These gains were partially offset by higher costs for fiber, energy and other materials and a less profitable product mix. In addition, results in 2003 included charges of $1.1 million for a workforce reduction and $1.3 million for a write-off of a paper machine.

Our technical paper business operating income increased $5.3 million, or 31.9% due to improved manufacturing operations, higher sales volumes and favorable foreign currency effects. The improved manufacturing costs were due to increased productivity, reduced waste and the benefits of cost reduction programs.

Our pulp business operating loss increased $104.0 million in 2004 and we incurred an operating loss of $120.5 million primarily due to the impairment loss for Terrace Bay. Higher selling prices of 15% and 2% for softwood and hardwood pulp, respectively, were partially offset by unfavorable currency effects and increased manufacturing costs. The higher costs resulted from a 7% decrease in the average exchange rate for the U.S. dollar relative to the Canadian dollar as well as higher fiber and maintenance costs.

We incurred $8.3 million of corporate expenses in 2004, including approximately $4.5 million of one-time start-up costs relating to our becoming an independent, public company and other post-Spin-Off costs to operate as a stand-alone company. There were no comparable costs in 2003.

Year 2003 versus 2002

	Percent Change in Operating Income Versus Prior Year					
		Change Due to				
	Total Change	Volume	Net Price	Fiber/ Wood Mix	Currency	Other[a]
Combined	(36)	(8)	9	(10)	(12)	(15)
Fine paper	(18)	(8)	2	(4)	–	(8)
Technical paper	(10)	(4)	3	(4)	3	(8)
Pulp[b]	–	–	–	–	–	–

(a) Includes distribution, pension, energy and other costs.

(b) Percentage changes from prior period have been omitted from this table for Pulp because percentage changes are not meaningful when there is pre-tax income in one period and a pre-tax loss in the other.

Overall operating income decreased $36.0 million, or 36.3%, in 2003 compared with 2002.

Our fine paper business operating income declined $14.0 million primarily due to the lower sales volumes and higher manufacturing costs. Manufacturing costs increased due to higher costs for fiber, energy and other materials and higher pension expense, as well as lower efficiencies resulting from the volume declines. These increases were partly offset by cost reduction programs that reduced certain raw material costs and improved labor efficiencies, as well as lower spending for advertising and general expenses. In addition, 2003 included the previously mentioned charges of $1.1 million for the workforce reduction and $1.3 million for the write-off of a paper machine.

Our technical paper business operating income decreased $1.8 million, as increased costs for fiber and manufacturing labor more than offset slightly higher-selling prices. Included in 2002 was $1.3 million received as a settlement for the synthetic label and specialties contract that was terminated in 2001.

Our pulp business operating income decreased $20.2 million and the business incurred an operating loss of $16.5 million in 2003. Higher-selling prices of 13% and 18% for softwood and hardwood pulp, respectively, were offset by increased manufacturing costs. These higher costs were a result of an average 12.0% weakening of the U.S. dollar relative to the Canadian dollar as well as higher wood and energy costs and lower mill efficiencies. Foreign currency transactional losses in 2003 were $10.5 million, versus a gain in 2002 of $0.2 million.

Additional Statement of Operations Commentary:

Selling, general and administrative expenses were $45.8 million, $34.6 million and $33.6 million for the years ended 2004, 2003 and 2002. The increase in 2004 is primarily due to $4.5 million of one-time, start-up costs related to our becoming an independent, public company and other post Spin-Off costs to operate as a stand-alone company.

We incurred $1.4 million of interest expense on our $225 million of senior notes for the month of December (following the Spin-Off).

The effective tax rate was 36.1%, 38.5% and 37.3% for the years 2004, 2003 and 2002, respectively. The decrease in the rates between 2004 and 2003 was primarily due to lower state and local income taxes. The increase in the rates between 2002 and 2003 was primarily due to the phase out of a Nova Scotia tax credit related to capital spending that ended in 2002 (see Note 4 of Notes to the Consolidated and Combined Financial Statements included elsewhere in this Annual Report for a reconciliation of the annual effective tax rates).

LIQUIDITY AND CAPITAL RESOURCES

(in millions) *Year Ended December 31,*	**2004**	2003	2002
Net cash flow provided by (used in):			
Operating activities	**$ 76.0**	$ 73.6	$ 111.8
Investment activities	**(19.1)**	(23.6)	(16.0)
Financing activities	**(37.8)**	(50.0)	(95.8)
Capital expenditures	**19.1**	24.4	18.4

Operating Cash Flow Commentary

Cash provided by operations of $76.0 million for the year ended December 31, 2004 increased $2.4 million from 2003. This increase was the result of increased earnings (after adjusting for the non-cash Terrace Bay impairment loss and related deferred tax benefits), partially offset by a smaller decrease in operating working capital than 2003, as discussed below. Cash provided by operations decreased $38.2 million or 34.2% in 2003 compared with 2002 primarily due to lower net income.

During 2004, higher average selling prices for pulp resulted in significantly higher accounts receivable and increased our investment in working capital at December 31, 2004 to $118.4 million. As a percentage of net sales, year-end working capital ranged between 14.0% and 15.3% during the period 2002 through 2004.

For periods subsequent to the Spin-Off, cash provided by operations will be adversely impacted by sales of pulp to Kimberly-Clark at higher discounts than those used to price transfers of pulp to Kimberly-Clark operations in the past. See "Business Outlook" contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of how our historical results would have been different if the higher discounts had been in effect.

Contractual Obligations

The following table presents the total contractual obligations for which cash flows are fixed or determinable as of December 31, 2004:

(in millions)	2005	2006	2007	2008	2009	Beyond 2009	Total
Unconditional purchase obligations	$ 39.5	$ 26.0	$ 25.8	$ 25.8	$ 25.8	$ 37.2	$ 180.1
Long-term debt payments	–	–	–	–	–	225.0	225.0
Interest payments on long-term debt	16.6	16.6	16.6	16.6	16.6	81.6	164.6
Other postretirement benefit obligations	1.6	1.8	2.0	2.2	2.5	17.0	27.1
Operating leases	2.7	2.7	1.7	1.7	1.7	15.1	25.6
Open purchase orders	20.1	–	–	–	–	–	20.1
Contributions to pension trusts	18.1	–	–	–	–	–	18.1
Transition services payments to Kimberly-Clark	7.5	–	–	–	–	–	7.5
Total contractual obligations	$ 106.1	$ 47.1	$ 46.1	$ 46.3	$ 46.6	$ 375.9	$ 668.1

The unconditional purchase obligations are for the purchase of raw materials, primarily wood chips, and utilities, principally electricity. Although the business is primarily liable for payments on the above operating leases and unconditional purchase obligations, based on historic operating performance and forecasted future cash flows, management believes the business' exposure to losses, if any, under these arrangements is not material.

The open purchase orders displayed in the table represent amounts the business anticipates will become payable within the next year for goods and services the business has negotiated for delivery.

The above table includes future payments that we will make for postretirement benefits other than pensions. Those amounts are estimated using actuarial assumptions, including expected future service, to project the future obligations.

We entered into a corporate services agreement with Kimberly-Clark pursuant to which Kimberly-Clark will provide a variety of administrative services for a period of time following the Spin-Off. Kimberly-Clark provides to us certain employee benefits administration and payroll, management information, transportation, environment and energy, purchasing and certain accounting functions. Each service is made available to us on an as-needed basis through December 31, 2005, or such shorter or longer periods as may be provided in the corporate services agreement. We paid $0.6 million for these services in the fourth quarter of 2004 and estimate these fees will be $7.5 million in 2005 (included in the table above).

Investing Commentary:

Capital spending in all years was below annual depreciation amounts of $35.8, $35.3 million and $34.3 million in 2004, 2003 and 2002, respectively. Over the three years ended December 31, 2004, approximately 40% of cumulative capital spending related to projects to maintain current levels of operations by replacing or maintaining existing equipment. An additional one-third of cumulative expenditures were for programs to enhance operating performance by increasing productivity or reducing operating costs, with the balance for environmental and other projects.

We anticipate that total capital expenditures for 2005 and 2006 will be substantially higher than they have been on average for historical periods. We have planned capital expenditure programs for which we anticipate incurring approximately $37 million in 2005 and approximately $42 million in 2006. These amounts include approximately $4 million in 2005 and approximately $14 million in 2006 for planned capital expenditures relating to protection of the environment. Including the amounts identified in the preceding sentence, planned expenditures for major environmental projects during the period 2005 through 2009 include approximately $20 million for an effluent discharge pipeline and a new outfall at the Pictou mill and between approximately $15 million and $25 million for equipment and engineering to abate total reduced sulphur emissions and for other environmental matters at the Pictou and Terrace Bay mills, to remove and replace transformers containing polychlorinated biphenyls at the Terrace Bay mill, to improve stream crossings in the timberlands licensed from the Province of Ontario and for an air scrubber for the Munising mill's coal-fired boiler. These capital expenditures are not expected to have a material adverse effect on the Company's financial condition, results of operations or liquidity.

Financing Commentary:

Prior to the Spin-Off, our financing (net of cash transfers to Kimberly-Clark) was provided by Kimberly-Clark. After the Spin-Off, financing is expected to come from cash generated from operations and long-term borrowing.

Prior to the Spin-Off, we incurred $225 million of long-term debt through the issuance of the initial senior notes. Proceeds from the note offering were used to pay a one-time Spin-Off payment of $213 million to Kimberly-Clark.

We will incur significant interest expense obligations under the senior notes and our revolving credit facility.

Management believes that the ability to generate cash from operations and our borrowing capacity under our revolving credit facility are adequate to fund working capital, capital spending and other cash needs in the foreseeable future. Our ability to generate adequate cash from operations in the future, however, will depend on, among other things, our ability to successfully implement our business strategies and cost-cutting initiatives, and to manage the impact of changes in pulp prices and currencies. We can give no assurance that we will be able to successfully implement those strategies and cost-cutting initiatives, or successfully manage our pulp pricing and currency exposures.

Our ability to issue additional stock will be constrained because such an issuance of additional stock may cause the Spin-Off to be taxable to Kimberly-Clark under Section 355(e) of the Internal Revenue Code, and under the tax sharing agreement, we would be required to indemnify Kimberly-Clark against that tax. See "Risk Factors – Risks Related to the Spin-Off and Our Separation from Kimberly-Clark" for a more detailed discussion of Section 355(e).

CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from these estimates, and changes in these estimates are recorded when known. The critical accounting policies used in the preparation of the combined financial statements are those that are important both to the presentation of financial condition and results of operations and require significant judgments with regard to estimates used. These critical judgments relate to the timing of recognizing sales revenue, the recoverability of deferred income tax assets, pension benefits and future cash flows associated with impairment testing of long-lived assets.

Revenue Recognition

We recognize sales revenue when all of the following have occurred: (1) delivery has occurred, (2) persuasive evidence of an agreement exists, (3) pricing is fixed or determinable, and (4) collection is reasonably assured. Delivery is not considered to have occurred until the customer takes title and assumes the risks and rewards of ownership. The timing of revenue recognition is largely dependent on shipping terms. Revenue is recorded at the time of shipment for terms designated free on board ("FOB") shipping point. For sales transactions designated FOB destination, revenue is recorded when the product is delivered to the customer's delivery site. With the exception of pulp sales to Kimberly-Clark and certain other customers, our sales terms are FOB shipping point and revenue is recognized at the time of shipment. For pulp sales to Kimberly-Clark and other customers that are designated FOB destination, revenue is recognized when the product is delivered to the customer's delivery site. Sales are reported net of allowable discounts and estimated returns. Reserves for cash discounts, trade allowances, credit losses and sales returns are estimated using historical experience.

Deferred Income Tax Assets

As of December 31, 2004, we have recorded deferred income tax assets totaling $30.5 million related to temporary differences, and we have established no valuation allowances against these deferred income tax assets. As of December 31, 2003, our net deferred income tax assets were $22.8 million. In determining the need for valuation allowances, we consider many factors, including the specific taxing jurisdiction, income tax strategies and forecasted earnings for the entities in each jurisdiction. A valuation allowance would be recognized if, based on the weight of available evidence, we conclude that it is more likely than not that some portion or all of the deferred income tax asset will not be realized.

Our operations have been included in the consolidated income tax returns of Kimberly-Clark. Kimberly-Clark will indemnify us for all income tax liabilities and retain rights to all tax refunds for periods through the date of the Spin-Off. Accordingly, the consolidated and combined balance sheet for periods prior to the Spin-Off does not include current or prior period income tax receivables or payables related to our operations, which were filed on a consolidated basis with Kimberly-Clark. For all periods, the income tax provisions have been determined as if we were a separate taxpayer.

Pension Benefits

Prior to the Spin-Off, the employees of our business participated in Kimberly-Clark's defined benefit pension plans and defined contribution retirement plans, which cover substantially all regular employees. In connection with the Spin-Off, Kimberly-Clark retained the obligations for former employees of the U.S. paper operations.

In connection with the Spin-Off, and as set forth in the employee matters agreement, obligations related to former and active employees of the Canadian pulp operations and active employees of the U.S. paper operations became our responsibility. A share of pension assets related to active employees of the U.S. paper operations were transferred from Kimberly-Clark's pension plan to a new pension plan established by us. This new plan provides substantially similar benefits and credits our employees for service earned with Kimberly-Clark. With respect to Canadian employees, we assumed the existing pension assets and obligations of the related Kimberly-Clark pension plans.

Kimberly-Clark's funding policy for the qualified, defined benefit plans that became our responsibility was to contribute assets to fully fund the accumulated benefit obligation. Subject to regulatory and tax deductibility limits, any funding shortfall was to be eliminated over a reasonable number of years. Nonqualified plans providing pension benefits in excess of limitations imposed by the taxing authorities were not funded.

Consolidated and combined pension expense for defined benefit pension plans was $10.7 million, $13.4 million and $4.2 million for the years ended December 31, 2004, 2003 and 2002, respectively. Pension expense is calculated based upon a number of actuarial assumptions applied to each of the defined benefit plans. The weighted-average, expected long-term rate of return on pension fund assets used to calculate pension expense in percents was 8.50, 8.50 and 9.31 for the years ended December 31, 2004, 2003 and 2002, respectively. The expected long-term rate of return on pension fund assets held by the Company (and prior to the Spin-Off, Kimberly-Clark), pension trusts was determined based on several factors, including input from pension investment consultants and projected long-term returns of broad equity and bond indices. Also considered were the plans' historical 10-year and 15-year compounded annual returns. Kimberly-Clark anticipated that on average the investment managers for each of the plans will generate annual long-term rates of return of at least 8.50%. Kimberly-Clark's expected long-term rate of return on the assets in the plans was based on an asset allocation assumption of about 70% with equity managers, with expected long-term rates of return of approximately 10%, and 30% with fixed income managers, with an expected long-term rate of return of about 6%. The actual asset allocation was regularly reviewed and periodically rebalanced to the targeted allocation when considered appropriate. Also, when deemed appropriate, hedging strategies were executed using index options and futures to limit the downside exposure of certain investments by trading off upside potential above an acceptable level. Such hedging strategies were executed in 2004, 2003 and 2002. Following the Spin-Off, we are following a similar methodology for determining our long-term rate of return on pension assets and investment strategy and also plan to continue to evaluate our long-term rate of return assumptions.

Pension expense was determined based on the fair value of assets rather than a calculated value that averages gains and losses ("Calculated Value") over a period of years. Investment gains or losses represent the difference between the expected return calculated using the fair value of the assets and the actual return based on the fair value of assets. The variance between the actual and the expected gains and losses on pension assets is recognized in pension expense more rapidly than it would be if a Calculated Value for plan assets was used. As of December 31, 2004, our plans had cumulative unrecognized investment losses and other actuarial losses of approximately $128.3 million. These unrecognized net losses may increase our future pension expense if not offset by (i) actual investment returns that exceed the assumed investment returns, (ii) other factors, including reduced pension liabilities arising from higher discount rates used to calculate our pension obligations or (iii) other actuarial gains, including whether such accumulated actuarial losses at each measurement date exceed the "corridor" determined under SFAS 87, *Employers' Accounting for Pensions*.

The discount (or settlement) rate that is utilized for determining the present value of future pension obligations generally has been based in the U.S. on the yield reported for the long-term, AA-rated corporate bond indexes, converted to an equivalent one-year compound basis. This practice was validated at December 31, 2002. The weighted average discount in percent was 5.75 and 6.20 for the years ended December 31, 2004 and 2003, respectively.

Our consolidated and combined pension expense was $10.7 million for 2004. This is based on an expected weighted-average, long-term rate of return on assets in our plans of 8.50%, a weighted-average discount rate for our plans of 6.21% and various other assumptions. Pension expense beyond 2004 will depend on future investment performance, our contributions to the pension trusts, changes in discount rates and various other factors related to the covered employees in the plans.

The fair value of the assets in our defined benefit plans increased to approximately $329 million at December 31, 2004 from about $275 million at December 31, 2003, primarily due to investment gains, currency exchange effects and plan contributions exceeding payments for pension benefits and plan expenses. Lower discount rates have caused the projected benefits obligations of the defined benefit plans to exceed the fair value of plan assets by approximately $58 million at December 31, 2004, compared with approximately $53 million at December 31, 2003. The fair value of plan assets exceeded the accumulated benefit obligation by about $6.5 million at the end of 2004. At the end of 2003, the fair value of the planned assets exceeded the accumulated benefit obligation by about $0.2 million. The Company and Kimberly-Clark contributed about $16.6 million to pension trusts related to plans for which we assumed responsibility in 2004 compared with $16.2 million in 2003. In addition, we made direct benefit payments of approximately $0.1 million in each of 2004, 2003 and 2002 for unfunded supplemental retirement benefits.

The discount rate used for our pension obligation is identical to the discount rate used for our other postretirement obligation. The discount rates displayed for the two types of obligations may appear different due to the weighting used in the calculation of the two weighted-average discount rates.

Impairment

Property, plant and equipment are tested for impairment in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, whenever events or changes in circumstances indicate that the carrying amounts of such long-lived assets may not be recoverable from future net pre-tax cash flows. Impairment testing requires significant management judgment including estimating the future success of product lines, future sales volumes, growth rates for selling prices and costs, alternative uses for the assets and estimated proceeds from disposal of the assets. Impairment testing is conducted at the lowest level where cash flows can be measured and are independent of cash flows of other assets. An asset impairment would be indicated if the sum of the expected future net pre-tax cash flows from the use of the asset (undiscounted and without interest charges) is less than the carrying amount of the asset. An impairment loss would be measured based on the difference between the fair value of the asset and its carrying amount. We determine fair value based on an expected present value technique in which multiple cash flow scenarios that reflect a range of possible outcomes and a risk-free rate of interest are used to estimate fair value.

The estimates and assumptions used in the impairment analysis are consistent with the business plans and estimates we use to manage our business operations. The use of different assumptions would increase or decrease the estimated fair value of the asset and would increase or decrease the impairment charge. Actual outcomes may differ from the estimates.

See "Results of Operations and Related Information – Analysis of Pre-tax Income (Loss) – Asset Impairment Loss" for a summary of our asset impairment test on the Terrace Bay pulp facility, which resulted in a net after-tax impairment loss of approximately $72.0 million in December 2004.

BUSINESS OUTLOOK

Recent Developments

On March 1, 2005, we announced the planned closure of the smaller of our two single-line pulp mills at the Terrace Bay facility (the "No. 1 Mill"). The No. 1 Mill was originally constructed in 1948 and has annual capacity of approximately 125,000 tons of bleached kraft pulp. In conjunction with the closing, we will offer early retirement and severance packages to approximately 130 employees. The closing was authorized by our Chief Executive Officer on February 28, 2005, pursuant to a resolution of the Board of Directors, and is expected to occur in early May 2005.

We expect to incur approximately $6.0 million of exit costs in connection with the closure, including one-time termination benefits related to early retirement, severance and defined-benefit pension plans of approximately $5.5 million and other associated exit costs of $0.5 million. In addition, we expect to incur approximately $1.0 million of general expenses related to training of employees. Approximately $6.3 million of the estimated costs of $7.0 million will result in future cash expenditures during 2005 and 2006.

In addition, in March 2005, we will record a pre-tax, non-cash impairment loss of approximately $0.9 million related to the remaining value of the long-lived assets of the No. 1 Mill at Terrace Bay (See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations and Related Information – Asset Impairment Loss").

As a result of closing the No. 1 Mill, we notified Kimberly-Clark of our intention to terminate a part of our commitment to supply and their requirement to purchase northern bleached hardwood kraft pulp pursuant to the terms of our pulp supply agreement. Under the pulp supply agreement, we were obligated to provide 40,000, 30,000, 20,000 and 10,000 tons of northern bleached hardwood kraft pulp produced at the Terrace Bay mill annually in 2005, 2006, 2007 and 2008, respectively. Our commitment to supply and Kimberly-Clark's requirement to purchase northern bleached hardwood kraft pulp pursuant to the terms of the pulp supply agreement from the Pictou mill (in annual quantities which are identical to those shown above) is unchanged.

We believe that the remaining productive capacity at our Terrace Bay and Pictou mills and the availability of market pulp are sufficient to supply our internal and external pulp requirements.

Pulp Operations

Transfers of Pulp within Kimberly-Clark prior to the Spin-Off. Historically, our pulp operations have been operated as a captive pulp producer for Kimberly-Clark's tissue and other businesses. Prior to the Spin-Off, intra-company transfers of pulp by our business to Kimberly-Clark were made pursuant to an advance transfer pricing agreement negotiated among Kimberly-Clark and certain taxing authorities. Under the advance transfer pricing agreement, pulp was transferred to Kimberly-Clark at a transfer price equal to a published industry index price less a discount agreed to among Kimberly-Clark and the taxing authorities. Kimberly-Clark believes that those negotiated and agreed discounts reflected the then current market conditions for pulp without the existence of a long-term, take or pay supply agreement.

Sales of Pulp to Kimberly-Clark after the Spin-Off. Pulp sales to Kimberly-Clark following the Spin-Off are made pursuant to a new pulp supply agreement. The prices at which we will sell pulp to Kimberly-Clark under the new pulp supply agreement are based on published industry index prices (subject to minimum and maximum prices for northern bleached softwood kraft pulp shipped to North America prior to December 31, 2007) less agreed discounts. Those discounts will be substantially higher than the discounts contained in the advance transfer pricing agreement. We believe that the discounts and the other terms reflected in the new pulp supply agreement are comparable to those which Kimberly-Clark currently could obtain from an unaffiliated third party, considering the magnitude of Kimberly-Clark's purchases, the term of the pulp supply agreement and the other terms reflected in the agreement.

If the new pulp supply agreement had been in place for the years ended December 31, 2004, 2003 and 2002, we estimate that our historical combined net sales and gross profit would have declined approximately as shown below:

	Net Sales			Gross Profit		
(in millions)	Historical	New Pulp Agreement	Decrease	Historical	New Pulp Agreement	Decrease
Year						
2004	**$ 772.1**	**$ 746.5**	**$ 25.6**	**$ 124.2**	**$ 98.6**	**$ 25.6**
2003[(a)]	710.3	685.8	24.5	107.9	83.4	24.5
2002[(a)]	702.0	684.5	17.5	131.6	114.1	17.5

(a) The above amounts of Net sales for the years ended December 31, 2003 and 2002 have been increased from the amounts previously reported by $44.5 million and $44.0 million, respectively, to be in conformity with EITF 00-10, which prohibits the netting of shipping and handling costs against revenues.

If the new pulp supply agreement had been in place for the years ended December 31, 2004, 2003 and 2002, we estimate that the historical net sales and gross profit (loss) of our pulp business would have decreased approximately as shown below:

	Net Sales			Gross Profit (Loss)		
(in millions)	Historical	New Pulp Agreement	Decrease	Historical	New Pulp Agreement	Decrease
Year						
2004	**$ 448.6**	**$ 423.0**	**$ 25.6**	**$ 7.0**	**$ (18.6)**	**$ 25.6**
2003[(b)]	405.1	380.6	24.5	3.4	(21.1)	24.5
2002[(b)]	380.0	362.5	17.5	10.8	(6.7)	17.5

(b) The above amounts of Net sales for the years ended December 31, 2003 and 2002 have been increased from the amounts previously reported by $38.6 million and $38.0 million, respectively, to be in conformity with EITF 00-10.

Other Items

As noted elsewhere in this Annual Report, our historical financial results will not be indicative of our future performance, nor do they reflect what our financial position and results of operations would have been had we operated as a separate, independent company during the periods presented. Among other things, our management anticipates that beginning in 2005, we will incur ongoing, full-year incremental selling, general and administrative expenses of approximately $14 million related primarily to reduced economies of scale as a result of operating on a stand-alone basis. In addition, we expect to pay Kimberly-Clark approximately $7.5 million pursuant to transition services agreements in 2005.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Neenah Paper, Inc.:

We have audited the accompanying consolidated balance sheet of Neenah Paper, Inc. and subsidiaries (the "Company") as of December 31, 2004 and the combined balance sheet of the Pulp and Paper Business of Kimberly-Clark Corporation ("Pulp and Paper Business"), consisting of the Fine Paper and Technical Paper divisions and the Canadian pulp operations, as of December 31, 2003, and the related consolidated and combined statements of operations, cash flows and changes in stockholders' equity and in invested equity for each of the three years in the period ended December 31, 2004. These consolidated and combined financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying combined financial statements were prepared to present the assets and liabilities and related results of operations and cash flows of the Pulp and Paper Business, which was spun off to Kimberly-Clark Corporation's stockholders as described in Note 1 to the consolidated and combined financial statements, and may not necessarily be indicative of the conditions that would have existed or the results of operations and cash flows if the Pulp and Paper Business had operated as a stand-alone company during the periods presented.

In our opinion, such consolidated and combined financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2004 and the Pulp and Paper Business at December 31, 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

DELOITTE & TOUCHE LLP

Atlanta, Georgia
March 30, 2005

Consolidated and Combined Statements of Operations

(in millions, except share and per share data) *Year Ended December 31,*	2004	2003	2002
Net Sales	$ 772.1	$ 710.3	$ 702.0
Cost of products sold	647.9	602.4	570.4
Gross Profit	124.2	107.9	131.6
Selling, general and administrative expenses	45.8	34.6	33.6
Asset impairment loss (Note 12)	112.8	–	–
Other (income) and expense – net	5.5	10.0	(1.3)
Operating Income (Loss)	(39.9)	63.3	99.3
Interest expense	1.4	–	–
Income (Loss) Before Income Taxes	(41.3)	63.3	99.3
Provision (benefit) for income taxes	(14.9)	24.4	37.0
Net Income (Loss)	$ (26.4)	$ 38.9	$ 62.3
Earnings (Loss) Per Common Share			
Basic	$ (1.79)	$ 2.64	$ 4.23
Diluted	$ (1.79)	$ 2.64	$ 4.23
Weighted Average Common Shares Outstanding *(in thousands)*			
Basic	14,738	14,738	14,738
Diluted	14,738	14,738	14,738

See Notes to Consolidated and Combined Financial Statements

Consolidated and Combined Balance Sheets

(in millions, except share data) *December 31,*	2004	2003
ASSETS		
Current Assets		
Cash and cash equivalents	$ 19.1	$ –
Accounts receivable, net	92.4	77.1
Inventories	88.7	85.7
Deferred income taxes	3.2	3.7
Prepaid and other current assets	2.2	4.9
Total Current Assets	205.6	171.4
Property, Plant and Equipment – net	257.6	368.1
Timberlands	5.2	5.2
Deferred Income Taxes	27.3	19.1
Prepaid and Intangible Pension Costs	72.9	24.2
Other Assets	18.0	4.0
Total Assets	$ 586.6	$ 592.0
LIABILITIES AND STOCKHOLDERS' AND INVESTED EQUITY		
Current Liabilities		
Trade accounts payable	$ 43.8	$ 32.7
Other payables	6.8	6.6
Accrued expenses	36.6	30.4
Total Current Liabilities	87.2	69.7
Long-term Debt	225.0	–
Noncurrent Employee Benefits and Other Obligations	48.0	54.1
Deferred Income Taxes	8.4	34.5
Total Liabilities	368.6	158.3
Commitments and Contingencies (Notes 9 and 10)		
Stockholders' and Invested Equity		
Common stock, par value $0.01 – authorized: 100,000,000 shares; issued and outstanding: 14,763,319 shares	0.1	–
Additional paid-in capital	239.2	–
Kimberly-Clark's net investment	–	436.8
Retained deficit	(70.7)	–
Accumulated other comprehensive income (loss)	51.6	(3.1)
Unearned compensation on restricted stock	(2.2)	–
Total Stockholders' and Invested Equity	218.0	433.7
Total Liabilities and Stockholders' and Invested Equity	$ 586.6	$ 592.0

See Notes to Consolidated and Combined Financial Statements

Consolidated and Combined Statements of Changes in Stockholders' and Invested Equity

(in millions, shares in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Kimberly-Clark's Net Investment	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation On Restricted Stock	Comprehensive Income
Balance, December 31, 2001	–	$ –	$ –	$ 479.5	$ –	$ (29.4)	$ –	
Net income	–	–	–	62.3	–	–	–	$ 62.3
Other comprehensive income								
Unrealized foreign currency translation	–	–	–	–	–	2.5	–	2.5
Minimum pension liability	–	–	–	–	–	(26.5)	–	(26.5)
Other	–	–	–	–	–	0.6	–	0.6
Net cash transfers to Kimberly-Clark	–	–	–	(95.8)	–	–	–	$ 38.9
Non-cash transfers from Kimberly-Clark	–	–	–	0.5	–	–	–	
Balance, December 31, 2002	–	–	–	446.5	–	(52.8)	–	
Net income	–	–	–	38.9	–	–	–	$ 38.9
Other comprehensive income								
Unrealized foreign currency translation	–	–	–	–	–	59.7	–	59.7
Minimum pension liability.	–	–	–	–	–	(9.4)	–	(9.4)
Other	–	–	–	–	–	(0.6)	–	(0.6)
Net cash transfers to Kimberly-Clark	–	–	–	(50.0)	–	–	–	$ 88.6
Non-cash transfers from Kimberly-Clark	–	–	–	1.4	–	–	–	
Balance, December 31, 2003	–	–	–	436.8	–	(3.1)	–	
Net income (loss)	–	–	–	44.3	(70.7)	–	–	$ (26.4)
Other comprehensive income								
Unrealized foreign currency translation	–	–	–	–	–	24.8	–	24.8
Minimum pension liability	–	–	–	–	–	30.0	–	30.0
Other	–	–	–	–	–	(0.1)	–	(0.1)
Net cash transfers to Kimberly-Clark	–	–	–	(37.6)	–	–	–	$ 28.3
Adjustment to deferred taxes at Spin-Off	–	–	–	8.2	–	–	–	
Other non-cash transfers to Kimberly-Clark	–	–	–	(1.8)	–	–	–	
Spin-Off payment to Kimberly-Clark	–	–	–	(213.0)	–	–	–	
Transfer to additional paid-in capital	–	–	236.9	(236.9)	–	–	–	
Issuance of common stock	14,738	0.1	–	–	–	–	–	
Restricted stock awards, less amortization	25	–	2.3	–	–	–	(2.2)	
Balance, December 31, 2004	**14,763**	**$ 0.1**	**$ 239.2**	**$ –**	**$ (70.7)**	**$ 51.6**	**$ (2.2)**	

See Notes to Consolidated and Combined Financial Statements

Consolidated and Combined Statements of Cash Flows

(in millions) *Year Ended December 31,*	2004	2003	2002
Operating Activities			
Net income (loss)	$ (26.4)	$ 38.9	$ 62.3
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	36.0	35.3	34.3
Asset impairment loss	112.8	–	–
Deferred income tax benefit	(43.6)	(8.2)	(1.7)
Loss on asset dispositions	3.1	0.1	3.1
Net cash provided by (used in) changes in operating working capital			
Accounts receivable	(14.1)	(3.6)	2.3
Inventories	(9.4)	(5.8)	21.4
Prepaid and other current assets	2.4	0.5	(0.6)
Trade accounts payable	11.1	6.1	(0.8)
Other payables	0.2	(4.0)	(5.4)
Accrued expenses	5.6	3.6	(2.3)
Foreign currency effects on working capital	5.7	13.5	0.7
Pension and other postretirement benefits	(7.4)	(1.3)	(1.3)
Other	–	(1.5)	(0.2)
Net Cash Provided by Operating Activities	76.0	73.6	111.8
Investing Activities			
Capital expenditures	(19.1)	(24.4)	(18.4)
Proceeds from dispositions of property	0.1	1.9	1.7
Other	(0.1)	(1.1)	0.7
Net Cash Used in Investing Activities	(19.1)	(23.6)	(16.0)
Financing Activities			
Proceeds from issuance of long-term debt	225.0	–	–
Debt issuance costs	(12.2)	–	–
Short-term borrowings	10.0	–	–
Repayments of short-term borrowings	(10.0)	–	–
Spin-Off payment to Kimberly-Clark	(213.0)	–	–
Net transfers to Kimberly-Clark	(37.6)	(50.0)	(95.8)
Net Cash Used in Financing Activities	(37.8)	(50.0)	(95.8)
Net Increase in Cash and Cash Equivalents	19.1	–	–
Cash and Cash Equivalents, Beginning of Year	–	–	–
Cash and Cash Equivalents, End of Year	$ 19.1	$ –	$ –
Supplemental Disclosure of Cash Flow Information:			
Cash paid during year for interest	$ –	$ –	$ –
Cash paid during year for income taxes	$ –	$ –	$ –
Non-cash transfers from Kimberly-Clark	$ 6.4	$ 1.4	$ 0.5

See Notes to Consolidated and Combined Financial Statements

Notes to Consolidated Financial Statements

(dollars 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 Canadian pulp business and its fine paper and technical paper businesses in the United States (collectively, the "Pulp and Paper Business"). The Canadian pulp business consists of the Terrace Bay, Ontario, pulp mill and the Pictou, Nova Scotia, pulp mill and related timberlands. The fine paper business is a leading producer of premium writing, text, cover and specialty papers. The technical paper business is a leading producer of durable, saturated and coated base papers for a variety of end uses.

On November 30, 2004, Kimberly-Clark completed the distribution of all of the shares of Neenah's common stock to the stockholders of Kimberly-Clark (the "Spin-Off"). Kimberly-Clark stockholders received a dividend of one share of Neenah's common stock for every 33 shares of Kimberly-Clark common stock held. Based on a private letter ruling received by Kimberly-Clark from the Internal Revenue Service, receipt of the Neenah shares in the Spin-Off was tax-free for U.S. federal income tax purposes. As a result of the Spin-Off, Kimberly-Clark transferred all of the assets and liabilities of the Pulp and Paper Business to Neenah. In addition, Kimberly-Clark transferred certain assets and liabilities of Kimberly-Clark sponsored employee benefit plans to the Company. Following the Spin-Off, Neenah is an independent public company and Kimberly-Clark has no continuing stock ownership.

Basis of Consolidation and Presentation

The consolidated and combined financial statements include the financial statements of the Company, and its wholly owned and majority owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

The consolidated and combined financial statements reflect the consolidated operations of Neenah and its subsidiaries as a separate, stand-alone entity subsequent to November 30, 2004, combined with the historical operations of the Pulp and Paper Business which were operated as part of Kimberly-Clark prior to the Spin-Off. The combined financial statements for periods through November 30, 2004 have been derived from the consolidated financial statements and accounting records of Kimberly-Clark using the historical results of operations and the historical basis of assets and liabilities of the Pulp and Paper Business. Management believes the assumptions underlying the combined financial statements for these periods are reasonable. However, the combined financial statements included herein for periods through November 30, 2004 do not reflect the Pulp and Paper Business' results of operations, financial position and cash flows in the future or what its results of operations, financial position and cash flows would have been had the Pulp and Paper Business been a stand-alone company during the periods presented. See Note 11 for transactions with Kimberly-Clark.

Kimberly-Clark's investment in the Pulp and Paper Business is shown as "Kimberly-Clark's net investment" in the combined financial statements through November 30, 2004, because no direct ownership relationship existed among the entities that comprised the Pulp and Paper Business. Inter-company accounts between the Pulp and Paper Business and Kimberly-Clark are combined with "Kimberly-Clark's net investment." As of November 30, 2004, the balance reflected in the "Kimberly-Clark's net investment" was transferred to "Additional paid-in capital" of Neenah. "Retained deficit" reflected in the consolidated financial statements represents net losses beginning December 1, 2004.

Basic earnings (loss) per share were computed by dividing net loss by the number of weighted average shares of common stock outstanding during the 2004 reporting period. Diluted earnings (loss) per share were calculated to give effect to all potentially dilutive common shares. In 2004, approximately 875,000 potentially dilutive options that were "out-of-the-money" were excluded from the computation of dilutive common shares. In addition, as a result of the net loss in 2004, the assumed incremental 60,683 shares resulting from the exercises of "in-the-money" stock options and the vesting of restricted stock and restricted stock units were excluded from the diluted earnings per share calculation, as the effect would have been anti-dilutive.

For 2003 and 2002, basic and diluted earnings per share were computed using the number of shares of Neenah common stock outstanding on November 30, 2004, the date on which Neenah common stock was distributed to the stockholders of Kimberly-Clark.

Prior to the Spin-Off, certain corporate, general and administrative expenses of Kimberly-Clark were allocated to the Pulp and Paper Business, using a three factor formula comprised of net sales, total assets and employee head count. In the opinion of management, such an allocation is reasonable. However, such expenses are not indicative of, nor is it practical or meaningful for management to estimate for all historical periods presented, the actual level of expenses that might have been incurred had the Pulp and Paper Business been operating as an independent company. General corporate overhead primarily includes information technology, accounting, cash management, legal, tax, insurance and public relations. These expenses amounted to $0.5 million, $0.7 million and $0.8 million in 2004, 2003 and 2002, respectively. Subsequent to November 30, 2004, the Company performed these functions using its own resources or purchased services, some of which were provided by Kimberly-Clark pursuant to a Corporate Services Agreement (See Note 11).

Kimberly-Clark used a centralized approach to cash management and the financing of its operations. Cash deposits from the Pulp and Paper Business prior to the Spin-Off were transferred to Kimberly-Clark on a regular basis and were netted against Kimberly-Clark's net investment account. Consequently, none of Kimberly-Clark's cash, cash equivalents or debt was allocated to the Pulp and Paper Business in the combined financial statements for periods through November 30, 2004.

Changes in Kimberly-Clark's net investment represent any funding from Kimberly-Clark for working capital and capital expenditures after giving effect to the Pulp and Paper Business' transfers to Kimberly-Clark of its cash flows from operations.

Cash Payment to Kimberly-Clark

On November 30, 2004, the Company paid a Spin-Off payment of $213 million to a Kimberly-Clark subsidiary primarily from the proceeds of a $225 million principal amount senior note offering (See Note 5).

Income Taxes

For periods prior to November 30, 2004, income tax provisions and related deferred tax assets and liabilities of the Pulp and Paper Business were calculated on a separate tax return basis. However, Kimberly-Clark managed its tax position for the benefit of its entire portfolio of businesses, and its tax strategies are not necessarily reflective of the tax strategies that the Pulp and Paper Business would have followed as a stand-alone entity.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting periods. Actual results could differ from these estimates, and changes in these estimates are recorded when known. Significant management judgment is required in determining the accounting for, among other things, pension and postretirement benefits, retained insurable risks, allowances for doubtful accounts, useful lives for depreciation and amortization, future cash flows associated with impairment testing for long-lived assets, income taxes and contingencies.

Revenue Recognition

The Company recognizes sales revenue when all of the following have occurred: (1) delivery has occurred, (2) persuasive evidence of an agreement exists, (3) pricing is fixed or determinable, and (4) collection is reasonably assured. Delivery is not considered to have occurred until the customer takes title and assumes the risks and rewards of ownership. The timing of revenue recognition is largely dependent on shipping terms. Revenue is recorded at the time of shipment for terms designated free on board ("FOB") shipping point. For sales transactions designated FOB destination, revenue is recorded when the product is delivered to the customer's delivery site. With the exception of pulp sales to Kimberly-Clark and certain other customers, the Company's sales terms are FOB shipping point and revenue is recognized at the time of shipment. For pulp sales to Kimberly-Clark and other customers that are designated FOB destination, revenue is recognized when the product is delivered to the customer's delivery site. Sales are reported net of allowable discounts and estimated returns. Reserves for cash discounts, trade allowances, credit losses and sales returns are estimated using historical experience.

Pursuant to the new pulp supply agreement, sales terms to Kimberly-Clark subsequent to the Spin-Off were changed to FOB destination rather than FOB shipping point. As a result, net sales in December 2004 were reduced by $12.9 million, reflecting the one-time effect of this change in terms.

Shipping and Handling Costs

All amounts billed to customers in a sales transaction related to shipping and handling are recorded as revenue, and costs incurred by the Company for shipping and handling are recorded as costs of products sold.

Certain prior years' amounts of shipping and handling costs have been adjusted in the combined statements of operations to be in conformity with EITF 00-10, *Accounting for Shipping and Handling Fees and Costs*, which became effective in 2000 and which prohibits the netting of such costs against revenues. Accordingly, amounts reflected for 2003 and 2002 for "Net sales" and "Cost of products sold" in the combined statements of operations have been increased from the amounts previously reported by $44.5 million and $44.0 million, respectively. This adjustment had no effect on the amount of "Gross profit" or any other captioned amounts in the combined statements of operations.

Cash and Cash Equivalents

Cash and cash equivalents include all cash balances and highly liquid investments with an initial maturity of three months or less. The Company places its temporary cash investments with high-credit, quality financial institutions.

Inventories

U.S. inventories are valued at the lower of cost, using the Last-In, First-Out (LIFO) method for financial reporting purposes, or market. Canadian inventories are valued at the lower of cost, using either the First-In, First-Out (FIFO) or a weighted-average cost method, or market. Cost includes labor, materials and production overhead. Inventories of the Canadian pulp operations include both roundwood (logs) and wood chips. These inventories are located both at the pulp mills and at various timberlands locations. In accordance with industry practice, physical inventory counts utilize "scaling" techniques to estimate quantities of roundwood, as well as various electronic devices to calculate wood chip inventory amounts. These techniques historically have provided reasonable estimates of such inventories.

Foreign Currency

Balance sheet accounts of the Canadian pulp operations are translated from Canadian dollars into U.S. dollars at period-end exchange rates, and income and expense are translated at average exchange rates during the period. Translation gains or losses related to net assets located in Canada are shown as a component of accumulated other comprehensive income (loss) in stockholders' and invested equity. 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) and expense – net in the combined statements of operations. Net foreign currency transaction gains (losses) for 2004, 2003 and 2002 were $(5.1) million, $(10.0) million and $0.6 million, respectively.

Property and Depreciation

Property, plant and equipment is stated at cost, less accumulated depreciation. Certain costs of software developed or obtained for internal use are capitalized. When property, plant and equipment is sold or retired, the costs and the related accumulated depreciation are removed from the accounts, and the gains or losses are recorded in other (income) and expense – net. For financial reporting purposes, depreciation is principally computed on the straight-line method over the estimated useful asset lives. Weighted-average useful lives are approximately 40 years for buildings, 10 years for land improvements and 18 years for machinery and equipment. The cost of permanent and secondary logging roads is capitalized and amortized over the estimated useful lives of the roads, primarily 20 years. The cost of tertiary roads (which are not permanent) is expensed as incurred. For income tax purposes, accelerated methods of depreciation are used.

Estimated useful lives are periodically reviewed and, when warranted, changes are made to them. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their cost may not be recoverable. An impairment loss would be recognized when estimated undiscounted future pre-tax cash flows from the use of the asset are less than its carrying amount. Measurement of an impairment loss would be based on the excess of the carrying amount of the asset over its fair value. Fair value is generally measured using discounted cash flows. See Note 12 for discussion of asset impairment losses recorded in December 2004 related to Terrace Bay's long-lived assets.

The costs of major rebuilds and replacements of plant and equipment are capitalized, and the cost of maintenance performed on manufacturing facilities, composed of labor, materials and other incremental costs, is charged to operations as incurred. Start-up costs for new or expanded facilities are expensed as incurred.

Timberlands

Timberlands are stated at cost, less the accumulated cost of timber previously harvested. The Company's owned timberlands have long-rotation and growing cycles averaging over 40 years. Capitalized costs for these timberlands include site preparation, initial planting and seeding. The costs of fertilization, control of competition (brush control) and seedling protection activities (principally herbicide and insecticide applications) during the stand establishment period also are capitalized. The Company charges capitalized costs, excluding land, to operations at the time the wood is harvested, based on periodically determined depletion rates.

Fertilization, control of competition and seedling protection activities following the stand establishment period are expensed as incurred. The Company pays stumpage fees for wood harvested under long-term licenses and charges such costs to operations as incurred. Costs of administration, insurance, property taxes, and interest are expensed as incurred.

The Company distinguishes between costs associated with pre-merchantable timber and costs associated with merchantable timber. Costs of merchantable timber are currently depletable, whereas costs of pre-merchantable timber are not yet depletable. Timberland depletion rates for owned timberlands are calculated periodically, based on capitalized costs and the total estimated volume of timber that is mature enough to be harvested and processed. Timber inventory volume is determined by adding an estimate of current-year growth to the prior-year ending balance, less the current-year harvest. The volume and growth estimates are tested periodically using statistical sampling techniques. The depletion rate calculated at the end of the year is used to calculate the cost of timber harvested in the subsequent year.

Research Expense

Research and development costs are charged to expense as incurred and are recorded in "Selling, general and administrative expenses" on the Consolidated and Combined Statement of Operations.

Fair Value of Financial Instruments

The carrying amounts reflected in the Consolidated and Combined Balance Sheets for cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to their short maturities. The fair value of long-term debt is estimated using discounted cash flow analyses, based on the Company's incremental borrowing rates for similar types of arrangements. The fair value of the Company's long-term debt at December 31, 2004 was $228.4 million compared to the carrying value of $225.0 million.

Other 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 consolidated and combined balance sheet. These unrealized gains and losses are referred to as other comprehensive income items. The accumulated other comprehensive income (loss) shown on the consolidated and combined balance sheets consists primarily of foreign currency translation and minimum pension liability adjustments. The foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in the Canadian pulp operations.

The changes in the components of other comprehensive income (loss) are as follows:

Year Ended December 31,	2004 Pre-tax Amount	2004 Tax Effect	2004 Net Amount	2003 Pre-tax Amount	2003 Tax Effect	2003 Net Amount	2002 Pre-tax Amount	2002 Tax Effect	2002 Net Amount
Unrealized foreign currency translation	$ 24.8	$ –	$ 24.8	$ 59.7	$ –	$ 59.7	$ 2.5	$ –	$ 2.5
Minimum pension liability	46.3	(16.3)	30.0	(14.5)	5.1	(9.4)	(41.1)	14.6	(26.5)
Other	(0.2)	0.1	(0.1)	(0.9)	0.3	(0.6)	0.9	(0.3)	0.6
Other comprehensive income (loss)	$ 70.9	$ (16.2)	$ 54.7	$ 44.3	$ 5.4	$ 49.7	$ (37.7)	$ 14.3	$ (23.4)

Accumulated balances of other comprehensive income (loss), net of applicable income taxes are as follows:

December 31,	2004	2003
Unrealized foreign currency translation	$ 57.9	$ 33.1
Minimum pension liability (net of income taxes benefits of $3.6 and $19.9)	(6.3)	(36.3)
Other	–	0.1
Accumulated other comprehensive income (loss)	$ 51.6	$ (3.1)

Stock Based Employee Compensation

The Company's stock based employee compensation plan is described in Note 7. As permitted by Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), the Company continues to use the intrinsic value method permitted by *Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations to account for stock option grants. No employee compensation has been charged to earnings because the exercise prices of all stock options granted have been equal to the market value of the Company or Kimberly-Clark's common stock at the date of grant. Had compensation expense been recorded under the provisions of SFAS 123, the impact on the Company's net income (loss) and income (loss) per share would have been:

(dollars in millions, except per share) *Year Ended December 31,*	2004	2003[a]	2002[a]
Reported net income (loss)	$ (26.4)	$ 38.9	$ 62.3
Pro forma compensation expense, net of tax	(1.2)	–	–
Pro forma net income (loss)	$ (27.6)	$ 38.9	$ 62.3
Reported net income (loss) per share:			
Basic	$ (1.79)	$ 2.64	$ 4.23
Diluted[b]	$ (1.79)	$ 2.64	$ 4.23
Pro forma net income (loss) per share:			
Basic	$ (1.87)	$ 2.64	$ 4.23
Diluted[b]	$ (1.87)	$ 2.64	$ 4.23

(a) The pro forma effect of stock options on net income is only presented for periods after November 30, 2004, the date on which Neenah common stock was distributed to stockholders of Kimberly-Clark.

(b) As a result of the net loss in 2004, the assumed incremental 60,683 shares resulting from the exercises of stock options and the vesting of restricted stock and restricted stock units were excluded for the diluted earnings per share calculation, as the effect would have been anti-dilutive.

The weighted-average fair value at date of grant for options granted after the Spin-Off and for Kimberly-Clark options converted on November 30, 2004 was $11.71 per share and was estimated using the Black-Scholes option valuation model with the following weighted-average assumptions (See Note 7 for a discussion of the 2004 option grants at a weighted-average exercise price $31.81):

	2004
Expected life in years	4.7
Interest rate	3.6%
Volatility	36.3%
Dividend yield	1.2%

In December 2004, the FASB issued SFAS 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"), which revises SFAS 123, *Accounting for Stock-Based Compensation*. SFAS 123R also supersedes APB 25, *Accounting for Stock Issued to Employees*, and amends SFAS 95, *Statement of Cash Flows.* (See Accounting Standards Changes below for a discussion of other standards.) In general, the accounting required by SFAS 123R is similar to that of SFAS 123. However, SFAS 123 gave companies a choice to either recognize the fair value of stock options in their income statements or to disclose the pro forma income statement effect of the fair value of stock options in the notes to the financial statements. SFAS 123R eliminates that choice and requires the fair value of all share-based payments to employees, including the fair value of grants of employee stock options, be recognized in the income statement, generally over the option vesting period. SFAS 123R must be adopted no later than July 1, 2005. Early adoption is permitted.

SFAS 123R permits adoption of its requirements using one of two transition methods:

(1) A modified prospective transition ("MPT") method in which compensation cost is recognized beginning with the effective date (a) for all share-based payments granted after the effective date and (b) for all awards granted to employees prior to the effective date that remain unvested on the effective date.

(2) A modified retrospective transition ("MRT") method which includes the requirements of the MPT method described above, but also permits restatement of financial statements based on the amounts previously disclosed under SFAS 123's pro forma disclosure requirements either for (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company is currently evaluating the timing and manner in which it will adopt SFAS 123R.

The Company currently accounts for share-based payments to employees using APB 25's intrinsic value method and, as such, has recognized no compensation cost for employee stock options. Accordingly, adoption of SFAS 123R's fair value method will have an effect on results of operations, although it will have no impact on overall financial position. The impact of adoption of SFAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had SFAS 123R been adopted in prior periods, the effect would have approximated the SFAS 123 pro forma net income and earnings per share disclosures shown.

SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required, thereby reducing net operating cash flows and increasing net financing cash flows in periods after adoption. Such amounts cannot be estimated for future periods because they depend on, among other things, when employees will exercise the stock options and the market price of the Company's stock at the time of exercise.

Accounting Standards Changes

In May 2003, SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity,* was issued. SFAS 150 requires that certain instruments classified as part of stockholders' equity or between stockholders' equity and liabilities be classified as liabilities. The Company has no instruments that were affected by SFAS 150.

In December 2003, FIN 46 (Revised December 2003), *Consolidation of Variable Interest Entities, an Interpretation of ARB 51*, ("FIN 46R") was issued effective for the first interim or annual period ending after December 31, 2003. FIN 46R requires consolidation of entities in which the Company is the primary beneficiary, despite not having voting control. Likewise, it does not permit consolidation of entities in which Neenah has voting control but is not the primary beneficiary. The Company currently has no interests in any variable interest entities. Accordingly, adoption of FIN 46R had no effect on the consolidated and combined financial statements.

In December 2003, SFAS 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, ("SFAS 132R") was issued. SFAS 132R revises the disclosures for pension plans and other postretirement benefit plans. The Company has adopted the annual and interim disclosure requirements of SFAS 132R.

In May 2004, FASB Staff Position 106-2 ("FSP 106-2"), *Accounting and Disclosure Requirements Related to Medicare Prescription Drug, Improvement and Modernization Act of 2003,* was issued. See Note 6 where implementation is discussed.

In November 2004, SFAS 151, *Inventory Costs – an amendment of ARB No. 43, Chapter 4*, ("SFAS 151"), was issued. SFAS 151 clarifies the accounting for abnormal amounts of facility expenses, freight, handling costs, and spoilage. It also requires that allocation of fixed production overheads to inventory be based on the normal capacity of production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Adoption of SFAS 151 is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In December 2004, SFAS 153, *Exchange of Nonmonetary Assets – an amendment of APB Opinion No. 29*, ("SFAS 153"), was issued. SFAS 151 amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. Adoption of SFAS 153 is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

NOTE 3. RISK MANAGEMENT

The Company is exposed to risks such as changes in foreign currency exchange rates and pulp prices. A variety of practices are employed to manage these risks, including operating and financing activities and, where deemed appropriate, the use of derivative instruments. Derivative instruments are used only for risk management purposes and not for speculation or trading. All foreign currency derivative instruments are either exchange traded or entered into with major financial institutions. Credit risk with respect to the counterparties is considered minimal in view of the financial strength of the counterparties.

In accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the Company records all derivative instruments as assets or liabilities on the balance sheet at fair value. Changes in the fair value of derivatives are either recorded in income or other comprehensive income, as appropriate. The gain or loss on derivatives designated as cash flow hedges is included in other comprehensive income in the period that changes in fair value occur and is reclassified to income in the same period that the hedged item affects income. The gain or loss on derivatives that have not been designated as hedging instruments is included in current income in the period that changes in fair value occur.

Pulp Price and Foreign Currency Risk

The operating results, cash flows and financial condition of the Company are subject to pulp price risk. Pulp prices, which are set in U.S. dollars, are determined by industry supply and demand. The average published industry index price of a metric ton of northern softwood kraft pulp in U.S. dollars was \$565 in 2001, \$487 in 2002, \$553 in 2003 and \$637 in 2004. The year-over-year decrease of \$78 per ton in the average published industry index price in 2002 resulted in a decline in gross sales of approximately \$44 million, whereas the year-over-year increases of \$66 per ton and \$84 per ton in the average published industry index price in 2003 and 2004, respectively, resulted in an increase in gross sales of approximately \$36 million and \$46 million, respectively.

Because the price of pulp is set 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 foreign currency and pulp price risks are managed from time-to-time by the use of foreign currency forward and pulp futures contracts. 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. Translation exposure is not hedged.

In addition, the Company is subject to price risk for utilities which are used in its manufacturing operations. Derivative instruments are used to hedge this risk when it is deemed prudent to do so.

Cash Flow Hedges

The Company's cash flow hedges were effective in 2004, 2003 and 2002 and consequently resulted in no net income effect. During the same period in which the hedged forecasted transactions affected earnings, the Company reclassified $0.6 million, $(0.5) million and $(0.8) million of after-tax (gains) losses from accumulated other comprehensive income to earnings in 2004, 2003 and 2002, respectively. At December 31, 2004, the Company expects to reclassify less than $0.1 million of after-tax gains from accumulated other comprehensive income to earnings during the next twelve months. In December 2004, the Company's Canadian subsidiary entered into a foreign currency forward exchange contract, designated as a cash flow hedge of U.S. dollar denominated pulp sales, in a notional principal amount of $25 million Canadian dollars and having a fair market value of $0.4 million at December 31, 2004. The contract matures ratably during the first quarter of 2005. In addition, the Company has a fixed price forward purchase contract to hedge fluctuations in the price of electricity at the Terrace Bay mill. The contract has a notional value of approximately $8.6 million and the fair market liability value of the contract was less than $0.1 million at December 31, 2004.

NOTE 4. INCOME TAXES

Income tax expense in the Company's consolidated and combined financial statements has been calculated on a separate tax return basis. The following table presents the principal reasons for the difference between the effective tax rate and the U.S. federal statutory income tax rate:

Year Ended December 31,	2004	2003	2002
U.S. federal statutory income tax rate	35.0 %	35.0 %	35.0 %
State and local income taxes, net of federal income tax effect	2.4	4.2	4.1
Canadian investment tax credits	–	–	(1.7)
Other differences – net	(1.3)	(0.7)	(0.1)
Effective income tax rate	36.1 %	38.5 %	37.3 %

The following table presents the U.S. and Canadian components of income before income taxes and the provision for income taxes:

Year Ended December 31,	2004	2003	2002
Income before income taxes:			
U.S.	$ 79.2	$ 81.5	$ 100.0
Canada	(120.5)	(18.2)	(0.7)
Total	(41.3)	63.3	99.3
Provisions for income taxes:			
Current:			
Federal	26.6	28.5	23.2
State and local	2.1	4.5	6.6
Canadian	–	(0.4)	8.9
Subtotal	28.7	32.6	38.7
Deferred:			
Federal	(0.2)	(2.1)	9.0
State and local	–	(0.5)	(0.3)
Canadian	(43.4)	(5.6)	(10.4)
Subtotal	(43.6)	(8.2)	(1.7)
Total	$ (14.9)	$ 24.4	$ 37.0

The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. The components of deferred tax assets and liabilities at December 31, 2004 and 2003 are as follows:

December 31,	2004	2003
Net current deferred income tax assets:		
Accrued liabilities	$ 4.4	$ 5.3
Other	(1.2)	(1.6)
Net current deferred income tax assets	$ 3.2	$ 3.7
Net noncurrent deferred income tax assets:		
Canadian timberlands	$ 72.3	$ 33.9
Employee benefits	16.1	10.7
Accumulated depreciation	(58.4)	(26.0)
Other	(2.7)	0.5
Net noncurrent deferred income tax assets	$ 27.3	$ 19.1
Net noncurrent deferred income tax liabilities:		
Accumulated depreciation	$ 8.4	$ 33.3
Other	–	1.2
Net noncurrent deferred income tax liabilities	$ 8.4	$ 34.5

No valuation allowance has been provided on deferred income tax assets. In determining the need for valuation allowances, the Company considers many factors, including the specific taxing jurisdiction, income tax strategies and forecasted earnings for the entities in each jurisdiction. A valuation allowance would be recognized if, based on the weight of available evidence, the Company concludes that it is more likely than not that some portion or all of the deferred income tax asset will not be realized.

As part of the Spin-Off transaction, the Company paid a one-time Spin-Off payment of $213 million to Kimberly-Clark to fund the purchase of the Canadian pulp assets and related timberlands. In accordance with EITF 94-10, *Accounting by a Company for the Income Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109*, the tax effects of the resulting change in the tax bases of the assets and liabilities were reflected in stockholders' and invested equity. The Company recorded a net charge to noncurrent deferred income taxes of approximately $8.2 million and an offsetting credit to "Kimberly-Clark's net investment" on the consolidated and combined balance sheet and statement of changes in stockholders' and invested equity.

All of the operations of the Pulp and Paper Business were included in the consolidated income tax returns of Kimberly-Clark. Kimberly-Clark agreed to indemnify the Company for all income tax liabilities and retain rights to all tax refunds relating to the Pulp and Paper Business in its consolidated income tax returns for periods through the date of the Spin-Off. Accordingly, the consolidated and combined balance sheets do not include current or prior period income tax receivables or payables related to the Pulp and Paper Business.

The Company's stock was distributed in a tax-free Spin-Off. Under terms of the tax sharing agreement between the Company and Kimberly-Clark, the Company could be liable for any income taxes if it commits a tainting event that destroys the tax-free nature of the Spin-Off.

NOTE 5. DEBT

The following debt was incurred either as a result of or since the Spin-Off. The Company did not have debt prior to November 30, 2004. At December 31, 2004, the Company had no required debt payments during the next five years.

Senior Unsecured Notes

On November 30, 2004, the Company completed an underwritten offering of ten-year, senior unsecured notes (the "Senior Notes") at face amount of $225 million. The Senior Notes bear interest at a rate of 7.375%, payable May 15 and November 15 of each year, commencing on May 15, 2005, and maturing on November 15, 2014. The proceeds from this offering were used to pay a special payment of $213 million to Kimberly-Clark at the Spin-Off. The Senior Notes are fully and unconditionally guaranteed by substantially all of the Company's subsidiaries. The Company expects to file a registration statement with the Securities and Exchange Commission to exchange the unregistered Senior Notes for registered notes with similar terms in the second quarter of 2005. If the Company does not complete the exchange of the Senior Notes within 270 days from the original issuance of the notes (a "Registration Default"), the Company will be obligated to pay additional interest ("Special Interest") on the Senior Notes. Special Interest will accrue at a rate of 0.25% per annum during the 90-day period following a Registration Default and will increase by 0.25% per annum for each subsequent 90-day period to a maximum Special Interest rate of 1.00% per annum. Special Interest is the exclusive remedy for a Registration Default.

Secured Revolving Credit Facility

On November 30, 2004, the Company entered into a Credit Agreement by and among Neenah, certain of its subsidiaries, the lenders listed in the Credit Agreement and JP Morgan Chase Bank, N.A. as agent for the lenders. Under the Credit Agreement, the Company has a secured revolving credit facility ("the Revolver") that provides for borrowings of up to $150 million. As of December 31, 2004, the Company had no amounts outstanding under the Revolver.

Under the Revolver, up to $20 million is available for the issuance of letters of credit ("LOCs") on the Company's behalf. Borrowing availability under the Revolver is reduced by outstanding LOCs. At December 31, 2004, the Company had approximately $6.1 million of LOCs outstanding and $143.9 million of borrowing availability under the Revolver. 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.

The Revolver is secured by substantially all of the Company's assets, including the capital stock of our subsidiaries and is guaranteed by Neenah Paper Company of Canada, a wholly-owned subsidiary. The Revolver will terminate on November 30, 2008. Availability under the Revolver will fluctuate over time depending on the value of inventory, receivables and various capital assets.

The interest rate applicable to borrowings under the Revolver will be either (1) the applicable base rate plus 0.25% to 0.75% or (2) a LIBOR-based rate ranging from LIBOR plus 1.75% to LIBOR plus 2.25%. Interest is computed based on actual days elapsed in a 360-day year, payable monthly in arrears for base rate loans, or for LIBOR loans, payable monthly in arrears and at the end of the applicable interest period. The commitment is subject to an annual facility fee of 0.375% on the average daily unused amount of the commitment.

The Senior Notes and the Revolver contain, among other provisions, covenants with which the Company must comply during the term of the agreements. Such covenants restrict the Company's ability to, among other things, incur certain additional debt, make specified restricted payments and capital expenditures, authorize or issue capital stock, enter into transactions with affiliates, consolidate or merge with or acquire another business, sell certain of its assets or liquidate, dissolve or wind-up the Company. In addition, the terms of the Revolver require the Company to achieve and maintain certain specified financial ratios. At December 31, 2004, the Company was in administrative default under the Credit Agreement for failure to provide financial statements in a timely manner. On January 31, 2005, the Credit Agreement was amended to waive the event of default. As of December 31, 2004, the Company was in compliance with all other such covenants.

The Company's ability to pay cash dividends on its Common Stock is limited under the terms of both the Credit Agreement and the Senior Notes. Pursuant to the terms of these agreements, the Company's ability to pay cash dividends on its common stock is limited to the lesser of 50% of Consolidated Net Income (as defined) or a total of $10.0 million in a 12-month period.

NOTE 6. POSTRETIREMENT AND OTHER BENEFITS

Pension Plans

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

Pension assets related to active employees of the U.S. paper operations for which the Company assumed responsibility were transferred from a Kimberly-Clark pension trust to a new trust for a pension plan established by the Company. The new pension plan provides for substantially similar benefits and credits such employees for service earned with Kimberly-Clark.

The Company's funding policy for its qualified defined benefit plans is to contribute assets to fully fund the accumulated benefit obligation ("ABO"). Subject to regulatory and tax deductibility limits, any funding shortfall is to be eliminated over a reasonable number of years. Nonqualified plans providing pension benefits in excess of limitations imposed by the taxing authorities are not funded.

The Company uses the fair value of pension plan assets to determine pension expense, rather than averaging gains and losses over a period of years. Investment gains or losses represent the difference between the expected return calculated using the fair value of the assets and the actual return based on the fair value of assets. As of December 31, 2004, the Company's plans had cumulative unrecognized investment losses and other actuarial losses of approximately $128.3 million.

A minimum pension liability for underfunded plans representing the excess of the unfunded ABO over previously recorded net pension liabilities has been reflected on the consolidated and combined balance sheet. The minimum pension liability is included in noncurrent employee benefits and other obligations on the consolidated and combined balance sheets. An offsetting amount is included as an intangible asset to the extent of unrecognized prior service cost, and the balance is included in accumulated other comprehensive income. In 2004, the accrual for the additional minimum pension liability decreased as the effect of a decrease in the discount rate used to estimate the ABO was more than offset by an increase in the fair value of pension plan assets. A decrease in 2003 in the discount rate used to estimate the ABO was the principal cause of the 2003 increase in the accrual for the additional minimum pension liability.

The following is a summary of amounts related to the minimum pension liability recorded in other comprehensive income:

December 31,	2004	2003
Minimum pension liability	$ 12.0	$ 62.6
Less intangible asset	2.1	6.4
Accumulated other comprehensive income	$ 9.9	$ 56.2

Other Postretirement Benefit Plans

Prior to the Spin-Off, the employees of the Pulp and Paper Business participated in Kimberly-Clark's healthcare and life insurance benefit plans, which covered substantially all retirees and active employees. Certain benefits were based on years of service and/or age at retirement. The plans were principally noncontributory for employees who were eligible to retire before December 31, 1992, and contributory for most employees who retire after January 1, 1993. Kimberly-Clark provided no subsidized benefits to most employees hired after 2003. On November 30, 2004, the Company assumed responsibility for obligations for the active employees of the Company and former employees of the Canadian pulp operations. The Company established new healthcare and life insurance benefit plans to provide substantially similar benefits and credit such employees for service earned with Kimberly-Clark.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") became law. Among other things, the Act provides a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy to sponsors of retiree healthcare benefit plans that provide a prescription drug benefit that is at least actuarially equivalent to Medicare Part D. On April 1, 2004, FASB Staff Position 106-2 ("FSP 106-2"), *Accounting and Disclosure Requirements Related to Medicare Prescription Drug, Improvement and Modernization Act of 2003*, was adopted. Adoption of FSP 106-2 reduced the Company's accumulated postretirement benefit obligation by approximately $6.8 million and resulted in an unrecognized actuarial gain of a similar amount. Adoption resulted in a $0.3 million reduction in postretirement benefits cost for the year ended December 31, 2004.

Prior to 2004, the U.S. plans limited Kimberly-Clark's future annual per capita retiree medical benefits to no more than 200% of the 1992 annual per capita cost. These plans reached this limitation (the "Cap") and were amended during 2003. Among other things, the amendments index the Cap by 3% annually beginning in 2005 for certain employees retiring on or before April 1, 2004 and limit the future cost for retiree healthcare benefits to a defined fixed per capita cost for certain employees retiring after April 1, 2004. At December 31, 2004, the assumed inflationary pre-65 healthcare cost trend rate used to determine year-end obligations was 8.7%, decreasing to 7.8% in 2006, and then gradually decreasing to an ultimate rate of 5.0% in 2011. The assumed inflationary post-65 healthcare cost trend rate used to determine year-end obligations was 8.8%, decreasing to 7.9% in 2006, and gradually decreasing to an ultimate rate of 5.0% in 2011. The assumed inflationary pre-65 healthcare cost trend rate used to determine obligations at December 31, 2003 and cost for the year ended December 31, 2004 was 7.7%, decreasing to 6.7% in 2005, and gradually decreasing to an ultimate rate of 5.0% in 2010. The assumed inflationary post-65 healthcare cost trend rate used to determine obligations at December 31, 2003 and cost for the year ended December 31, 2004 was 8.1% decreasing to 7.1% in 2005, and gradually decreasing to an ultimate rate of 5.1% in 2010.

An accrued benefit obligation for other postretirement benefits assumed by the Company is reflected in noncurrent employee benefits and other obligations on the consolidated and combined balance sheet.

The following table reconciles the benefit obligations, plan assets, funded status and net liability information of the Company's pension and other benefit plans.

	Pension Benefits		Postretirement Benefits Other than Pensions	
Year Ended December 31,	2004	2003	2004	2003
Change in Benefit Obligation:				
Benefit obligation at beginning of year	$ 328.7	$ 234.5	$ 50.5	$ 34.7
Service cost	9.1	7.6	1.2	1.2
Interest cost	24.2	17.5	3.4	2.6
Currency	23.2	43.7	3.2	5.4
Actuarial loss (gain)	19.5	35.4	(1.8)	7.4
Benefit payments from plans	(10.9)	(10.4)	(1.1)	(1.0)
Adjustment related to Spin-Off	(8.1)	–	(0.4)	–
Participant contributions	0.5	0.5	–	–
Other	(0.1)	(0.1)	–	0.2
Benefit obligation at end of year	$ 386.1	$ 328.7	$ 55.0	$ 50.5
Change in Plan Assets:				
Fair value of plan assets at beginning of year	$ 275.3	$ 198.5	$ –	$ –
Actual gain on plan assets	35.1	35.4	–	–
Employer contributions	16.6	16.2	1.1	1.0
Currency	19.6	35.1	–	–
Benefit payments	(10.9)	(10.4)	(1.1)	(1.0)
Participant contributions	0.5	0.5	–	–
Adjustment related to Spin-Off	(7.7)	–	–	–
Fair value of plan assets at end of year	$ 328.5	$ 275.3	$ –	$ –
Funded Status:				
Benefit obligation in excess of plan assets	$ (57.6)	$ (53.4)	$ (55.0)	$ (50.5)
Unrecognized net actuarial loss	128.3	113.3	14.2	10.7
Unrecognized transition amount	(0.7)	(0.8)	–	–
Unrecognized prior service cost	6.4	7.0	0.3	0.1
Net amount recognized	$ 76.4	$ 66.1	$ (40.5)	$ (39.7)
Amounts Recognized in the Balance Sheets:				
Prepaid benefit cost	$ 76.4	$ 66.1	$ –	$ –
Intangible asset	2.1	6.4	–	–
Accrued benefit cost	(12.0)	(62.6)	(40.5)	(39.7)
Accumulated other comprehensive income	9.9	56.2	–	–
Net amount recognized	$ 76.4	$ 66.1	$ (40.5)	$ (39.7)

Summary disaggregated information about the pension plans follows:

December 31,	Assets Exceed ABO 2004	Assets Exceed ABO 2003	ABO Exceeds Assets 2004	ABO Exceeds Assets 2003	Total 2004	Total 2003
Projected benefit obligations	$ 333.2	$ 61.2	$ 52.9	$ 267.5	$ 386.1	$ 328.7
ABO	275.8	45.5	46.2	229.6	322.0	275.1
Fair value of plan assets	288.7	60.0	39.8	215.3	328.5	275.3

Components of Net Periodic Benefit Cost

Year Ended December 31,	Pension Benefits 2004	Pension Benefits 2003	Pension Benefits 2002	Postretirement Benefits Other than Pensions 2004	Postretirement Benefits Other than Pensions 2003	Postretirement Benefits Other than Pensions 2002
Service cost	$ 9.1	$ 7.1	$ 6.3	$ 1.2	$ 1.0	$ 1.0
Interest cost	24.2	21.9	19.2	3.4	3.6	3.2
Expected return on plan assets[(a)]	(27.7)	(22.4)	(23.9)	–	–	–
Recognized net actuarial loss	4.7	6.1	1.9	(4.6)	0.2	–
Amortization of unrecognized transition asset	(0.2)	(0.2)	(0.2)	–	–	–
Amortization of prior service cost	1.0	0.9	0.9	–	–	–
Adjustment related to Spin-Off	(0.4)	–	–	(0.4)	–	–
Net periodic benefit cost (credit)	$ 10.7	$ 13.4	$ 4.2	$ (0.4)	$ 4.8	$ 4.2

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

Weighted-Average Assumptions Used to Determine Benefit Obligations at December 31

Year Ended December 31,	Pension Benefits 2004	Pension Benefits 2003	Postretirement Benefits Other than Pensions 2004	Postretirement Benefits Other than Pensions 2003
Discount rate	5.75%	6.20%	5.75%	6.17%
Rate of compensation increase	3.75%	3.70%	–	–

Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended December 31

Year Ended December 31,	Pension Benefits 2004	Pension Benefits 2003	Pension Benefits 2002	Postretirement Benefits Other than Pensions 2004	Postretirement Benefits Other than Pensions 2003	Postretirement Benefits Other than Pensions 2002
Discount rate	6.21%	6.95%	7.05%	6.17%	6.91%	7.09%
Expected long-term return on plan assets	8.50%	8.50%	9.31%	–	–	–
Rate of compensation increase	3.75%	3.90%	4.00%	–	–	–

Expected Long-Term Rate of Return and Investment Strategies

The expected long-term rate of return on pension fund assets held by the Company's pension trusts was determined based on several factors, including input from pension investment consultants and projected long-term returns of broad equity and bond indices. Also considered were the plans' historical 10-year and 15-year compounded annual returns. It is anticipated that on average the investment managers for each of the plans will generate annual long-term rates of return of 8.5%. The expected long-term rate of return on the assets in the plans was based on an asset allocation assumption of about 70% with equity managers, with expected long-term rates of return of approximately 10%, and 30% with fixed income managers, with an expected long-term rate of return of about 6%. The actual asset allocation is regularly reviewed and periodically rebalanced to the targeted allocation when considered appropriate. Also, when deemed appropriate, hedging strategies are executed using index options and futures to limit the downside exposure of certain investments by trading off upside potential above an acceptable level. Such hedging strategies were executed in 2003 and 2002. Following the Spin-Off, the Company is following a similar methodology for determining its long-term rate of return on pension assets and investment strategy and is continuing to evaluate its long-term rate of return assumptions.

Plan Assets

Pension plan asset allocations are as follows:

Percentage of Plan Assets at December 31,	**2004**	2003	2002
Asset Category			
Equity securities	**66%**	70%	68%
Debt securities	**24%**	28%	30%
Real estate	**3%**	2%	2%
Cash and money-market funds	**7%**	–%	–%
Total	**100%**	100%	100%

Plan assets were not invested in Neenah securities for periods subsequent to the Spin-Off or Kimberly-Clark securities prior to the Spin-Off.

Cash Flows

The Company expects to contribute approximately $18.1 million to its pension trusts in 2005.

Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

(in millions)	Pension Plans	Other Postretirement Benefits
2005	$ 13.8	$ 1.6
2006	15.1	1.8
2007	16.4	2.0
2008	18.0	2.2
2009	19.6	2.5
Years 2010 - 2014	128.9	17.0

Healthcare Cost Trends

Assumed healthcare cost trend rates affect the amounts reported for postretirement healthcare benefit plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects:

	One-Percentage-Point	
	Increase	Decrease
Effect on total of service and interest cost components	$ 0.5	$ 0.4
Effect on post-retirement benefit obligation	6.8	5.3

Defined Contribution Retirement Plans

Contributions to the defined contribution retirement plans are primarily based on the age and compensation of covered employees. These contributions, all of which were charged to expense, were $0.5 million in each of 2004, 2003 and 2002. In connection with the Spin-Off, Kimberly-Clark transferred the related assets and liabilities of these plans to trusts established by the Company. In December 2004, the Company established defined contribution retirement plans that provide substantially similar benefits.

Investment Plans

Voluntary contribution investment plans are provided to substantially all employees. Under the plans, Kimberly-Clark matched a portion of employee contributions. Costs charged to expense under the plans were $1.0 million, $1.2 million and

$1.2 million in 2004, 2003 and 2002, respectively. In connection with the Spin-Off, Kimberly-Clark transferred the related assets and liabilities to trusts established by the Company. In December 2004, the Company established investment plans that provide substantially similar benefits.

NOTE 7. STOCK COMPENSATION PLANS

During 2003, 2002 and in prior years, certain employees of the Pulp and Paper Business were granted stock options, restricted stock and (prior to 1999) participation shares under Kimberly-Clark's stock compensation plans.

On August 31, 2004, Kimberly-Clark, acting as the sole shareholder of the Company, approved the Neenah Paper, Inc. 2004 Omnibus Stock and Incentive Plan (the "Omnibus Plan"). The Company then adopted and established the Omnibus Plan under unanimous written consent of the Neenah Board of Directors on December 1, 2004. With this approval, the Company reserved 3,500,000 shares of the Common Stock for issuance under the Omnibus Plan. Pursuant to the terms of the Omnibus Plan, the compensation committee of the Company's Board of Directors may grant awards of various type of equity-based compensation, including incentive and nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares and performance units, in addition to certain cash-based awards. All grants and awards under the plan will be made at fair market value and no grant or award may be repriced after its grant. In general, the options expire 10 years from the date of grant and vest over a three-year service period. At December 31, 2004, a total of 2,263,401 shares of Common Stock were reserved for future issuance under the Omnibus Plan.

Stock Options

In connection with the Spin-Off, options to acquire 390,508 shares of Kimberly-Clark common stock that were outstanding immediately prior to the Spin-Off were converted into 724,449 substitute options to purchase the Company's Common Stock under the Omnibus Plan. The awards converted were adjusted to maintain both the pre-conversion aggregate intrinsic value of each award and the ratio of the per share exercise price to the market value per share. Vesting terms and expiration dates were also preserved. The number of shares and new exercise prices were established using a ratio conversion methodology approved under FASB Interpretation No. 44 based on the fair market value of the Company's common stock on the date of grant.

The Kimberly-Clark stock options awarded to employees of the Pulp and Paper Business prior to the Spin-Off were granted with an exercise price equal to the market value of a share of common stock on the date of grant and were accounted for using APB 25. No employee compensation was charged to earnings in the combined statements of operations for periods prior to the Spin-Off because the exercise prices of all stock options granted was equal to the market value of Kimberly-Clark's common stock on the date of grant.

On December 15, 2004, an award of nonqualified stock options to purchase 442,540 shares of Common Stock (the "Fresh Start Options") was made to the management team and directors of the Company. The exercise price of the Fresh Start Options was equal to the market value of the Company's stock on the date of grant. The Fresh Start Options expire in 10 years and vest 30% on the first anniversary of the date of grant, 30% on the second anniversary and 40% on the third anniversary.

Data concerning stock option activity follows[a]:

	2004	
	Number of Options	Weighted Average Exercise Price
Conversion of Kimberly-Clark options	724,449	$ 31.32
Fresh Start Options granted	442,540	32.60
Exercised	–	–
Expired or cancelled	–	–
Outstanding – End of year	1,166,989	$ 31.81
Exercisable – End of year	532,554	$ 32.84

(a) Information with respect to the stock option awards to acquire the Company's Common Stock is presented for periods subsequent to November 30, 2004, the date on which Neenah common stock was distributed to the stockholders of Kimberly-Clark.

Data concerning options at December 31, 2004 follows:

	Options Outstanding			Options Exercisable	
	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Number of Options	Weighted-Average Price
\$24.01 – \$26.04	209,490	\$ 24.23	7.7	84,932	\$ 24.55
\$26.95 – \$30.15	82,335	\$ 28.97	3.9	82,335	\$ 28.97
\$32.60 – \$37.59	875,164	\$ 33.89	8.9	365,287	\$ 35.64
	1,166,989	\$ 31.81	8.3	532,554	\$ 32.84

Restricted Stock Awards

A number of employees of the Pulp and Paper Business were granted Kimberly-Clark restricted stock awards in previous years. These awards generally vested and became unrestricted shares in three to five years from the date of grant. At the time of the Spin-Off, the vesting schedule of restricted stock awards for employees of the Pulp and Paper Business were adjusted so that the awards vested on a prorated basis determined by the number of full years of employment with Kimberly-Clark during the restriction period. Unvested restricted shares of Kimberly-Clark common stock were forfeited.

On December 1, 2004, the Company awarded 25,360 replacement restricted shares to employees whose restricted shares of Kimberly-Clark common stock were forfeited. The number of restricted shares was calculated using a ratio conversion methodology approved under FASB Interpretation No. 44 based on the fair market value of the Company's common stock on the date of grant. The shares retained the Kimberly-Clark vesting schedule with 2,489 shares, 3,681 shares, 2,025 shares, 16,591 shares and 574 shares vesting in 2005, 2006, 2007, 2008 and 2009, respectively. Holders of Kimberly-Clark restricted stock are entitled to dividends and are permitted to vote such awarded shares, but the sale or transfer of such shares is limited during the restricted period.

The price of Kimberly-Clark's common stock at the date of grant determined the value of the restricted stock, and such value was recorded at the date of the grant as unearned compensation. This unearned compensation is amortized to expense over the periods of restriction. Amounts expensed in the Consolidated and Combined Statements of Operations related to stock-based employee compensation (consisting solely of restricted stock in 2004) were \$0.6 million, \$0.5 million and \$0.4 million in 2004, 2003 and 2002, respectively.

On December 15, 2004, Neenah awarded 40,800 and 3,450 Restricted Stock Units ("RSUs") to members of the management team and Board of Directors of the Company, respectively. The RSUs carry a promise to pay out in Common Stock at a future date. In general, the RSUs awarded to members of the management team vest over a five-year period, with one-third vesting on the third anniversary of the date of grant, one-third vesting on the fourth anniversary, and the balance vesting on the fifth anniversary. The RSUs awarded to members of the Board of Directors vest on the first anniversary of the date of grant. Holders of RSUs are entitled to dividends but are not permitted to vote such awarded shares and the sale or transfer of such shares is limited during the restricted period.

Participation Shares

Prior to 1999, Kimberly-Clark awarded key employees participation shares that were payable in cash at the end of the vesting period. The amount of cash paid to participants was based on the increase in the book value of Kimberly-Clark's common stock during the award period. Participants did not receive dividends on the participation shares, but their accounts were credited with dividend shares payable in cash at the maturity of the award. Neither participation nor dividend shares were shares of Kimberly-Clark common stock. Amounts expensed in the Consolidated and Combined Statements of Operations related to participation shares were \$0.4 million and \$0.6 million in 2003 and 2002, respectively. The plan was terminated in 2003 and payment was made by Kimberly-Clark in February 2004 for all remaining vested awards.

NOTE 8. STOCKHOLDERS' EQUITY

Common Stock

The Company has authorized 100 million shares of $0.01 par value common stock ("Common Stock"). Holders of the Company's Common Stock are entitled to one vote per share. In conjunction with the Spin-Off, 14,737,959 share of Common Stock were issued to the stockholders of Kimberly-Clark as a dividend in the ratio of one share of the Company's Common Stock for every 33 shares of Kimberly-Clark common stock outstanding.

Preferred Stock

The Company has authorized 20 million shares of $0.01 par value preferred stock. The preferred stock may be issued in one or more series and with such designations and preferences for each series as shall be stated in the resolutions providing for the designation and issue of each such series adopted by the Board of Directors of the Company. The Board of Directors is authorized by the Company's articles of incorporation to determine the voting, dividend, redemption and liquidation preferences pertaining to each such series. No shares of preferred stock have been issued by the Company.

NOTE 9. COMMITMENTS

Leases

The future minimum obligations under operating leases having a noncancelable term in excess of one year as of December 31, 2004, are as follows:

Year Ending December 31:	
2005	$ 2.7
2006	2.7
2007	1.7
2008	1.7
2009	1.7
Thereafter	15.1
Future minimum obligations	$ 25.6

Rental expense under operating leases was $3.9 million, $2.7 million and $2.4 million in 2004, 2003 and 2002, respectively.

Purchase Commitments

The Company has entered into long-term contracts for the purchase of sawmill wood chips and utilities, principally electricity. The minimum purchase commitments extend beyond 2009. Commitments under these contracts are approximately $39.5 million in 2005, $26.0 million in 2006, $25.8 million in 2007, $25.8 million in 2008 and $25.8 million in 2009. Total commitments beyond 2009 are $37.2 million.

Although the Company is primarily liable for payments on the above-mentioned leases and purchase commitments, management believes exposure to losses, if any, under these arrangements is not material.

NOTE 10. CONTINGENCIES AND LEGAL MATTERS

Litigation

A subsidiary of Kimberly-Clark is a co-defendant in a vehicle accident lawsuit pending in Ontario (Canada) Superior Court of Justice since August 1998. The plaintiffs in this lawsuit include the driver of one of the vehicles involved in the accident and his passengers. The driver sustained severe injuries, including paralysis, as a result of the accident on a bush road located within a forest where the subsidiary conducts logging operations. The plaintiffs claim that Kimberly-Clark was responsible for maintaining the bush road on which the accident occurred. In particular, the plaintiffs claim that Kimberly-Clark should have cut the trees and other growth on the sides of the bush road and the alleged failure to do so caused or contributed to the cause of the accident. The plaintiffs are seeking significant money damages, plus costs and attorneys' fees. Kimberly-Clark has denied liability and has raised numerous defenses in this lawsuit. Pursuant to the Distribution Agreement, the Company will indemnify Kimberly-Clark for liabilities and costs, including attorneys' fees and other costs of defense, arising out of this lawsuit, net of any insurance recovery by Kimberly-Clark. The Company expects this matter to be set for trial in 2006.

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

Indemnifications

Pursuant to the Distribution Agreement, the Pulp Supply Agreement, the Employee Matters Agreement and the Tax Sharing Agreement, the Company has agreed to indemnify Kimberly-Clark for certain liabilities or risks related to the Spin-Off (See Note 11). Many of the potential indemnification liabilities under these agreements are unknown, remote or highly contingent, and most are unlikely to ever require an indemnity payment. Furthermore, even in the event that an indemnification claim is asserted, liability for indemnification is subject to determination under the terms of the applicable agreement. For these reasons, the Company is unable to estimate the maximum potential amount of the potential future liability under the indemnity provisions of these agreements. However, the Company accrues for any potentially indemnifiable liability or risk under these agreements for which it believes a future payment is probable and a range of loss can be reasonably estimated. As of December 31, 2004, we believe our liability under such indemnification obligations was not material.

Environmental, Health and Safety Matters

Neenah is subject to federal, state, provincial and local laws, regulations and ordinances relating to various environmental, health and safety matters. The Company is in compliance with, or is taking actions designed to ensure compliance with, these laws, regulations and ordinances. However, the nature of the Company's business exposes it to the risk of claims with respect to environmental, health and safety matters, and there can be no assurance that material costs or liabilities will not be incurred in connection with such claims. Except for certain orders issued by environmental, health and safety regulatory agencies, with which management believes the Company is in compliance and which management believes are immaterial to the results of operations of the Company's business, Neenah is not currently named as a party in any judicial or administrative proceeding relating to environmental, health and safety matters.

While the Company has incurred in the past several years, and will continue to incur, capital and operating expenditures in order to comply with environmental, health and safety laws, regulations and ordinances, management believes that its future cost of compliance with environmental, health and safety laws, regulations and ordinances, and its exposure to liability for environmental, health and safety claims will not have a material adverse effect on its financial condition, results of operations or liquidity. However, future events, such as changes in existing laws and regulations or contamination of sites owned, operated or used for waste disposal by the Company (including currently unknown contamination and contamination caused by prior owners and operators of such sites or other waste generators), may give rise to additional costs which could have a material adverse effect on the Company's financial condition, results of operations or liquidity.

Neenah incurs capital expenditures necessary to meet legal requirements and otherwise relating to the protection of the environment at its facilities in the United States and Canada. For these purposes, the Company has planned capital expenditure programs for which it anticipates incurring approximately $4 million in 2005 and approximately $14 million in 2006, of which no material amount is the result of environmental fines or settlements.

Employees and Labor Relations

At December 31, 2004, the Company had 2,060 regular, full-time employees. Contracts covering approximately 625 and 501 domestic and Canadian employees, respectively, are scheduled for renegotiation in 2005. Such contracts include approximately 241 employees at the Pictou mill and 184 employees at the Whiting mill who are working under the terms of contracts that expired on June 1, 2004 and February 1, 2005, respectively. By operation of Nova Scotia labor law, the terms of the expired collective bargaining agreement at the Pictou mill will remain in effect until completion of the collective bargaining process. The Company and its unions generally have good working relationships and management believes its labor agreements contain wage and fringe benefit programs that are competitive within the applicable industry segment and geographic region. Although the Company believes that it has satisfactory relations with its employees, there can be no assurance that the Company will not have labor disputes in the future.

NOTE 11. TRANSACTIONS WITH KIMBERLY-CLARK

During all periods presented, the Company transferred softwood and hardwood pulp to Kimberly-Clark. For periods prior to the Spin-Off, such intra-company transfers were made pursuant to an advance transfer pricing agreement negotiated among Kimberly-Clark and certain taxing authorities. Under the advance transfer pricing agreement, pulp was transferred to Kimberly-Clark at a transfer price equal to a published industry index price less a discount. Net sales revenue for the pulp transferred to Kimberly-Clark were $351.0 million, $305.1 million and $262.1 million for the years ended December 31, 2004, 2003 and 2002, respectively. Settlement of such pulp transfers was effected through Kimberly-Clark's net investment account. In connection with the Spin-Off, the Company and Kimberly-Clark entered into a new Pulp Supply Agreement as described below.

In connection with the Spin-Off, the Company and Kimberly-Clark executed and delivered the Distribution Agreement (the "Distribution Agreement"), and certain related agreements, which are summarized below.

Distribution Agreement

The Distribution Agreement provided for, among other things, the principal corporate transactions required to effect the separation of the Pulp and Paper Business from Kimberly-Clark, the distribution of the Company's common stock to the holders of record of Kimberly-Clark common stock and other agreements governing the Company's relationship with Kimberly-Clark after the Spin-Off. Pursuant to the Distribution Agreement, Kimberly-Clark transferred to the Company assets used primarily in the Company's business and in general the Company assumed and agreed to perform and fulfill all of the liabilities arising out of the ownership or use of the transferred assets or the operation of the transferred business. The Distribution Agreement provides for cross-indemnities principally designed to place financial responsibility for the obligations and liabilities of the Pulp and Paper Business with the Company, and financial responsibility for the obligations and liabilities of Kimberly-Clark's retained businesses with Kimberly-Clark, except as may otherwise be provided in the Distribution Agreement.

Pulp Supply Agreement

The Company and Kimberly-Clark have entered into a Pulp Supply Agreement pursuant to which the Company agreed to supply and Kimberly-Clark agreed to purchase northern bleached softwood kraft pulp and northern bleached hardwood kraft pulp. Under the Pulp Supply Agreement, the Company must supply and Kimberly-Clark must purchase annually declining specified minimum tonnages of pulp. For each of 2005 and 2006, the minimum commitment for northern bleached softwood kraft pulp is 440,000 air-dried metric tons; for 2007 the minimum commitment is 395,000 air-dried metric tons and for 2008 and any subsequent years the minimum commitment is 345,000 air-dried metric tons. The amounts of those minimum commitments represent approximately 80%, 71%, and 62%, respectively, of the Company's total production of northern bleached softwood kraft pulp in 2004. The minimum commitment for northern bleached hardwood kraft pulp for 2005, 2006, 2007 and 2008 is 80,000, 60,000, 40,000 and 20,000 air-dried metric tons, respectively. The amounts of those minimum commitments represent approximately 52%, 39%, 26% and 13%, respectively, of the Company's total production of northern bleached hardwood kraft pulp in 2004. In March 2005, the Company notified Kimberly-Clark of its intention to terminate the Pulp Supply Agreement with respect to northern bleached hardwood kraft pulp produced at the Terrace Bay mill (See Note 15).

Under the Pulp Supply Agreement, the prices for northern bleached softwood kraft pulp and northern bleached hardwood kraft pulp will be based on published industry index prices for the pulp (subject to minimum and maximum prices for northern bleached kraft softwood pulp shipped to North America prior to December 31, 2007), less agreed upon discounts. The commitments are structured as supply-or-pay and take-or-pay arrangements. Accordingly, if the Company does not supply the specified minimums, the Company must pay Kimberly-Clark for the shortfall based on the difference between the contract price and any higher price that

Kimberly-Clark pays to purchase the pulp, plus 10% of that difference. If Kimberly-Clark does not purchase the specified minimums, Kimberly-Clark must pay for the shortfall based on the difference between the contract price and any lower price the Company obtains for the pulp, plus 10% of the difference. The Company will incur the cost of freight to delivery points specified in the agreement.

Either party can elect a two-year, phase-down period for the agreement, to begin no earlier than January 1, 2009, under which the minimum commitments for northern bleached softwood kraft pulp in the first and second years of the phase-down period would be 277,500 and 185,000 air-dried metric tons, respectively. In addition, the Company has the right at any time to terminate its obligation to supply northern bleached hardwood kraft pulp upon three months notice to Kimberly-Clark. Either the Company or Kimberly-Clark may terminate the pulp supply agreement for certain events specified in the agreement, including a material breach of the agreement by the other party that is not cured after 30 days' notice, insolvency or bankruptcy of the other party, or a fundamental change in the nature of the business of the other party that may substantially affect its ability to sell or to purchase or utilize pulp under the agreement. In addition, Kimberly-Clark may terminate the agreement if the ownership or control of the Company or any of its pulp production facilities becomes vested in or is made subject to the control or direction of, any direct competitor of Kimberly-Clark or any governmental or regulatory authority or any other third party, who in Kimberly-Clark's reasonable judgment may not be able to reliably perform the Company's obligations under the agreement. Kimberly-Clark may also terminate the agreement upon one year's notice if, as a result of the Company's forestry activities, continued use of the Company's pulp by Kimberly-Clark does or, in Kimberly-Clark's reasonable judgment is likely to, result in a substantial loss of sales of Kimberly-Clark's products or to otherwise materially and adversely affect the reputation of Kimberly-Clark or its products. Kimberly-Clark may also terminate the agreement upon 180 days notice that the Company's failure to comply with U.S. customs requirements jeopardizes Kimberly-Clark customs certification.

Corporate Services Agreement

The Company and Kimberly-Clark have entered into a Corporate Services Agreement whereby Kimberly-Clark will provide to the Company, on an interim, transitional basis, various corporate support services, including: certain employee benefits administration and payroll, management information, transportation, environment and energy, purchasing, treasury, accounting and other services, as well as transitional office space for the Company's research team. Each service will be made available to the Company on an as-needed basis through December 31, 2005, or such shorter or longer periods as may be provided in the Corporate Services Agreement. The fees charged for the services will generally be based upon the costs of providing the services. The Company may terminate the provision of a particular service upon 30 days' notice to Kimberly-Clark except where longer notice periods are specified in the Corporate Services Agreement. In addition, either the Company or Kimberly-Clark may terminate the Corporate Services Agreement for cause or upon certain changes of ownership relating to the other party as set forth in the Corporate Services Agreement.

Employee Matters Agreement

The Company and Kimberly-Clark have entered into an Employee Matters Agreement which provides for their respective obligations to employees and former employees who are or were associated with the Pulp and Paper Business and for other employment and employee benefits matters.

Pursuant to the Employee Matters Agreement, the Company agreed to employ or offer to employ all employees of Kimberly-Clark with employment duties principally related to the Pulp and Paper Business on terms and conditions substantially similar to the current terms and conditions of their employment with Kimberly-Clark. The Company agreed that, subject to applicable laws, to maintain labor agreements with substantially the same terms and conditions that existed with Kimberly-Clark.

The Company also assumed, and indemnified Kimberly-Clark against, certain liabilities related to employees of the Pulp and Paper Business who are employed by the Company and retired Canadian employees. The Company assumed responsibility for the Kimberly-Clark retirement plans in which employees of the Pulp and Paper Business participated.

The Company granted credit for service recognized under the Kimberly-Clark plans for all purposes under its plans. Kimberly-Clark transferred the assets and liabilities of the Kimberly-Clark retirement plans attributable to transferring active employees and retired Canadian employees of the Pulp and Paper Business to the Company.

In connection with the Spin-Off, outstanding options held by transferring employees under Kimberly-Clark's equity compensation plans (other than the Kimberly-Clark Corporation Global Stock Option Plan) were converted into substitute options to purchase Company common stock, or to the extent such options were exercisable they may instead, at the election of the option holder on or before November 30, 2004, remain exercisable in accordance with the terms of such plans as applicable to terminated employees.

Tax Sharing Agreement

The Company and Kimberly-Clark have entered into a Tax Sharing Agreement, which generally governs Kimberly-Clark's and the Company's respective rights, responsibilities and obligations after the Spin-Off with respect to taxes attributable to the Company's business, as well as any taxes incurred by Kimberly-Clark as a result of the failure of the Spin-Off to qualify for tax-free treatment under Section 355 of the Code.

General Taxes. Under the Tax Sharing Agreement, Kimberly-Clark is generally liable for all pre-Spin-Off, and the Company is generally be liable for all post-Spin-Off, U.S. federal income taxes, foreign taxes and certain state taxes attributable to the Company's business. The Tax Sharing Agreement sets forth rules for determining which taxes are attributable to pre-Spin-Off and post-Spin-Off periods and rules on the effect of subsequent adjustments to those taxes due to tax audits or examinations.

Distribution-Related Taxes. Under the Tax Sharing Agreement, the Company is liable for taxes incurred by Kimberly-Clark that arise as a result of the Company taking or failing to take, as the case may be, certain actions that result in the Spin-Off failing to meet the requirements of a tax-free distribution under Section 355 of the Code. The Company is also liable for taxes incurred by Kimberly-Clark in connection with certain acquisitions or issuances of Company stock, even if such acquisitions or issuances occurred after the Spin-Off, if such acquisitions or issuances result in the Spin-Off failing to meet the requirements of a tax-free distribution pursuant to Section 355(e) of the Code.

Administrative Matters. The Tax Sharing Agreement also sets forth Kimberly-Clark's and the Company's respective obligations with respect to the filing of tax returns, the administration of tax contests, assistance and cooperation and other matters.

NOTE 12. ASSET IMPAIRMENT LOSS

The Company's Terrace Bay, Ontario, pulp manufacturing facility incurred operating losses in 2002, 2003 and 2004. The Company anticipates that the facility will continue to incur operating losses in 2005, 2006 and 2007. The principal causes of these projected losses are:

- continued high operating costs at this facility;
- prices for pulp sold to Kimberly-Clark under the new pulp supply agreement, which will be at substantially higher discounts than those at which pulp was transferred to Kimberly-Clark prior to the Spin-Off;
- anticipated lower market prices for pulp in the second half of 2005 and forward as a result of an expected downturn in the pulp cycle; and
- continued strength of the Canadian dollar relative to the U.S. dollar.

Because projected extended periods of operating losses are indicators of impairment under SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"), the Company performed an asset impairment test on the facility under the guidance of SFAS 144, which indicated that the carrying amount of the Terrace Bay facility would not be recoverable from estimated future cash flows. Accordingly, in December 2004, the Company recorded a pre-tax, non-cash impairment loss of approximately $110.0 million to reduce the carrying amount of the Terrace Bay facility. In addition, in December 2004, in recognition of the probability that Terrace Bay's No. 1 mill would be closed (See Note 15), the Company recorded an additional impairment loss of approximately $2.8 million related to the long-lived assets of the Terrace Bay facility. A deferred tax benefit of approximately

$40.8 million was also recorded as a result of the impairment losses, resulting in a net after-tax charge of approximately $72.0 million.

In determining the impairment losses, the estimated fair value of the Terrace Bay facility was based on probability-weighted, pre-tax cash flows from operating the facility, discounted at a risk-free interest rate. The significant assumptions used to determine fair value of the facility included the Company's long-term projections of the market price of pulp, the projected cost structure of the facility and the long-term relationship of the Canadian dollar and the U.S. dollar. The Company also considered its plans to improve the cost structure at Terrace Bay, primarily through future capital projects and a plan for a cogeneration arrangement that would lower the cost of electricity, when determining the fair value of the facility used to determine the impairment losses. This estimate of the fair value of the Terrace Bay facility reflects these assumed improvements to the facility's cost structure.

Prior to the Spin-Off, Kimberly-Clark's management also performed an impairment test of the Terrace Bay facility under the guidance of SFAS 144. The purpose of that analysis was to determine if the Terrace Bay facility was impaired when held by Kimberly-Clark prior to the Spin-Off. As operated by Kimberly-Clark, the Terrace Bay facility supplied more than 90% of the pulp it produced to other Kimberly-Clark businesses where it was used to produce tissue and other products. Kimberly-Clark's management concluded that the facility was not impaired prior to the Spin-Off because, as used by Kimberly-Clark, it was an integrated part of Kimberly-Clark's tissue and other businesses and the estimated undiscounted future cash flows of the businesses consuming such pulp were sufficient to recover the carrying amounts of their long-lived assets, including the Terrace Bay facility.

NOTE 13. BUSINESS SEGMENT AND GEOGRAPHIC INFORMATION

The Company reports its operations in three segments: Fine Paper, Technical Paper and Pulp. The Fine Paper business is a leading producer of premium writing, text, cover and specialty papers. The Technical Paper business is a leading producer of durable, saturated and coated base papers for a variety of end uses. The Pulp business consists of the Terrace Bay, Ontario, pulp mill and the Pictou, Nova Scotia, pulp mill and related timberlands. Each segment requires different technologies and marketing strategies. Disclosure of segment information is on the same basis that management uses internally for evaluating segment performance and allocating resources.

Prior to the Spin-Off, Kimberly-Clark provided the Pulp and Paper Business with certain centralized administrative functions to realize economies of scale and efficient use of resources. The costs of shared services, and other administrative functions managed on a common basis, are allocated to the segments based on usage, where possible, or other factors based on the nature of the activity. The accounting policies of the reportable operating segments are the same as those described in the Summary of Significant Accounting Policies (see Note 2).

Business Segments

	Fine Paper	Technical Paper	Pulp	Unallocated Corporate Costs	Intersegment Sales	Combined Total
Net Sales						
Year						
2004	**$ 220.8**	**$ 132.3**	**$ 448.6**	**$ –**	**$ (29.6)**	**$ 772.1**
2003[(a)]	210.4	121.6	405.1	–	(26.8)	710.3
2002[(a)]	224.7	120.7	380.0	–	(23.4)	702.0
Operating Income (Loss)						
Year						
2004[(b)]	**67.0**	**21.9**	**(120.5)**	**(8.3)**	**–**	**(39.9)**
2003	63.2	16.6	(16.5)	–	–	63.3
2002	77.2	18.4	3.7	–	–	99.3
Depreciation and Amortization						
Year						
2004	**9.7**	**3.7**	**22.4**	**0.2**	**–**	**36.0**
2003	9.6	4.0	21.7	–	–	35.3
2002	10.0	4.0	20.3	–	–	34.3
Total Assets						
Year						
2004	**140.9**	**58.2**	**382.3**	**5.2**	**–**	**586.6**
2003	131.9	62.8	397.3	–	–	592.0

(a) The above amounts of Net sales for the years ended December 31, 2003 and 2002 have been increased from the amounts previously reported to be in conformity with EITF 00-10, which prohibits the netting of shipping and handling costs against revenues. Amounts reflected for "Net sales" in 2003 for the Fine Paper and Pulp businesses increased from the amounts previously reported by $8.1 million and $38.6 million, respectively. Amounts reflected for "Net sales" in 2002 for the Fine Paper and Pulp businesses increased from the amounts previously reported by $8.1 million and $38.0 million, respectively.

(b) Income before income taxes for the pulp business in 2004 includes an impairment loss of $112.8 million for the Terrace Bay facility.

	Fine Paper	Technical Paper	Pulp	Corporate	Combined Total
Capital Spending					
Year					
2004	**$ 3.5**	**$ 1.6**	**$ 11.0**	**$ 3.0**	**$ 19.1**
2003	2.5	2.2	19.7	–	24.4
2002	4.8	4.6	9.0	–	18.4

Geographic Information

	United States	Canada	Inter-Geographic Items	Combined Total
Net Sales				
Year				
2004	**$ 354.0**	**$ 448.2**	**$ (30.1)**	**$ 772.1**
2003	332.8	404.6	(27.1)	710.3
2002	349.4	378.5	(25.9)	702.0
Total Assets				
Year				
2004	**250.2**	**336.4**	**–**	**586.6**
2003	195.0	397.0	–	592.0

Net sales are attributed to geographic areas based on the physical location of the entities comprising the Pulp and Paper Business and the Company for the respective years. Segment identifiable assets are those that are directly used in the segments operations. Corporate assets are primarily cash, prepaid pension costs and deferred financing costs.

Concentrations

For the years 2004, 2003 and 2002, the Company had $351.0 million, $305.1 million and $262.1 million, respectively, of net sales revenue for pulp transferred to Kimberly-Clark. For the periods presented, other than Kimberly-Clark, no single customer accounts for more than 10% of the consolidated and combined revenue of the Company. Except for wood chips used by the pulp mills and certain specialty latex grades used by Technical Paper, management is not aware of any significant concentration of business transacted with a particular supplier that could, if suddenly eliminated, have a material adverse affect on its operations. In 2004 and 2003, over 55% of the wood chips used by the Pictou mill were supplied by two suppliers and approximately 60% of the wood chips used by the Terrace Bay mill were supplied by one supplier. While management believes that alternative sources of critical supplies, such as wood chips, would be available, disruption of its primary sources could create a temporary, adverse effect on product shipments. An interruption in supply of a latex specialty grade could disrupt and eventually cause a shutdown of production of certain technical paper, latex specialty grades.

NOTE 14. SUPPLEMENTAL DATA

Supplemental Statement of Operations Data

Year Ended December 31,	2004	2003	2002
Summary of Advertising and Research Expenses			
Advertising expense	$ 7.7	$ 5.8	$ 6.7
Research expense	1.7	2.1	1.8

Supplemental Balance Sheet Data

December 31,	2004	2003
Summary of Accounts Receivable, net		
Accounts Receivable:		
From customers	$ 84.9	$ 74.8
Other	11.8	3.5
Less allowance for doubtful accounts and sales discounts	(4.3)	(1.2)
Total	$ 92.4	$ 77.1

Accounts receivable are carried at amounts that approximate fair value.

December 31,	2004	2003
Summary of Inventories		
Inventories by Major Class:		
Raw materials	$ 31.1	$ 37.2
Work in process	7.7	5.7
Finished goods	42.1	28.8
Supplies and other	14.4	20.5
	95.3	92.2
Excess of FIFO cost over LIFO cost	(6.6)	(6.5)
Total	$ 88.7	$ 85.7

The FIFO values of total inventories valued on the LIFO method were $33.5 million and $27.6 million at December 31, 2004 and 2003, respectively.

December 31,	2004	2003
Summary of Property, Plant and Equipment – Net		
Land and land improvements	$ 4.8	$ 3.2
Buildings	84.6	143.4
Machinery and equipment	487.9	820.5
Roads	26.5	50.7
Construction in progress	13.6	7.3
	617.4	1,025.1
Less accumulated depreciation	359.8	657.0
Net Property, Plant and Equipment[(a)]	$ 257.6	$ 368.1

(a) In December 2004, the Company recorded an impairment loss of $112.8 million to write down the value of the Terrace Bay facility.

December 31,	2004	2003
Summary of Accrued Expenses		
Accrued salaries and employee benefits	$ 27.2	$ 22.9
Accrued income taxes	0.5	–
Accrued interest	1.4	–
Other	7.5	7.5
Total	$ 36.6	$ 30.4

NOTE 15. SUBSEQUENT EVENT

On March 1, 2005, the Company announced the planned closure of the smaller of the two single-line pulp mills at the Terrace Bay facility (the "No. 1 Mill"). The No. 1 Mill was originally constructed in 1948 and has annual capacity of approximately 125,000 tons of bleached kraft pulp. In conjunction with the closing, the Company will offer early retirement and severance packages to approximately 130 employees. The closing was authorized by our Chief Executive Officer on February 28, 2005, pursuant to a resolution of the Board of Directors, and is expected to occur in early May 2005.

The Company expects to incur approximately $6.0 million of exit costs in connection with the closure, including one-time termination benefits related to early retirement, severance and defined-benefit pension plans of approximately $5.5 million and other associated exit costs of $0.5 million. In addition, we expect to incur approximately $1.0 million of general expenses related to training of employees. Approximately $6.3 million of the estimated costs of $7.0 million will result in future cash expenditures during 2005 and 2006.

In addition, in March 2005, the Company will record a pre-tax, non-cash impairment loss of approximately $0.9 million related to the remaining value of the long-lived assets of the No. 1 Mill (See Note 12).

As a result of closing the No. 1 Mill, the Company notified Kimberly-Clark of its intention to terminate a part of its commitment to supply and their requirement to purchase northern bleached hardwood kraft pulp pursuant to the terms of the pulp supply agreement. Under the pulp supply agreement, the Company was obligated to provide 40,000, 30,000, 20,000 and 10,000 tons of northern bleached hardwood kraft pulp produced at the Terrace Bay mill annually in 2005, 2006, 2007 and 2008, respectively. Our commitment to supply and Kimberly-Clark's requirement to purchase northern bleached hardwood kraft pulp pursuant to the terms of the pulp supply agreement from the Pictou mill (in annual quantities which are identical to those shown above) are unchanged.

NOTE 16. UNAUDITED QUARTERLY DATA

	2004 Quarters [a]				
	First	Second	Third	Fourth	Year
Net Sales[d]	**$ 198.4**	**$ 207.4**	**$ 188.9**	**$ 177.4[c]**	**$ 772.1**
Gross Profit	**33.1**	**45.0**	**23.3**	**22.8**	**124.2**
Operating Income (Loss)	**24.3**	**37.3**	**7.8**	**(109.3)[b]**	**(39.9)**
Net Income (Losss)	**15.1**	**23.7**	**4.5**	**(69.7)[b]**	**(26.4)**
Earnings (Loss) Per Common Share[e]:					
Basic	**$ 1.03**	**$ 1.60**	**$ 0.31**	**$ (4.73)**	**$ (1.79)**
Diluted	**$ 1.03**	**$ 1.60**	**$ 0.31**	**$ (4.73)**	**$ (1.79)**

	2003 Quarters [a]				
	First	Second	Third	Fourth	Year
Net Sales [d]	$ 174.9	$ 173.3	$ 179.6	$ 182.5	$ 710.3
Gross Profit	27.5	24.5	24.1	31.8	107.9
Operating Income	14.9	10.8	15.5	22.1	63.3
Net Income	9.4	6.4	8.9	14.2	38.9
Earnings Per Common Share[e]:					
Basic	$ 0.64	$ 0.43	$ 0.60	$ 0.97	$ 2.64
Diluted	$ 0.64	$ 0.43	$ 0.60	$ 0.97	$ 2.64

(a) The annual maintenance shutdowns for the Company's two pulp mills occurred during the third quarter in 2004 instead of one each during the second and third quarters in 2003 and 2002.

(b) Includes an asset impairment loss of $112.8 million.

(c) Net sales subsequent to the Spin-Off (in December 2004) were reduced by $12.9 million, reflecting the one-time effect resulting from the new pulp supply agreement with Kimberly-Clark which transfers title at product delivery rather than shipment date.

(d) The above amounts of Net sales for all quarters prior to the fourth quarter of 2004 have been increased from the amounts previously reported to be in conformity with EITF 00-10, which prohibits the netting of shipping and handling costs against revenues. Net sales for the first, second and third quarters of 2004 were increased from amounts previously reported by $12.6 million, $12.7 million and $10.9 million, respectively. Net sales for the year and first, second, third and fourth quarters of 2003 were increased from amounts previously reported by $44.5 million, $11.0 million, 10.5 million, $11.5 million and $11.5 million, respectively. (See Note 2)

(e) For 2004 prior to the Spin-Off and 2003, basic and diluted earnings per share were computed using the number of shares of Neenah common stock outstanding on November 30, 2004, the date on which Neenah common stock was distributed to the stockholders of Kimberly-Clark.

Being one of the world's most respected paper companies, we couldn't limit the paper used in our annual report to just one choice. So we've used a range of our most popular paper brands. For help in identifying them, use the simple key to the right.

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Jerry Burns,
and photos on pages 28–33:
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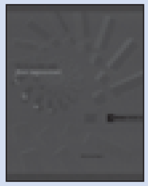

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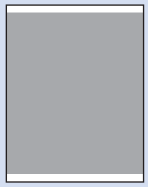

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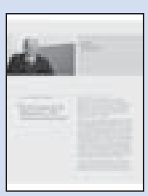

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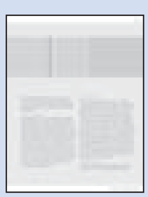

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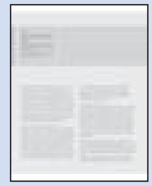

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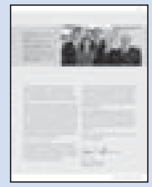

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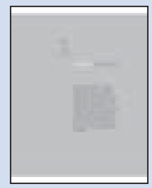

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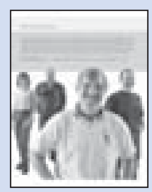

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80 lb. text

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Haviland Blue,
80 lb. text

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Haviland Blue,
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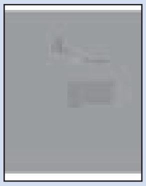

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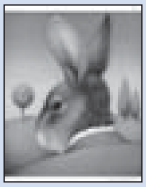

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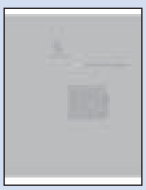
80 lb. text



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Pistachio,
80 lb. text

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100 lb. text

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Classic Natural White,
100 lb. text

Page 21:
CLASSIC CREST®,
Avalanche White, Super Smooth,
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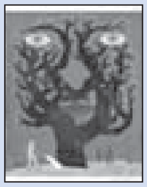

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Page 25:
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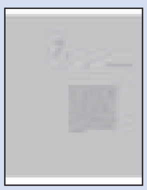

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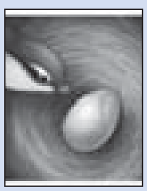

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100 lb. text

Page 29:
ENVIRONMENT®,
Alpaca,
80 lb. text

Page 30:
ENVIRONMENT®,
Alpaca,
80 lb. text

Page 31:
CLASSIC® Linen,
Solar White,
80 lb. text

Page 32:
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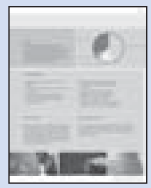
Solar White,
80 lb. text



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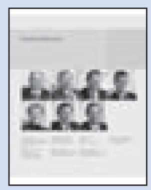
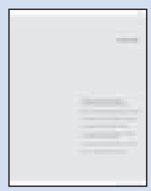
Solar White,
80 lb. text



Page 34:
CLASSIC® Linen,
Solar White,
80 lb. text



Pages 35–82
CLASSIC CREST®,
Potomac Blue,
80 lb. text

Shareholder Information

Corporate Headquarters

Neenah Paper, Inc.
3460 Preston Ridge Road
Suite 600
Alpharetta, GA 30005
678.566.6500
www.neenah.com

Annual Meeting of Shareholders

The annual meeting of the shareholders of Neenah Paper, Inc. will be held Monday, June 20, 2005, at 2:00 p.m., Central time (3:00 p.m, Eastern time), at Neenah Paper Whiting Mill, 3243 Whiting Road, Stevens Point, WI 54481.

Registrar and Transfer Agent

EquiServe Trust Company, N.A.
P.O. Box 43010
Providence, RI 02940
www.equiserve.com
877.498.8847

Investor Information

Inquiries and requests for information, including the Company's annual report to the Securities and Exchange Commission on Form 10-K, may be obtained at no charge by visiting the Company's web site at www.neenah.com or by otherwise contacting the company as follows:

Neenah Paper, Inc.
Attn: Stockholder Services
3460 Preston Ridge Road
Suite 600
Alpharetta, GA 30005
866.548.6569
or via e-mail to investors@neenahpaper.com

Stock Exchange

NP LISTED NYSE

Neenah Paper's common stock is traded on the New York Stock Exchange under the symbol NP.

Independent Accountants

Deloitte & Touche LLP
191 Peachtree Street
Suite 1500
Atlanta, GA 30303

Business Description

Neenah Paper manufactures and distributes a wide range of premium and specialty paper grades, with well-known brands such as CLASSIC®, ENVIRONMENT®, KIMDURA® and MUNISING LP®. The Company also produces and sells bleached pulp, primarily for use in the manufacture of tissue and writing papers. Neenah Paper is based in Alpharetta, Georgia, and has manufacturing operations in Wisconsin, Michigan and in the Canadian provinces of Ontario and Nova Scotia.

Neenah Paper, Inc. **2004** Annual Report

NEENAH PAPER INC

3460 Preston Ridge Road
Suite 600
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