Neenah Paper:

UnFOLDING

Annual Report 2005

NEENAH PAPER INC

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. Additional information about Neenah Paper can be found at the company's web site at www.neenah.com.

"We are evolving into something more than the sum of three businesses."

– Sean T. Erwin
President and Chief Executive Officer

To Neenah Paper Shareholders:

As years go, 2005 was a meaningful one for Neenah Paper. It marked our first full year as a stand-alone public company. For us, it was a year of challenge, learning and progress. Neenah Paper, like most manufacturing companies, faced significant pressures from the higher cost of energy and materials. Our pulp operations in Canada were additionally affected by the continued strengthening of the Canadian dollar, which is up by over 30 percent in a little over two years.

We responded to these challenges while also taking actions to strengthen and build our business for the long term. The successful launch of the new EAMES™ line of fine papers, the start-up of a new paper machine headbox at our Munising Technical Products mill and cost savings initiatives executed at all our mills are just a few examples of actions we completed. We also invested in our infrastructure and supply chain capabilities with the implementation of the first phase of our Oracle ERP system. Additionally, while making things happen today, we were able to further define our strategic plans and actions going forward.

A Challenging and Exciting First Year

Consolidated net sales for 2005 were $733 million versus $772 million in 2004. The decrease in sales was in pulp, where volumes declined due to the decision to close the No. 1 mill at Terrace Bay on May 1 and selling prices that were lower as a result of higher price discounts given to Kimberly-Clark in 2005, compared with 2004, when our operations were part of that company.

In both 2004 and 2005, we recorded non-cash impairment charges to write down the amount of our Terrace Bay fixed assets to a value based on expectations of its future cash-generating capabilities. At the spin-off in 2004, there was a pre-tax impairment charge of $113 million. In 2005, an additional $54 million pre-tax charge was taken, bringing the value of the fixed assets to zero.

An operating loss of $31 million was reported for 2005, and included the effects of the charges for impairment and the No. 1 mill closure of $60 million. The comparable 2004 operating loss was $40 million, but included the impairment charge of $113 million. As expected at the spin-off, results were impacted by higher pulp

As we evolve, the future of Neenah Paper will be in increasing the size and proportion of our two paper businesses.

discounts, added corporate expenses as a stand-alone company, and interest expense for the debt we incurred at the spin-off. Additional factors impacting results in 2005 were a stronger Canadian dollar and increased energy and material costs. These factors were partly offset by our cost improvement programs, which delivered over $25 million of savings in 2005, and selling price increases implemented across all product segments.

Our Fine Paper segment continued to outperform the market due to the quality and position of our products and the strength of our brands. Net sales of $222 million represented a slight year-on-year increase, despite a market that declined more than three percent. The launch of the EAMES™ Paper Collection in the second quarter was an unqualified success, further solidifying Neenah's position as the innovative brand leader in the premium paper market. We broadened our product line with the addition of new translucent Web+Plus™ papers. Our mills continued to deliver cost savings and recently entered into an agreement with a waste-to-energy firm in Wisconsin to process some of our manufacturing byproducts to generate steam. This allows us to significantly cut natural gas consumption at our Neenah mill, an example of environmental stewardship that also reduces cost.

In Technical Products, volumes increased three percent, driven by growth in tape and abrasives, although net sales fell slightly, from $132 to $131 million. Sales were affected by lower shipments of heat transfer papers, which were sold through a distributor until mid-year, at which point we terminated that agreement and began to work directly with customers to restore growth for this technologically advanced product. A key challenge that Technical Products faced in 2005 was from rising oil-based latex costs. To help offset this, our mills delivered cost savings of over $3 million and we also implemented surcharges and price increases.

2005 was a particularly tough year to be in the Canadian forest products industry. The strong rise of the Canadian dollar combined with escalating costs for energy and materials put virtually the entire industry in a loss position. Our Pulp segment reported an operating loss of $93 million, including the effects of the charges for impairment and the No. 1 mill closure of $60 million. As a result of the difficult environment, we worked to make progress on a number of fronts to address costs. In March, we made the difficult decision to shut down the older No. 1 mill at Terrace Bay. Its small scale did not justify the investment necessary to compete successfully in today's global pulp market. Later in the year, the Terrace Bay team re-engineered their approach to the annual maintenance down, saving millions of dollars. Following the down, the mill set numerous new production records and for the year was able to decrease manufacturing costs by seven percent, despite rising wood and energy costs. Both Terrace Bay and Pictou received Sustainable Forestry Initiative® certification in 2005, indicating our forests are being managed in an environmentally responsible manner.

While we successfully negotiated labor agreements at each of our paper mills and the Pictou mill, the year ended on a somber note, as a revised labor agreement with the woodlands workers at Terrace Bay was not reached. The woodland workers chose to go on strike on January 30, 2006, ultimately requiring the mill to shut down for lack of wood in mid-February.

Where We Go from Here

As the theme for this annual report points out, as a new company, Neenah's story is an unfolding one. While that is true, the message of that story has remained consistent since day one. We have always believed that the foundation for our future lies in our ability to sustain growth, create value from our Pulp business and deliver attractive returns. In 2005, we further developed and began executing a strategic plan that would bring those objectives to fruition.

Strong brands, innovative products, motivated people – at Neenah Paper, that's what drives our growth.

An Evolving Portfolio

At the time Neenah Paper was spun off in November 2004, it was comprised of three separate business units – a very well known branded premium fine paper franchise, a technical paper business and pulp operations. Half of our sales were pulp. As we evolve, the future of Neenah Paper will be in increasing the size and proportion of our two paper businesses, through organic growth and also potentially through acquisitions.

We own some of the strongest, most admired brands in the fine paper industry, giving us a solid foundation upon which to build. Our Technical Products business centers on producing a wide range of synthetic and paper-based products. Our research and development activities are now leading us in new directions, where our processes and proprietary capabilities can create value for customers and shareholders. These strengths will be leveraged as we evaluate new opportunities.

Growth Expectations

Strong brands, innovative products, motivated people – at Neenah Paper, that's what drives our growth. Prior to the spin-off, our paper businesses were to some extent in a "harvest" mode. We are now choosing how we invest in and manage these businesses for long-term growth.

In the Fine Paper segment, we are encouraging customers to "trade up" to the value and quality of Neenah Paper to present their message, and we hope to help grow the premium paper segment, which is now only three percent of the uncoated market. We are also exploring new sales and distribution channels for our products, including retailers and high-end packaging.

In our Technical Products segment, we are restoring an important component – customer development partnerships – and are now jointly working with our customers to explore how our products, processes and technology can meet their specific needs. To facilitate that, we have increased our research and development staff and capabilities. In fact, to emphasize the different directions available to us, you may have noticed we have changed the name of this segment from Technical Paper to Technical Products.

Growth starts with the top line, but requires constant attention to the bottom line as well. Our "Ring-the-Bell" costs savings program remains active and will continue to be part of our performance expectations each year. We will also deliver profits through increased size and scale, improvements in our Technical Products mix and control over corporate expenses, debt and taxes.

Delivering Value

At Neenah Paper, return on capital is an important metric to us and to our shareholders. We will drive this through wise capital investment decisions, cost savings initiatives, and tough but necessary decision-making. Our job is to make things happen.

Neenah's Board of Directors has adopted strong corporate governance policies and has taken an active interest in ensuring that shareholders' interests are both represented and protected. These actions should help deliver value and returns to our shareholders.

2005 was an exciting, challenging year for Neenah Paper, a year of tough decisions and determined actions. But to put it in perspective, it was just year one of what we hope will be a long unfolding journey into our future. I'd like to thank our employees, directors, customers and shareholders – both for your support and for sharing our vision for success.

Sean T. Erwin
Chairman, President and Chief Executive Officer

NEENAH PAPER AT A GLANCE

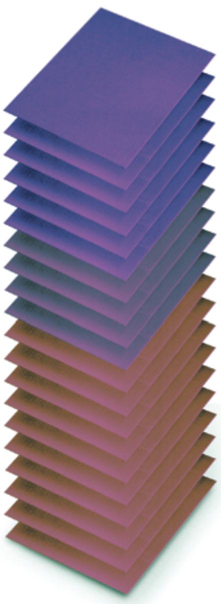
Neenah Paper: Setting a new standard in fine paper, technical products and pulp.

Our Fine Paper business produces premium writing, text, cover, specialty and private watermark papers that are used in identity packages, annual reports, 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®, UV/ULTRA® II Papers and the EAMES™ Paper Collection.

Our Technical Products business is an industry leader in research, technology and problem-solving, focused on durable, saturated, synthetic and coated base papers. Our customers are located in 40 countries around the world. For more than half a century, our innovative paper products have replaced those made from wood, plastic, cloth and leather. Our technical papers are not end-use products; they are essential components in the manufacture of other products. Our papers fit a wide array of applications, including abrasives, labels, decorative components, heat transfer and medical packaging.

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.

2005 NET SALES

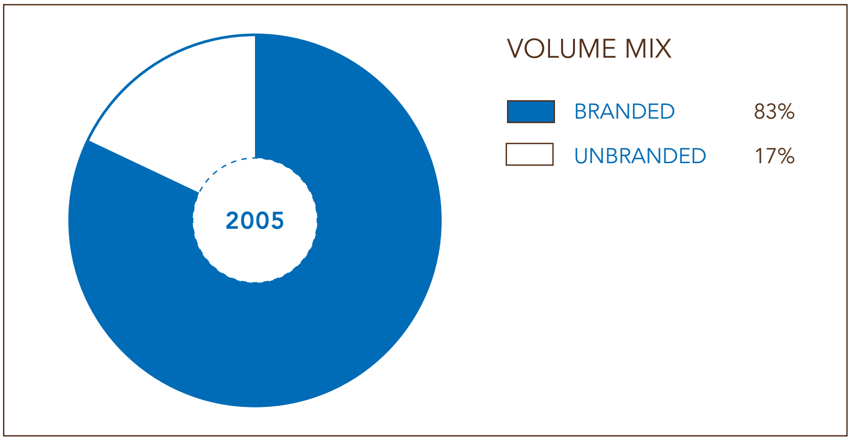


technical products
17%

fine paper
30%

pulp
53%

Fine Paper Neenah Paper's powerhouse of fine paper brands reads like a veritable who's who in premium paper. For more than 20 years, designers and printers have considered Neenah brands, such as CLASSIC CREST® and CLASSIC® Linen, to be their first choice for aesthetics, performance, consistency, availability, quality, and value. Today, Neenah's fine paper brands continue to occupy a premium position in the marketplace. Our introduction of the EAMES™ Paper Collection put us on the leading edge of paper innovation. As more and more customers look to high-quality paper to convey their messages, we see an opportunity to tip the scale in Neenah's favor.



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

2005 FINE PAPER HIGHLIGHTS

- Net sales up one percent for the year
- Launched the exclusive EAMES™ Paper Collection, which offers three new color palettes and unique surface finishes previously unexplored on paper
- Entered into a joint agreement with Sihl Paper, a global manufacturer of specialty papers based in Switzerland, to manufacture UV/ULTRA® II Web+Plus™ papers to provide Neenah Paper customers a broader range of printing applications for these translucent papers
- Began purchasing "green steam" from Minergy Corporation at our Neenah, Wisconsin mill. By purchasing this steam we will significantly reduce natural gas consumption and reduce paper mill byproducts going to landfill

1.

Premium paper makes an impression. It influences how the world perceives your company. Corporations print on Neenah Fine Paper to communicate quality. Even more important, they select Neenah Fine Paper to communicate a message. With the expanding spectrum of Neenah Fine Paper brands, we command a strong market position.

1. What's good for the environment is good for FedEx Kinko's. They chose Neenah ENVIRONMENT® brand papers, made with 100 percent post-consumer fiber, for several of their resumé, executive and card stock papers.
2. Designers often turn to nature for inspiration. Neenah's Fine Paper brands are a design inspiration in themselves.
3. Everything about the Starwood Preferred Guest Platinum program connotes elite status. That includes the welcome package, printed on Neenah EAMES™ Painting.
4. The designer's choice. For more than two decades, graphic designers have specified Neenah's Fine Paper brands for their clients – and for themselves.
5. The most important rule of all. Design firm Rule29 selected CLASSIC CREST® for their award-winning, self-promotional hardbound book, *Rules 1–28*.
6. What do many award-winning annual reports have in common? Neenah Fine Paper – brands such as CLASSIC®, CLASSIC CREST®, ENVIRONMENT®, EAMES™ and more.

FINE PAPER

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TECHNICAL PRODUCTS

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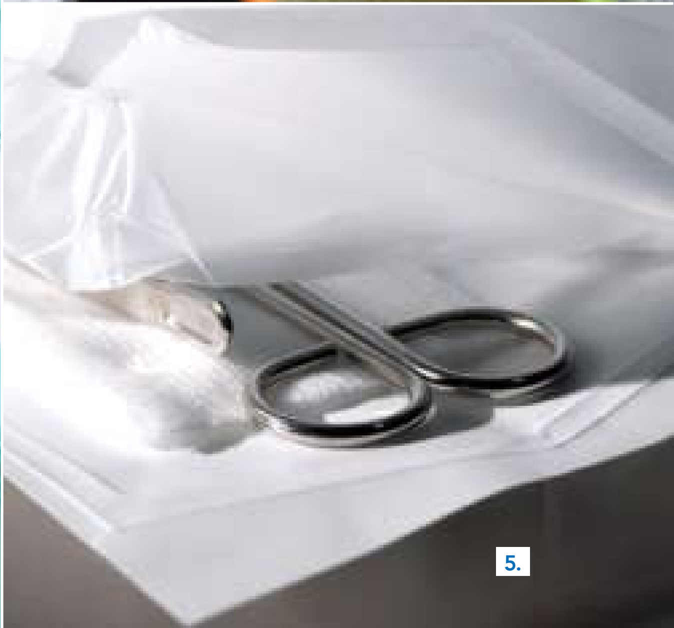

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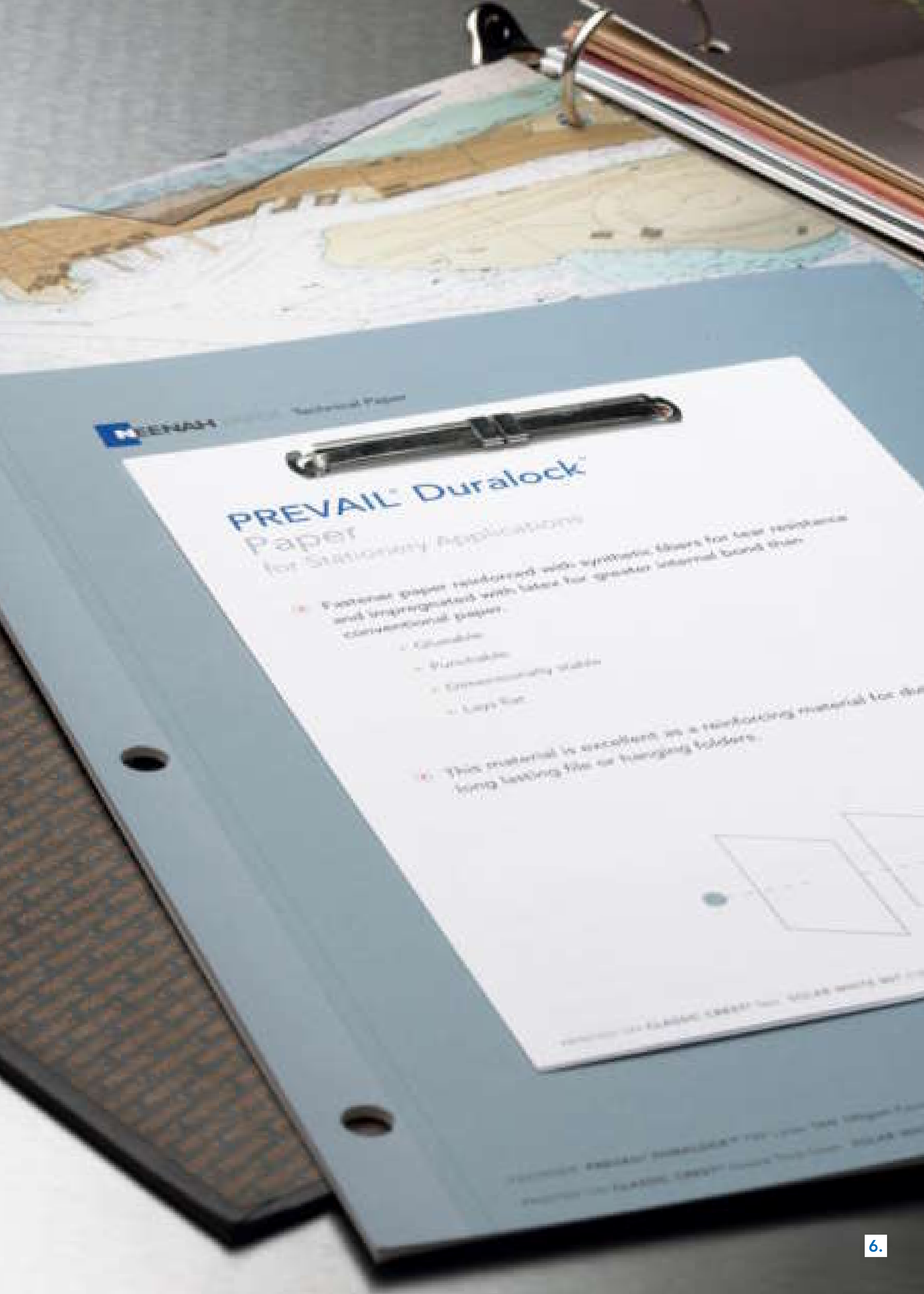
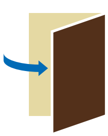

Technical Paper
PREVAIL® Duralock™
Paper
for Stationery Applications

Labels, tags, tapes, pre-mask, medical packaging, book components, furniture components, abrasives, heat transfer and more – chances are, you've come across Neenah's Technical Products before. They're in items you use everyday.

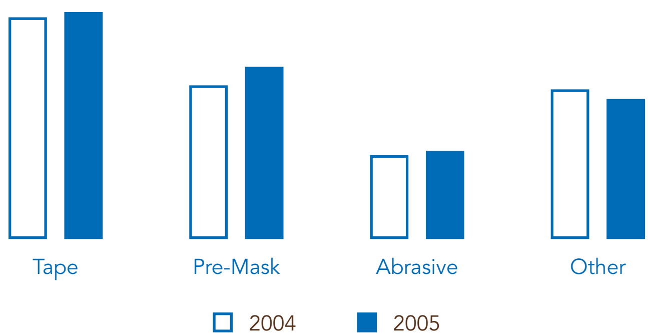
1. Scratch the surface of a great abrasive and you'll find a great backing material. Like Neenah's latex-saturated and coated papers, used worldwide for nearly 50 years.
2. Neenah makes heat transfer history. New PHOTOTRANS® ImageClip™ does away with those annoying plastic polymer windows around the image area.
3. Some label stock offers strength, while others offer good graphic qualities. Neenah Paper's KIMDURA® line of synthetic paper provides both, including resistance to UV radiation.



4. It's tempting to say that Neenah wrote the book on bookbinding. Actually, Neenah just supplies the binding components – from decorative converting base papers to stretch papers for the spine.
5. Neenah Paper Medical Packaging Paper is extremely heat stable, so it holds up under widely used processes.
6. Cellulose pulp reinforced with long, nylon fibers and saturated with durable latex. That's the formula for Prevail® Paper. Paper so strong you can even put grommets in it.

Technical Products Neenah's Technical Products division takes a proactive stance in developing solutions that meet customers' specific needs. Our Research and Development group works closely with customers to find new and improved uses for our products. Our expertise and experience in developing specialty substrate materials has made Neenah Technical Products a preferred supplier around the world. Our continued focus and investment in R&D opens new opportunities for our solutions and ensures that we maintain a leadership position in our categories.

VOLUME GROWTH

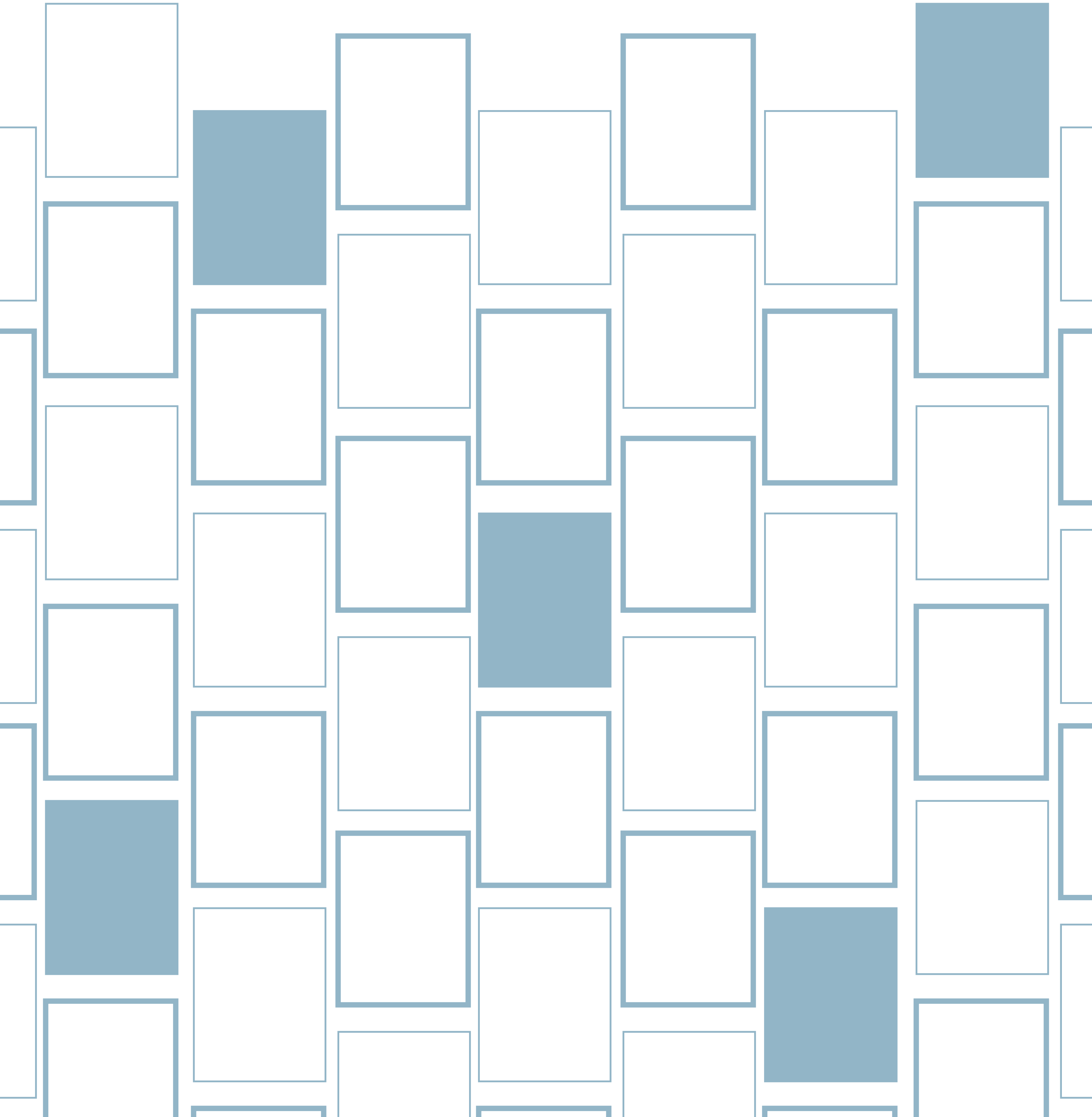


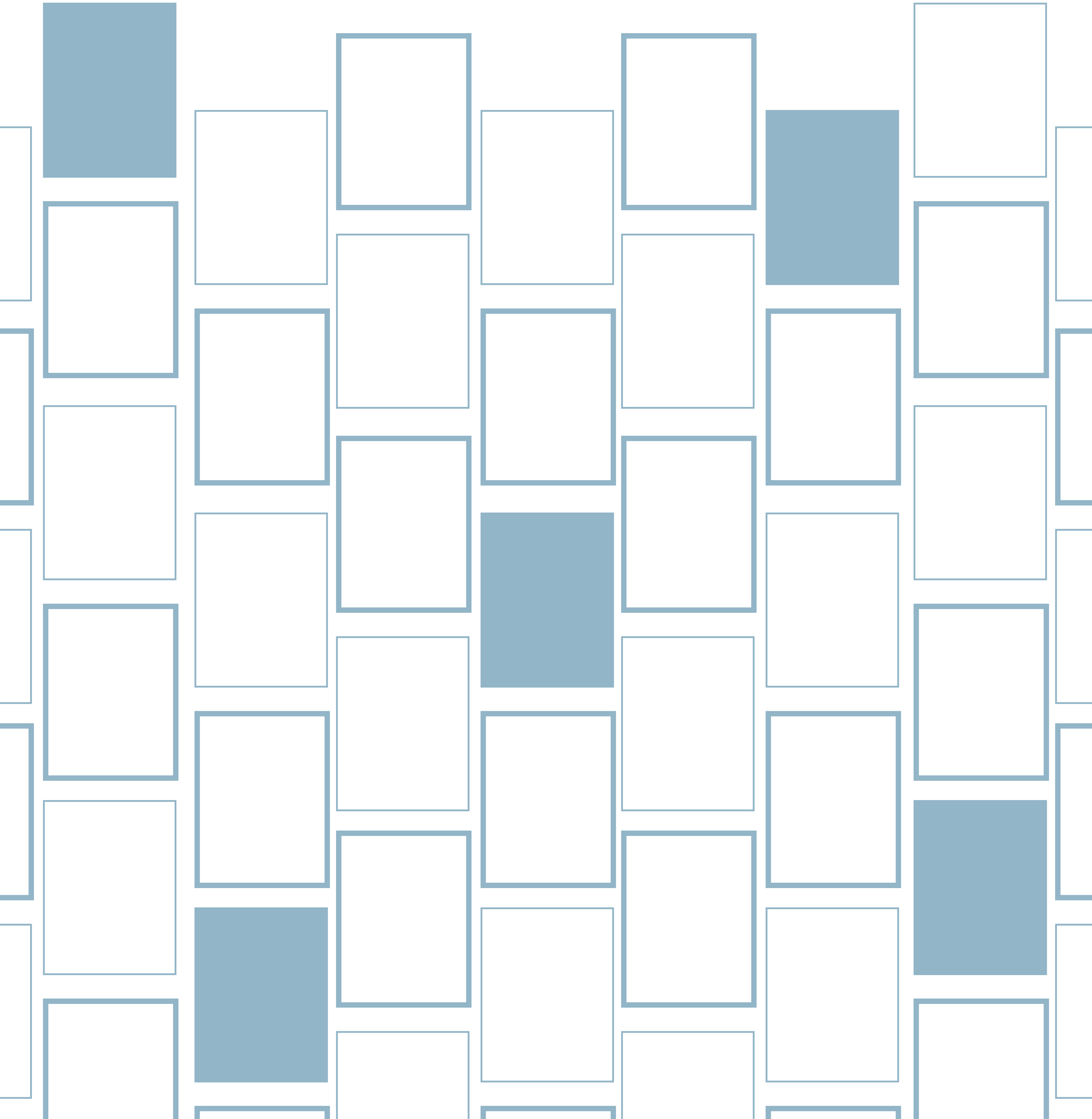
OUR BRANDS

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

2005 TECHNICAL PRODUCTS HIGHLIGHTS

- Expanded our Research and Development capabilities
- Introduced new heat transfer technology with PHOTOTRANS® ImageClip™ Heat Transfer Paper
- Launched the first breathable reinforced paper that withstands ozone sterilization for medical packaging
- Initiated a development project for Neenah™ Mirror Finish Abrasive Paper
- Arranged a supply agreement with Performance Industrial Tape Specialists Co. Ltd. (PITS)
- Added two new KIMDURA® Synthetic Papers, KIMDURA UV and KIMDURA Multi-Task





Pulp Neenah Paper's Pulp division produces approximately 600,000 metric tons of chlorine-free pulp annually from our two Canadian pulp operations. Our mills are SFI® certified, adhering to the latest in forest management technology and practices. Our focus in pulp continues to be on reducing costs, and in 2005, we closed the oldest and smallest of our two pulp mills at our Terrace Bay, Ontario facility.

OUR STRENGTHS

FLEXIBLE PRODUCTION
Softwood and hardwood pulp and various blends

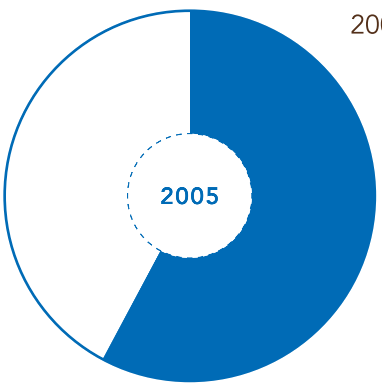
SUSTAINABILITY
Sustainable Forestry Initiative® (SFI) certification

STRATEGIC LOCATION
Pulp mills service customers in North America and Europe

CHLORINE-FREE
100% elemental chlorine-free (ECF) pulp

REFORESTATION
Seedling tree nursery at the Pictou timberland

2005 VOLUMES BY LOCATION



TERRACE BAY
375,000 metric tons

PICTOU
265,000 metric tons

2005 PULP HIGHLIGHTS

- Achieved SFI® (Sustainable Forest Initiative) and ISO 14000 certification for Pictou and Terrace Bay woodlands operations
- Shutdown the Terrace Bay No. 1 mill, saving $2–$4 million annually
- Upgraded Pictou baling to meet market demands for integrity and appearance
- Delivered significant cost savings by modifying annual maintenance approach at Terrace Bay

1.

From facial tissue to fine writing paper, Neenah pulp is the quality ingredient for a variety of paper products. Our pulp operations produce both bleached northern hardwood and softwood kraft pulp. The latter has exceptional tensile strength and low coarseness. In other words, it's a high-quality pulp.

1. Before it became pulp, it was a tree growing in Neenah Paper's Pictou, Nova Scotia, woodlands. And before it was a tree, it was a seedling growing in Neenah's nursery facilities, part of Neenah's Sustainable Forestry Initiative® (SFI) program.
2. Where does the pulp from Neenah's pulp mills go? Some of it goes to Neenah's paper mills, where it is turned into Neenah paper.
3. The majority of Neenah's pulp production goes into the manufacture of tissue paper products.
4. If you ever wondered what wood chips used to make Neenah pulp look like – they look like this.
5. Things that people use in everyday living, like these rolls of masking tape, also use Neenah pulp.

PULP


2.


4.


3.


5.

Board of Directors

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

Edward Grzedzinski
Former Chief Executive Officer, NOVA Information Systems

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

Timothy S. Lucas, CPA
Independent Consultant, Lucas Financial Reporting

John F. McGovern
Partner, Aurora Capital, LLC
Former Executive Vice President and Chief Financial Officer, Georgia-Pacific Corporation

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

Stephen M. Wood, Ph.D.
Independent Consultant, AFD Group, LLC
Former Chief Executive Officer, Kraton Polymers

Executive Team

Steven S. Heinrichs
Senior Vice President, General Counsel and Secretary

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

William K. O’Connor
Senior Vice President, Sales and Marketing

James R. Piedmonte
Senior Vice President, Operations

A Special Thanks

On January 10, 2006, Neenah’s Board of Directors elected John F. McGovern to serve as a director of Neenah Paper to replace James G. Grosklaus who resigned from the Board on November 3, 2005. Jim, as a former Executive Vice President with Kimberly-Clark, had a tremendous knowledge of our businesses and was instrumental in their growth and success. We would like to express our sincere appreciation to Jim for his contributions in helping set our new company on the road to success.

Overview

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

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

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

Our technical products business is a leading producer of durable, saturated and coated base papers and films for a variety of end uses. We sell our technical products globally into 15 product categories, and we focus on categories where we believe we are a market leader or have a competitive advantage, which include, among others, the specialty tape, label, abrasive, medical packaging and heat transfer technical products markets. We are also a global supplier of materials used to create customer specific components for furniture, book covers and original equipment manufacturers' products. Our customers are located in more than 35 countries and include 3M Company, Perfecseal, Avery Dennison Corporation and Saint-Gobain Group. Our technical products manufacturing facility is located in Munising, Michigan.

Our pulp business primarily produces northern bleached softwood kraft pulp used by paper mills to manufacture tissue and printing and writing papers. Our pulp business consists of mills located in Pictou, Nova Scotia and Terrace Bay, Ontario, together with related timberlands. The Pictou mill is comprised of a single-line pulp facility, which produces primarily softwood pulp, as well as timberlands encompassing approximately one million acres of owned and 200,000 acres of licensed or managed land in Nova Scotia. Timberland operations on land owned and licensed by the Pictou mill are provided by third-party contractors. In 2005, the Pictou mill produced approximately 265,000 metric tons of bleached kraft pulp.

On May 1, 2005, we closed the smaller of two single-line pulp mills at the Terrace Bay facility (the "No. 1 Mill"). The No. 1 Mill was originally constructed in 1948 and had annual capacity of approximately 125,000 tons of bleached kraft pulp. Following the closure of the No. 1 Mill, the Terrace Bay mill is comprised of a single-line pulp facility, which produces primarily softwood pulp, and a timberlands operation. Terrace Bay holds non-exclusive rights under a sustainable forest license to harvest wood off approximately 4.6 million acres of land owned by the Province of Ontario. In 2005, the Terrace Bay mill produced approximately 375,000 metric tons of pulp, including approximately 45,000 metric tons at the No. 1 Mill.

Recent Developments

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

Most of the approximately 400 hourly and salaried workers employed at the mill were laid off for an indefinite period during the two weeks following the commencement of closure activities. A small group of hourly and salaried employees will remain at the facility for security operations, boiler and related equipment operation and maintenance during the warm shutdown. An extended work stoppage at the mill could have a material impact on our liquidity and results of operations.

Products

Fine Paper Business. The fine paper business manufactures and sells branded, world-class premium writing, text, cover and specialty papers used in corporate annual reports, corporate identity packages, invitations, personal stationery and high-end packaging. Net sales of the fine paper business were approximately $222 million in 2005, $221 million in 2004 and $210 million in 2003.

Premium writing papers are used for business and personal stationery, corporate letterhead, corporate identity packages, private watermarked papers, envelopes and similar end-use applications. Market leading writing papers are sold by the fine paper business under the CLASSIC®, ENVIRONMENT®, NEENAH®, ATLAS® and OLD COUNCIL TREE® trademarks, which are denoted by a brand watermark in each sheet of writing paper. During 2005, we successfully introduced the EAMES™ Paper Collection which leveraged processes from both our fine paper and technical product businesses to create three unique finishes and 16 new colors inspired by the work of the designers Charles and Ray Eames. The fine paper business also sells private watermarked and other custom-manufactured writing papers.

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

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

Technical Products Business. The technical products business is a leading producer of durable, saturated and coated base papers and films for a variety of end uses, including tapes, premask, abrasives, labels, medical packaging, decorative components and heat transfer papers. Net sales of our technical products business were approximately $131 million in 2005, $132 million in 2004 and $122 million in 2003. KIMDURA®, MUNISING LP®, PREVAIL™ and NEENAH® are brands of our technical products business.

Products of the technical products business are typically sold to other manufacturers as a component of a finished product. The technical products business sells its products into five major market segments – tape, premask, abrasives, label and medical packaging – and 10 other specialty segments. Several key market segments served, including tape and abrasives, are global in scope.

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

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

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

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

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

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

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

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

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

Markets and Customers

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

The fine paper business sells its products through our sales and marketing organizations primarily in three channels: authorized paper distributors, converters and direct sales to specialty businesses. Distributor sales account for more than 80% of our customer base in the fine paper business, including distributor-owned paper stores. There is also a small but growing sales channel in office supply catalogs and business copy center stores, primarily to distributors in North America. Less than 5% of the sales of our fine paper business in 2005 were exported to international distributors in Europe, South Africa, Asia and Australia.

Sales to the fine paper business's two largest customers (both of which are distributors) represented approximately 35% of its total sales in 2005. We have limited our distribution agreements to improve our ability to control the marketing of our products. Although a complete loss of either of these customers would cause a temporary decline in the business's sales volume, the decline could be partially offset by expanding sales to existing distributors, and further offset over a several month period with the addition of new distributors.

Technical Products Business. The technical products business relies on a direct sales team and marketing organization to sell its products into 15 separate market segments in the U.S. and more than 35 export markets. Such segments, broadly defined as polymer impregnated and synthetic paper, include papers used as components in the following applications: saturated label, clean room papers, release papers, abrasives, masking tape, decal premask, heat transfer, medical packaging, decorative components, durable printing papers, furniture components, washable tag and industrial components. Our technical products business is recognized as a leading specialty paper manufacturer in the following market segments: furniture components, washable tag, decal premask, saturated label, clean room, saturated release paper, reinforced medical packaging and saturated abrasive backings.

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

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

The technical products business has over 500 customers worldwide. The distribution of sales in 2005 was approximately 70% in North America, 15% in Europe and 15% in Latin America and Asia. Customers typically convert and transform base papers and film into finished rolls and sheets by adding adhesives, coatings and finishes. Such transformed product is then sold to end-users.

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

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

In 2005, Terrace Bay and Pictou produced about 335,000 metric tons and 225,000 metric tons, respectively, of northern bleached softwood kraft pulp. In 2005, approximately 80% of our pulp mills' northern bleached softwood kraft pulp production was transferred to Kimberly-Clark. Our pulp mills have historically transferred more than 90% of their output of northern bleached softwood kraft pulp to Kimberly-Clark.

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

In 2005, both our Terrace Bay and Pictou mills produced about 40,000 metric tons of northern bleached hardwood kraft pulp. In 2005, our pulp mills transferred approximately 50,000 metric tons of northern bleached hardwood kraft pulp to Kimberly-Clark and less than 10,000 metric tons to our fine paper business. The balance of the pulp mills' output of northern bleached hardwood kraft pulp was sold to paper mills in the northeastern and midwestern United States.

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

Historically, our pulp mills have transferred their pulp directly to Kimberly-Clark and used brokers for sales to external customers. We will utilize our internal sales team to generate sales to external customers.

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

Geographic Information. For geographic information regarding the revenue and assets attributable to each of the product segments discussed above see Note 13 of the Consolidated and Combined Financial Statements appearing hereafter.

Selected Financial Data

The following table sets forth our selected historical financial and other data. You should read the information set forth below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our historical consolidated and combined financial statements and the notes to those consolidated and combined financial statements included elsewhere in this Annual Report. The statement of operations data for each of the years ended December 31, 2005, 2004 and 2003 and the balance sheet data as of December 31, 2005 and 2004 set forth below are derived from our audited historical consolidated and combined financial statements included elsewhere in this Annual Report. The statement of operations data for the years ended December 31, 2002 and 2001 and the balance sheet data as of December 31, 2003 and 2002 set forth below are derived from our audited historical combined financial statements not included in this Annual Report. The balance sheet data as of December 31, 2001 set forth below are derived from our unaudited historical combined financial statements not included in this Annual Report.

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. The historical financial and other data for periods through November 30, 2004 have been prepared on a combined basis from Kimberly-Clark's consolidated financial statements using the historical results of operations and bases of the assets and liabilities of Kimberly-Clark's fine paper and technical products businesses in the United States and its Canadian pulp business and give effect to allocations of expenses from Kimberly-Clark. For a description of these allocations, see Note 1 of the notes to our audited historical consolidated and combined financial statements included elsewhere in this Annual Report. The historical financial and other data for periods prior to November 30, 2004 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.

Prior to the Spin-Off, all of the operations of our pulp and paper business were included in the consolidated income tax returns of Kimberly-Clark. Under the tax-sharing agreement, Kimberly-Clark will indemnify us for all income tax liabilities and retain rights to all tax refunds relating to operations in the consolidated income tax returns for periods through the date of the Spin-Off. Accordingly, the combined balance sheets for 2003, 2002 and 2001 do 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. The income tax provisions were determined as if our business were a separate taxpayer.

(dollars in millions except per share) Year Ended December 31,	2005	2004	2003	2002	2001
Consolidated and Combined Statement of Operations Data [(a)]					
Net sales	$733.4	$772.1	$710.3	$702.0	$744.0
Cost of products sold	655.9	647.9	602.4	570.4	601.2
Gross profit	77.5	124.2	107.9	131.6	142.8
Selling, general and administrative expenses	53.2	45.8	34.6	33.6	37.2
Restructuring costs and asset impairment loss [(b)] [(c)]	59.8	112.8	–	–	–
Other (income) and expense – net	(4.7)	5.5	10.0	(1.3)	(4.5)
Operating income (loss)	(30.8)	(39.9)	63.3	99.3	110.1
Interest expense	18.2	1.4	–	–	–
Income (loss) before income taxes	(49.0)	(41.3)	63.3	99.3	110.1
Provision (benefit) for income taxes	(19.3)	(14.9)	24.4	37.0	35.5
Net income (loss)	$ (29.7)	$ (26.4)	$ 38.9	$ 62.3	$ 74.6
Earnings (loss) per basic share [(d)]	$ (2.02)	$ (1.79)	$ 2.64	$ 4.23	$ 5.06
Earnings (loss) per diluted share [(d)]	$ (2.02)	$ (1.79)	$ 2.64	$ 4.23	$ 5.06
Other Financial Data [(c)]					
Net cash flow provided by (used in):					
Operating activities	$ 22.8	$ 76.0	$ 73.6	$111.8	$145.2
Investment activities	(25.8)	(19.1)	(23.6)	(16.0)	(26.1)
Financing activities	(3.6)	(37.8)	(50.0)	(95.8)	(119.1)
Capital expenditures	25.7	19.1	24.4	18.4	29.1
Ratio of earnings to fixed charges [(e)]	[(e)]	[(e)]	71.3x	125.1x	123.3x

(dollars in millions) As of December 31,	2005	2004	2003	2002	2001
Consolidated and Combined Balance Sheet Data [(c)]					
Working capital	$123.9	$116.4	$101.7	$ 98.4	$114.1
Total assets	537.0	557.3	592.0	540.3	602.0
Long-term debt	226.3	225.0	–	–	–
Total liabilities	371.7	360.2	158.3	146.6	151.9
Total stockholders' and invested equity	165.3	197.1	433.7	393.7	450.1

(a) As noted elsewhere in this Annual Report, for periods prior to the Spin-Off, 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.

(b) In 2005, we recorded a $53.7 million pre-tax non-cash impairment loss to write off the carrying value of the Terrace Bay facility's tangible long-lived assets. In addition, we recorded a $6.1 million pre-tax charge for exit costs in connection with the closure of the smaller of the two single-line pulp mills at our Terrace Bay facility. The charge included $5.0 million for one-time termination benefits related to early retirement, severance and defined benefit pension plans, $0.3 for other associated exit costs and $0.8 million for a non-cash asset impairment loss (See Management's Discussion and Analysis of Financial Condition and Results of Operations – Asset Impairment Loss).

(c) In 2004, we recorded a $112.8 million pre-tax, non-cash impairment loss to reduce the carrying amount of the Terrace Bay facility (See Management's Discussion and Analysis of Financial Condition and Results of Operations – Asset Impairment Loss).

(d) As a result of the net loss in 2005 and 2004, 48,000 and 61,000 incremental shares, respectively, resulting from the assumed exercises of "in-the-money" stock options and 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, 2002 and 2001, basic and diluted earnings per share were computed using the number of shares of Neenah common stock outstanding at the Spin-Off date.

(e) For purposes of determining the ratio of earnings to fixed charges, earnings consist of income before income taxes (less interest) plus fixed charges. Fixed charges consist of interest expense, including amortization of debt issuance costs, and the estimated interest portion of rental expense. For the years ended December 31, 2005 and 2004, our earnings were insufficient to cover fixed charges by $49.0 million and $41.3 million, respectively.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis presents the factors that had a material effect on our results of operations during the years ended December 31, 2005, 2004 and 2003. 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

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. The results of operations of our business after the Spin-Off are and will continue to be significantly different from 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 from 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. 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; and
- Critical Accounting Policies and Use of Estimates.

OVERVIEW OF BUSINESS

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

In managing this diverse pulp and paper business, management believes that achieving and maintaining a leadership position for its fine paper and technical products 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 products 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.

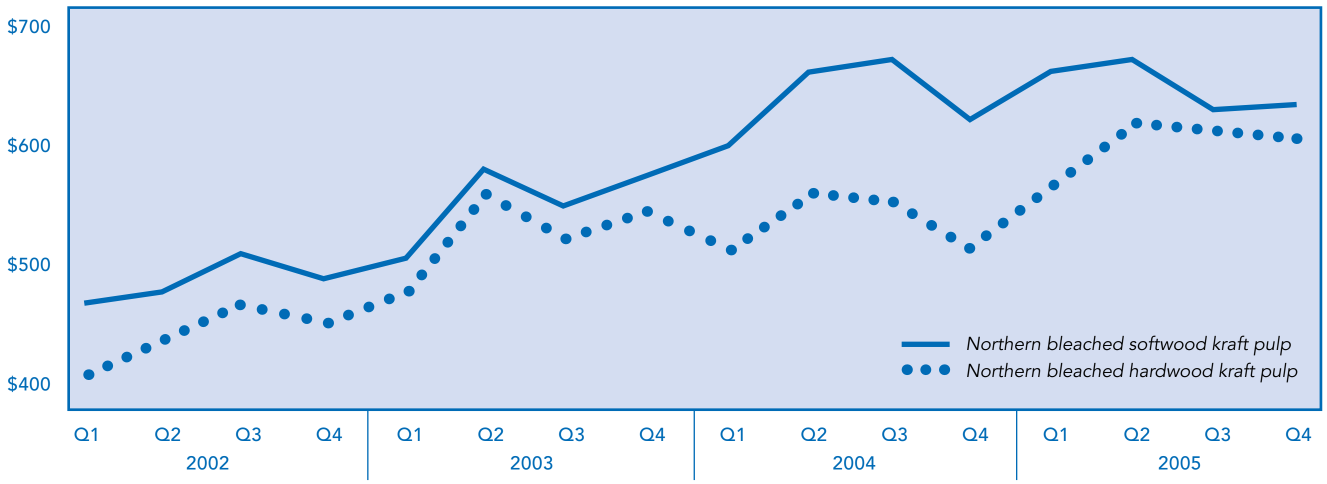
Cost Control. To improve and maintain our competitive position, we must control our raw material, manufacturing, distribution and other costs. A significant share of our investments in capital improvements are intended to achieve cost savings and improvements in productivity.

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.

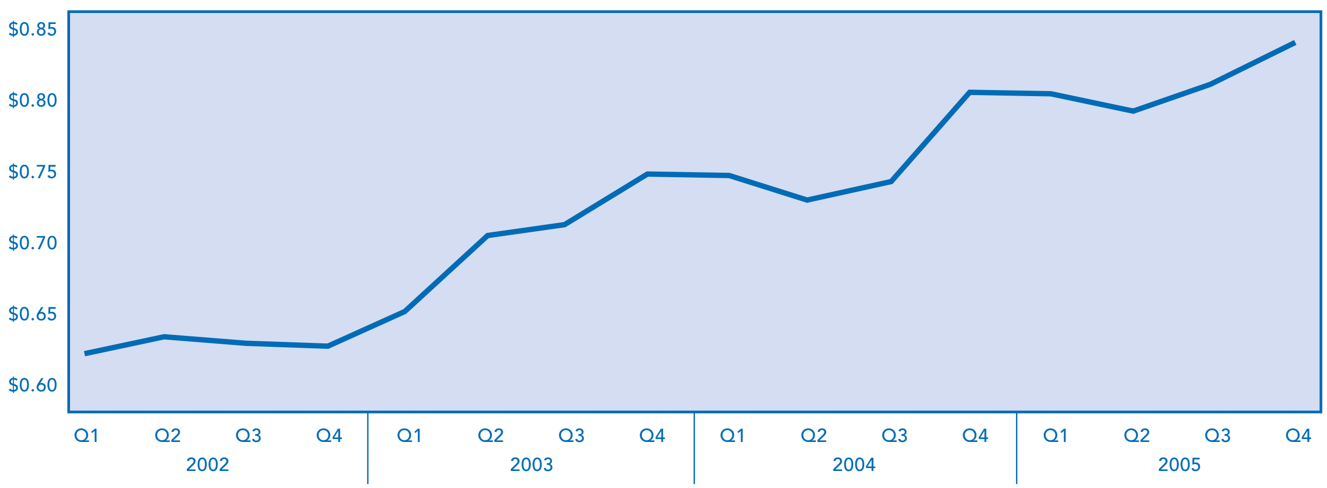
General Economic Conditions. The markets for all of our products are affected to a significant degree by general economic conditions. Downturns and improvements in the U.S. economy or in our export markets affect the demand for our products.

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 *value of Canadian dollar versus U.S. dollar*



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 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 products business is a leading producer of durable, saturated and coated base papers and films for a variety of end uses. We sell our technical products globally into 15 product categories, and we focus on nine categories where we believe we are a market leader, which include, among others, the tape, label, abrasive, medical packaging and heat transfer technical products markets. We are also a global supplier of materials used to create customer specific components for furniture, book covers and original equipment manufacturers' products. Our customers are located in more than 35 countries and include 3M Company, Perfecseal, Avery Dennison Corporation and Saint-Gobain Group. Our technical products manufacturing facility is located in Munising, Michigan.

Our pulp business 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 2005, the Pictou mill produced approximately 255,000 metric tons of bleached kraft pulp. In May, 2005, we closed the smaller of the two single-line pulp facilities at Terrace Bay (the "No. 1 Mill"). Following the closure of the No.1 Mill, the Terrace Bay mill is comprised of a single-line pulp facility which produces primarily softwood pulp and a timberlands operation. Terrace Bay holds non-exclusive rights under a sustainable forest license to harvest wood off approximately 4.6 million acres of land owned by the Province of Ontario. In 2005, the Terrace Bay mill produced approximately 375,000 metric tons of pulp, including approximately 45,000 metric tons produced by the No. 1 Mill.

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 products 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, 2005, 2004 and 2003.

Executive Summary:

Our operating results were adversely affected by asset impairment losses in each of 2005 and 2004 and restructuring activities in 2005 at our Terrace Bay facility. In May 2005, we closed the No. 1 Mill at the Terrace Bay facility following a strategic review of the facility's operations which indicated that the No. 1 Mill's small scale and high cost did not justify the investment necessary to make it competitive in the global pulp market. In December 2004 and 2005, we recorded pre-tax non-cash asset impairment losses of $112.8 million and $53.7 million, respectively, that in total reduced the carrying value of the Terrace Bay facility's long-lived assets to zero (see Note 12 of Notes to Consolidated and Combined Financial Statements included elsewhere in this Annual Report).

Excluding the impact of the restructuring activities and asset impairment losses, operating results in 2005 were unfavorable to the prior year primarily due to the continued strength of the Canadian dollar relative to the U.S. dollar, increased discounts on pulp sales to Kimberly-Clark pursuant to our pulp purchase agreement, costs related to our operation as a stand-alone company and higher raw material and energy costs, partially offset by higher selling prices.

In February 2006, we suspended pulp manufacturing activities at our Terrace Bay pulp mill as a result of a lack of wood fiber for its operations. The mill's fiber supply has been exhausted as a result of a strike by the approximately 250 unionized woodlands workers employed by our forestry operations that supply wood fiber to the mill.

Most of the approximately 400 hourly and salaried workers employed at the mill were laid off for an indefinite period during the two weeks following the commencement of closure activities. Pursuant to the terms of our labor agreements and Canadian laws, if the work stoppage continues through May 2006, we will be required to make payments to laid-off workers of approximately $8 million in the second quarter of 2006. Additional payments of from one to three times that amount could be required dependent upon, among other things, the duration of the work stoppage. We will continue to incur certain operating costs for the mill during the work stoppage, including costs for a limited number of hourly and salaried employees who will remain at the facility for security operations, boiler and related equipment operation and maintenance during the winter months. In addition, pulp shipments will continue until the mill's finished goods inventory is exhausted.

Pursuant to the terms of our pulp supply agreement with Kimberly-Clark, during the continuance of a "Terrace Bay Force Majeure Event," or a different "Force Majeure Event" (as defined in the Pulp Supply Agreement), we are generally excused, without penalty, from our obligations to supply and Kimberly-Clark is excused, also without penalty, from its commitments to purchase pulp under the pulp supply agreement during the continuance, and to the extent of, such event. A strike, labor disturbance and other events beyond our control are considered force majeure events under the pulp supply agreement if such events ultimately prevent us from supplying contractually agreed upon quantities of pulp to Kimberly-Clark.

We have suspended substantially all capital expenditures at Terrace Bay for the duration of the work stoppage. We have planned capital expenditures for 2006 of approximately $30 to $35 million. The timing and amount of actual capital expenditures in 2006 will depend on, among other things, the outcome of negotiations with the labor union (See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources").

Availability under our revolving credit facility fluctuates over time depending on the value of our inventory, receivables and various capital assets. An extended work stoppage could result in a decrease in the value of the assets securing our credit facility and a reduction in availability under the revolving credit facility. An extended work stoppage at the mill could have a material impact on our liquidity and results of operations.

Analysis of Net Sales – Years Ended December 31, 2005, 2004 and 2003

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

Year Ended December 31,	2005	2004	2003
Fine Paper	30 %	28 %	29 %
Technical Products	17	16	16
Pulp	53	56	55
Consolidated	100 %	100 %	100 %

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

(in millions) *Year Ended December 31,*	2005	2004	2003
Fine Paper	$ 222.3	$ 220.8	$ 210.4
Technical Products	130.6	132.3	121.6
Pulp	400.7	448.6	405.1
Intersegment sales	(20.2)	(29.6)	(26.8)
Consolidated	$ 733.4	$ 772.1	$ 710.3

Commentary:

Year 2005 versus 2004

	Change in Net Sales Versus Prior Year			
		Change Due To		
	Total Change	Net Volume	Product Price	Mix
Fine Paper	$ 1.5	$ (0.2)	$ 3.3	$ (1.6)
Technical Products	(1.7)	3.7	2.1	(7.5)
Pulp [(a)]	(47.9)	(52.0)	(16.5)	20.6
Intersegment sales	9.4	–	–	9.4
Consolidated	$ (38.7)	$ (48.5)	$ (11.1)	$ 20.9

(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.*

Consolidated net sales decreased $38.7 million, or 5.0%, in 2005 compared with 2004 primarily due to lower pulp volume and higher discounts on pulp shipments to Kimberly-Clark, partially offset by improvement in pulp product mix.

Our fine paper business net sales increased $1.5 million, or 0.7%, primarily due to higher average net selling prices, partially offset by lower product mix. Favorable pricing was primarily due to realization of a price increase for most branded products implemented in December 2004 and an additional increase for selected branded products in the third quarter of 2005. Product mix decreased as a result of shipping a higher proportion of lower-priced grades. Unit volumes were essentially unchanged from the prior year while the uncoated free sheet market decreased approximately 3% in 2005.

Our technical products business net sales decreased $1.7 million, or 1.3%, as 3% growth in unit volumes and favorable product pricing was more than offset by lower heat transfer shipments and a product mix with a higher proportion of relatively lower priced premask and tape volume. The volume improvement reflected strong growth in sales of premask and tape products partially offset by reduced label shipments. Favorable average net selling prices were due to realization of a price increase implemented in the fourth quarter of 2004 and a surcharge implemented in the third quarter of 2005 to recover increased costs for oil-based latex. Sales and mix were adversely affected by reduced heat transfer shipments related to our termination of a distribution agreement and the shift in sales volumes.

Our pulp business net sales decreased $47.9 million, or 10.7%, primarily due to lower shipment volumes and higher discounts on pulp shipments to Kimberly-Clark, partially offset by a shift in product mix to a higher proportion of softwood pulp shipments. Pulp shipment volume was 11% lower than the prior year due to the closure of the No. 1 Mill and, to a lesser extent, extended downtime at the Terrace Bay mill to replenish wood chip inventories. Average net selling prices were unfavorable to the prior year as marginally higher average market prices for softwood pulp were more than offset by higher discounts (approximately $27.4 million) on shipments to Kimberly-Clark pursuant to our pulp supply agreement. Product mix increased from the prior year due to a higher proportion of softwood shipments and increased sales of logs to sawmills and veneer manufacturers.

Year 2004 versus 2003

	Change in Net Sales Versus Prior Year			
		Change Due To		
	Total Change	Net Volume	Product Price	Mix
Fine Paper	$ 10.4	$ 15.2	$ (1.1)	$ (3.7)
Technical Products	10.7	8.5	(0.5)	2.7
Pulp [(a)]	43.5	(9.2)	53.1	(0.4)
Intersegment sales	(2.8)	–	–	(2.8)
Consolidated	$ 61.8	$ 14.5	$ 51.5	$ (4.2)

(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.*

Consolidated 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 paper and technical products 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 products 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% of total 2003 pulp revenues, reflecting the one-time effect of revised sales terms in the new pulp supply agreement with Kimberly-Clark which transfers title at product delivery rather than shipment date.

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,	2005	2004	2003
Net sales	100.0 %	100.0 %	100.0 %
Cost of products sold	89.4	83.9	84.8
Gross profit	10.6	16.1	15.2
Selling, general and administrative expenses	7.3	5.9	4.9
Restructuring costs and asset impairment loss	8.2	14.6	–
Other (income) and expense – net	(0.7)	0.7	1.4
Operating income (loss)	(4.2)	(5.1)	8.9
Interest expense	2.5	0.2	–
Income (loss) before income taxes	(6.7)	(5.3)	8.9
Provision (benefit) for income taxes	(2.6)	(1.9)	3.4
Net income (loss)	(4.1)%	(3.4)%	5.5 %

Analysis of Operating Income (Loss) – Years Ended December 31, 2005, 2004 and 2003

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

(in millions) *Year Ended December 31,*	2005	2004	2003
Fine Paper	$ 58.4	$ 67.0	$ 63.2
Technical Products	10.5	21.9	16.6
Pulp	(93.2)	(120.5)	(16.5)
Unallocated corporate costs	(6.5)	(8.3)	–
Total	$ (30.8)	$ (39.9)	$ 63.3

Commentary:

Year 2005 versus 2004

	Change in Operating Income Versus Prior Year					
		Change Due To				
	Total Change	Volume	Net Price [b]	Material and Energy Costs [c]	Currency	Other [d]
Fine Paper	$ (8.6)	$ (0.1)	$ (0.2)	$ (4.3)	$ –	$ (4.0)
Technical Products	(11.4)	0.8	(1.5)	(6.4)	–	(4.3)
Pulp [a]	27.3	(7.0)	(12.2)	(11.5)	(15.9)	73.9
Unallocated corporate costs	1.8	–	–	–	–	1.8
Consolidated	$ 9.1	$ (6.3)	$ (13.9)	$ (22.2)	$ (15.9)	$ 67.4

(a) The operating loss for our pulp business in 2005 and 2004 includes restructuring costs and asset impairment losses of $59.8 million and $112.8 million, respectively.

(b) Includes price changes, net of pulp discounts and changes in product mix.

(c) Includes price changes for raw materials and energy.

(d) Includes restructuring costs, annual maintenance-related downtime spending, other materials, manufacturing labor, distribution and selling, general and administrative expenses.

Our operating loss of $30.8 million in 2005 decreased $9.1 million versus the prior year period. Excluding Restructuring costs and asset impairment losses related to our Terrace Bay mill of $59.8 million and $112.8 million, in 2005 and 2004 respectively, operating results in the current year were $43.9 million unfavorable to 2004. Higher raw material and energy costs, unfavorable currency translation effects related to the strengthening of the Canadian dollar compared to the U.S. dollar, higher discounts on pulp sales to Kimberly-Clark and costs associated with our operation as a stand-alone company were the primary drivers of the unfavorable comparison.

Operating income for our fine paper business decreased $8.6 million primarily due to increased manufacturing and distribution costs and costs associated with our operation as a stand-alone company. The increase in manufacturing costs was primarily due to higher raw material prices including an 11% increase in average hardwood pulp prices, gas prices that increased more than 20% from the prior year and increased costs for chemicals and dyes. The increase in distribution costs was primarily due to an increase in fuel prices. In addition, net price was unfavorable to the prior year as an increase in the proportion of unbranded product sales more than offset branded product price increases implemented in December 2004 and the third quarter of 2005.

Operating income for our technical products business decreased $11.4 million due to higher manufacturing costs, costs associated with our operation as a stand-alone company and lower average net selling prices, partially offset by favorable volume. The increase in manufacturing costs was primarily due to higher costs for oil-based latex and increased utility costs related to higher coal prices. Net price was unfavorable as higher average prices were more than offset by lower heat transfer shipments and the shift in product mix to selling a higher proportion of relatively lower priced premask and tape products. Volume was favorable to the prior year primarily due to the strong growth in premask sales.

Our pulp business incurred an operating loss of $93.2 million in 2005, which was $27.3 million favorable to the prior year. Operating results for our pulp business were affected by Restructuring costs and asset impairment losses related to our Terrace Bay mill of $59.8 million and $112.8 million in 2005 and 2004, respectively. Excluding the effect of Restructuring activities in both years, our pulp business recorded an operating loss of $33.4 million in 2005 which was $25.7 unfavorable to the prior year. The unfavorable comparison to the prior year was primarily due to higher discounts on pulp shipments to Kimberly-Clark pursuant to our pulp supply agreement, unfavorable currency translation effects, increased fiber and energy-related manufacturing costs and costs associated with our operation as a stand-alone company. These unfavorable factors were partially offset by lower maintenance spending, costs savings related to the closure of the No. 1 Mill and higher average market prices for softwood pulp. The decrease in maintenance spending was primarily due to reducing scheduled downtime at Terrace Bay.

Restructuring Costs and Asset Impairment Losses

In December 2005 and 2004, we recorded pre-tax, non-cash impairment losses of approximately $53.7 million and $112.8 million, respectively, to reduce the carrying amount of the Terrace Bay facility to its estimated fair value. Deferred tax benefits of approximately $20.6 million and $40.8 million were recorded in 2005 and 2004, respectively, as a result of the impairment losses, resulting in net after-tax charges of approximately $33.1 million and $72.0 million. The cumulative effect of the impairment charges was to reduce the carrying value of the Terrace Bay facilities tangible long-lived assets to zero.

In May 2005, the No.1 Mill was closed and early retirement and severance packages were offered to approximately 150 employees. During 2005, we recorded approximately $5.0 million for one-time termination benefits related to early retirement, severance and defined benefit pension plans in connection with the closure of the mill and approximately $0.3 million for other exit costs. In addition, we recorded a pre-tax, non-cash asset impairment loss of approximately $0.8 million to write off the carrying value of the long-lived assets of the No. 1 Mill.

Year 2004 versus 2003

	Change in Operating Income Versus Prior Year					
		Change Due To				
	Total Change	Volume	Net Price (b)	Material and Energy Costs (c)	Currency	Other (d)
Fine Paper	$ 3.8	$ 5.6	$ (6.7)	$ (2.0)	$ –	$ 6.9
Technical Products	5.3	2.0	(1.5)	(2.0)	1.5	5.3
Pulp (a)	(104.0)	0.6	52.1	(5.6)	(29.4)	(121.7)
Unallocated corporate costs	(8.3)	–	–	–	–	(8.3)
Consolidated	$(103.2)	$ 8.2	$ 43.9	$ (9.6)	$ (27.9)	$(117.8)

(a) *The operating loss for our pulp business in 2004 includes restructuring costs and asset impairment loss of $112.8 million.*

(b) *Includes price changes, net of pulp discounts and changes in product mix.*

(c) *Includes price changes for raw materials and energy.*

(d) *Includes restructuring costs, annual maintenance-related downtime spending, other materials, manufacturing labor, distribution and selling, general and administrative expenses.*

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 products 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.

Additional Statement of Operations Commentary:

Selling, general and administrative expenses were $53.2 million, $45.8 million and $34.6 million for the years ended 2005, 2004 and 2003. We incurred $29.6 million of expenses in 2005 related to our operation as a stand-alone company following the Spin-Off, of which $22.2 million was reflected in selling, general and administrative expenses. The increase in selling, general and administrative expenses in 2004 versus 2003 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.

In 2005, we incurred $18.2 million of net interest expense (including $2.0 million of amortization of debt issuance costs) primarily on our $225 million of senior notes. In 2004, we incurred $1.4 million of net interest expense on our $225 million of senior notes for the month of December (following the Spin-Off). Kimberly-Clark used a centralized approach to cash management and the financing of its operations. As a result, none of Kimberly-Clark's cash, cash equivalents, debt or interest income or expense was allocated to the Pulp and Paper Business for periods prior to the Spin-Off.

The effective tax benefit rate was 39.4% and 36.1% for the years 2005 and 2004, respectively. The increase in the benefit rate between 2005 and 2004 was primarily due to an increase in the proportion of non-taxable income items to the pre-tax loss and generating a higher proportion of the pre-tax losses in tax jurisdictions with relatively higher marginal tax rates. The effective tax rate in 2003 was 38.5%. The change in the effective benefit and tax rates in 2004 and 2003, respectively, was primarily due to lower state and local income taxes (see Note 4 of Notes to 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,*	2005	2004	2003
Net cash flow provided by (used in):			
Operating activities	$ 22.8	$ 76.0	$ 73.6
Investment activities	(25.8)	(19.1)	(23.6)
Financing activities	(3.6)	(37.8)	(50.0)
Capital expenditures	25.7	19.1	24.4

Operating Cash Flow Commentary

Cash provided by operations of $22.8 million for the year ended December 31, 2005 decreased $53.2 million from 2004. This decrease was the result of lower earnings (excluding the non-cash effects of the Terrace Bay impairment loss and related deferred tax benefits and depreciation) and higher income tax payments, partially offset by a decrease in our investment in operating working capital. The decrease in operating working capital was primarily due to lower accounts receivable, partially offset by a decrease in accounts payable related to the timing of payments following the Spin-Off. 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 (excluding the non-cash effects of the Terrace Bay impairment loss and related deferred tax benefits and depreciation), partially offset by a smaller decrease in operating working capital than 2003, as discussed below.

During 2005, higher discounts on pulp shipments to Kimberly-Clark and lower pulp volume resulted in lower accounts receivable and reduced our investment in operating working capital (excluding the effects of a stronger Canadian dollar relative to the U.S. dollar). Our reduced investment in operating working capital due to lower accounts receivable was partially offset by an increase of $7.6 million in inventories (excluding the effects of a stronger Canadian dollar relative to the U.S. dollar). We built pulp finished good inventories to comply with contractually required safety stock levels as we transition to being a supplier of market pulp. 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.

Investing Commentary:

Capital spending in 2005 of $25.7 million was $6.6 million higher than the comparable prior year period. The increased spending was primarily for the acquisition and installation of enterprise resource planning (“ERP”) software and leasehold improvements at our new research and development center.

We anticipate capital expenditures for 2006 will be approximately $30 to $35 million. The timing and amount of capital expenditures will depend on the outcome of negotiations with regulatory authorities and labor unions, the results of engineering studies and the remediation methods ultimately selected. These capital expenditures are not expected to have a material adverse effect on our financial condition, results of operations or liquidity.

Financing Commentary:

Our liquidity requirements are being provided by cash generated from operations and short- and long-term borrowings. Prior to the Spin-Off, our financing (net of cash transfers to Kimberly-Clark) was provided by Kimberly-Clark.

In 2005, we financed the acquisition of our ERP software ($3.6 million) through third-party financing payable over three years. We financed our current year insurance premiums ($2.3 million) through the issuance of a short-term note. Payments under the agreements for our ERP software and insurance premiums in the current year were $1.1 million and $2.3 million, respectively.

We paid cash dividends of $0.40 per share or $5.9 million in 2005.

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 for the next 12 months. Our ability to generate adequate cash from operations beyond 2006, 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.

Contractual Obligations

The following table presents the total contractual obligations for which cash flows are fixed or determinable as of December 31, 2005:

(in millions)	2006	2007	2008	2009	2010	Beyond 2010	Total
Unconditional purchase obligations	$ 26.9	$ 26.7	$ 26.8	$ 26.7	$ 9.6	$ 28.9	$145.6
Long-term debt payments	1.2	1.3	–	–	–	225.0	227.5
Interest payments on long-term debt	16.7	16.7	16.6	16.6	16.6	66.4	149.6
Other postretirement benefit obligations	1.8	2.0	2.3	2.6	3.0	20.6	32.3
Operating leases	2.6	1.6	1.4	1.3	1.2	7.3	15.4
Open purchase orders	20.2	–	–	–	–	–	20.2
Contributions to pension trusts	12.2	–	–	–	–	–	12.2
Total contractual obligations	$ 81.6	$ 48.3	$ 47.1	$ 47.2	$ 30.4	$348.2	$602.8

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

The open purchase orders displayed in the table represent amounts we anticipate will become payable within the next year for goods and services that we have 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.

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 consolidated 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 reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenue and expenses.

The following summary provides further information about the critical accounting policies and should be read in conjunction with the notes to the Consolidated and Combined Financial Statements. We believe that the consistent application of our policies provides readers of Neenah's financial statements with useful and reliable information about our operating results and financial condition.

We have discussed the application of these critical accounting policies with our Board of Directors and Audit Committee.

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. With the exception of pulp sales to Kimberly-Clark and certain other customers, our sales terms are FOB shipping point. 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, 2005, we have recorded deferred income tax assets totaling $29.3 million related to temporary differences, and we have established no valuation allowances against these deferred income tax assets. As of December 31, 2004, our net deferred income tax assets were $1.2 million. In determining the need for valuation allowances, we consider many factors, including specific taxing jurisdictions, sources of taxable income, 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 assets will not be realized.

Prior to the Spin-Off, our operations were 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.

Financial Instruments

Cash and cash equivalents include all cash balances and highly liquid investments with an initial maturity of three months or less. We place our temporary cash investments with high credit quality financial institutions.

We use derivative instruments to manage exposures to foreign currency and commodity price risks. We principally use foreign currency forward and pulp future contracts to hedge against these exposures. Derivative instruments are recorded on the balance sheet as assets or liabilities and measured at fair market value. Derivative instruments that have been designated as hedges of anticipated future cash flows are marked-to-market through accumulated other comprehensive income (balance sheet adjustments) until such time as the related forecasted transactions affect earnings. Derivatives that are not designated as hedges are adjusted to fair value through other income. Fair value estimates are based on relevant market information, including current market rates and prices. The fair value estimates for derivative instruments are provided to us by banks known to be high-volume participants in these markets. We document relationships between hedging instruments and hedged items, and link derivatives designated as cash flow hedges to specific forecasted transactions. We also assess and document, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows associated with the hedged items.

Pension Benefits

In connection with the Spin-Off, and as set forth in the employee matters agreement, obligations for Kimberly-Clark's defined benefit pension plans and defined contribution retirement plans related to active and former employees of the Canadian pulp operations and active employees of the U.S. paper operations became our responsibility. Kimberly-Clark retained the obligations for former employees of the U.S. paper operations. 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. The 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.

Our funding policy for qualified defined benefit plans is to contribute assets to fully fund the accumulated benefit obligation. 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.

Consolidated and combined pension expense for defined benefit pension plans was $13.2 million, $10.7 million and $13.4 million for the years ended December 31, 2005, 2004 and 2003, respectively. In addition, in May 2005 we recognized a pre-tax charge of $1.6 million for a partial settlement of certain pension obligations related to the closure of the No. 1 Mill. 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 8.41, 8.50 and 8.50 for the years ended December 31, 2005, 2004 and 2003, respectively. The expected long-term rate of return on pension fund assets held by our (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. We anticipate that on average the investment managers for our U.S. and Canadian plans will generate annual long-term rates of return of at least 8.0% and 8.5%, respectively. Our expected long-term rate of return on the assets in the plans is based on an asset allocation assumption of about 60% with equity managers, with expected long-term rates of return of approximately 10%, and 40% 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 2005, 2004 and 2003. We evaluate our investment strategy and long-term rate of return on pension asset assumptions at least annually.

Pension expense is estimated 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, 2005, our plans had cumulative unrecognized investment losses and other actuarial losses of approximately $147.8 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 Statement of Accounting Standards ("SFAS") 87, *Employers' Accounting for Pensions*.

The discount (or settlement) rate that is utilized for determining the present value of future pension obligations generally is 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. The weighted-average discount rate in percents was 5.20 and 5.75 at December 31, 2005 and 2004, respectively.

Our consolidated pension expense of $13.2 million in 2005 is based on an expected weighted-average long-term rate of return on assets of 8.41%, a weighted-average discount rate of 5.75% and various other assumptions. Pension expense beyond 2005 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 $375 million at December 31, 2005 from about $329 million at December 31, 2004, primarily due to investment gains, plan contributions and currency exchange effects exceeding payments for pension benefits. Lower discount rates caused the projected benefit obligations of the defined benefit plans to exceed the fair value of plan assets by approximately $75 million at December 31, 2005, compared with approximately $58 million at December 31, 2004. The accumulated benefit obligation exceeded the fair value of plan assets by about $5.4 million at the end of 2005. At the end of 2004, the fair value of plan assets exceeded the accumulated benefit obligation by about $6.5 million. Contributions to pension trusts in 2005 were $20.3 million (including $1.6 million for special termination benefits related to the closure of the No. 1 Mill) compared with $16.6 million in 2004. In addition, we made direct benefit payments of approximately $0.1 million in each of 2005, 2004 and 2003 for unfunded supplemental retirement benefits.

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 Operating Income (Loss) – Asset Impairment Loss" for a summary of our asset impairment test on the Terrace Bay pulp facility, which resulted in net pre-tax impairment losses of approximately $54.5 million and $112.8 million in 2005 and 2004, respectively.

Quantitative and Qualitative Disclosures About Market Risk

As a multinational enterprise, we are exposed to risks such as changes in commodity prices, foreign currency exchange rates, interest rates and environmental regulation. 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. Credit risk with respect to the counterparties is considered minimal in view of the financial strength of the counterparties.

Presented below is a description of our most significant risks.

Foreign Currency Risk

Our results of operations and cash flows are affected by changes in the Canadian dollar exchange rate relative to the U.S. dollar. Exchange rate fluctuations can have a material impact on our financial results because substantially all of our pulp mills' expenses are incurred in Canadian dollars and our pulp revenues are denominated in U.S. dollars. In 2005, a hypothetical $0.01 increase in the Canadian dollar relative to the U.S. dollar, would have decreased our income before income taxes by approximately $5 million, excluding additional currency re-measurement losses.

We use hedging arrangements to reduce our exposure to exchange rate fluctuations, although these arrangements could result in us incurring higher costs than we would incur without the arrangements. In 2005, we entered into a series of foreign currency forward exchange contracts, designated as cash flow hedges, of U.S. dollar denominated pulp sales. At December 31, 2005 we had foreign currency contracts outstanding in a notional amount of $213 million Canadian dollars. The fair value of the contracts was $9.3 million U.S. dollars and was reflected on the balance sheet as an asset. The weighted average exchange rate for the foreign currency contracts at December 31, 2005 was $0.820 U.S. dollars per Canadian dollar and the contracts extend through May 2007.

Currency transactional exposures are also sensitive to changes in the exchange rate of the U.S. dollar against the Canadian dollar. We performed a sensitivity test to quantify the effects that possible changes in the exchange rate of the U.S. dollar would have on our pre-tax income based on the transactional exposure at December 31, 2005. The effect is calculated by multiplying our net monetary asset or liability position by a 10% change in the exchange rate of the Canadian dollar versus the U.S. dollar. The results of this sensitivity test are presented in the following paragraph.

As of December 31, 2005, a 10% unfavorable change in the exchange rate of the U.S. dollar against the Canadian dollar involving balance sheet transactional exposure would have resulted in a net pre-tax loss of approximately $4 million.

Finally, the translation of the balance sheets of our Canadian operations from Canadian dollars into U.S. dollars also is sensitive to changes in the exchange rate of the U.S. dollar against the Canadian dollar. Consequently, we performed a sensitivity test to determine if changes in the exchange rate would have a significant effect on the translation of the balance sheets of our Canadian operations into U.S. dollars. These translation gains or losses are recorded as unrealized translation adjustments, or UTA, within stockholders' equity. The hypothetical change in UTA is calculated by multiplying the net assets of our Canadian operations by a 10% change in the U.S.$/Canadian$ exchange rate. The results of this sensitivity test are presented in the following paragraph.

As of December 31, 2005, a 10% unfavorable change in the exchange rate of the U.S. dollar against the Canadian dollar would have decreased our stockholders' equity by approximately $18 million. The hypothetical increase in UTA is based on the difference between the December 31, 2005 exchange rate and the assumed exchange rate.

Commodity Risk

Pulp. Our results of operations, cash flows and financial position are sensitive to the selling prices of wood pulp. Wood pulp is a commodity for which there are multiple other suppliers. Typically, commodities businesses compete primarily on the basis of price and availability. The revenues from producing a commodity tend to be cyclical, with periods of shortage and rapidly rising prices leading to increased production and increased industry investment until supply exceeds demand. Those periods are then typically followed by periods of reduced prices and excess and idled capacity until the cycle is repeated.

The markets and profitability of pulp have been, and are likely to continue to be, cyclical. Because our pulp business competes primarily on the basis of price and availability, the financial success of our pulp mills depends on their ability to produce pulp at a competitive cost. Accordingly, we must continuously and effectively manage our cost structure and production capacity to be able to respond effectively to business cycles in the pulp industry.

We use hedging arrangements to reduce our exposure to pulp price fluctuations, although these arrangements could result in us incurring higher costs than we would incur without the arrangements. In 2005, we entered into a series of pulp futures contracts to hedge fluctuations in pulp prices through December 2006. At December 31, 2005, we had future contracts for 144,000 metric tons of pulp with a notional amount of approximately $91 million. The fair value of the contracts was $1.2 million and was reflected on the balance sheet as a liability. The weighted average price for the pulp futures contracts at December 31, 2005 was $631 per metric ton.

Based on 2005 shipment volume, a $10 per metric ton unfavorable change in the market price for northern bleached softwood kraft pulp (excluding the impact of volume and other discounts) would reduce pre-tax income by approximately $6 million.

Raw Materials. We purchase a substantial portion of the raw materials and energy necessary to produce our products on the open market, and, as a result, the price and other terms of those purchases are subject to change based on factors such as worldwide supply and demand and government regulation. We do not have significant influence over our raw material or energy prices and generally do not possess enough power to pass increases in those prices along to purchasers of our products, unless those increases coincide with increased demand for the product. Therefore, an increase in raw material or energy prices could occur at the same time that prices for our products are decreasing and have an adverse effect on our results of operations, financial position and cash flows.

We obtain most of the wood fiber required for our Terrace Bay pulp mill and a portion of the wood fiber required for the Pictou pulp mill from timberland areas licensed by the Ontario and Nova Scotia provincial governments, respectively. These governments have granted us non-exclusive licenses for substantial timberland areas from which we obtain fiber, and we also obtain fiber harvested from timberland areas licensed to others by these governments. There can be no assurance that the amount of fiber that we are allowed to harvest from these licensed areas will not be decreased, or that our licenses will continue to be renewed or extended by the governments on acceptable terms. In each of the areas where our Canadian pulp mills are located, there is increasing competition for wood fiber from various other users. Changes in governmental practices and policies as they apply to us and to others from whom we obtain fiber may result in less fiber being available, increased costs to obtain the fiber and additional expense in meeting forestry standards. These results could have a material adverse effect upon our financial position, liquidity and results of operations.

In 2005, two suppliers provided over 70% of the wood chips used by the Pictou mill and three suppliers provided approximately 50% of the wood chips used by the Terrace Bay mill. While we believe that alternative sources of critical supplies, such as wood chips, would be available, disruption of our primary sources could create a temporary, adverse effect on product shipments. Also, an interruption in supply of single source specialty grade latex to our technical products business could disrupt and eventually cause a shutdown of production of certain technical products.

We generate substantially all of our electrical energy at the Munising and Pictou mills and approximately one-half of the electrical energy at the Terrace Bay mill. Availability of energy is not expected to be a problem in the foreseeable future, but the purchase price of such energy can and likely will fluctuate significantly based on fluctuations in demand and other factors. In addition, we have forward purchase contracts for natural gas through June 2006. At December 31, 2005, we had future contracts for 373,000 MMBTUs of natural gas with a notional amount of approximately $3 million. The weighted average price for the natural gas futures contracts at December 31, 2005 was $9.01 per MMBTU. In January 2006, we entered into an agreement to purchase 350 million tons per year of "Green Steam" to supply energy at our Neenah paper mill. We anticipate that the agreement will substantially reduce the mill's annual consumption of natural gas. There is no assurance that we will be able to obtain electricity or natural gas purchases on favorable terms in the future.

Interest Rate Risk. We are exposed to interest rate risk on our fixed rate long-term debt and our variable rate bank debt.

Quantitative and Qualitative Disclosures About Market Risk

Our objective is to manage the impact of interest rate changes on earnings and cash flows from our variable rate debt and on the market value of our fixed rate debt. At December 31, 2005, we had $226.3 million of fixed rate long-term debt outstanding and no variable rate borrowings outstanding under our revolving credit agreement. We are exposed to fluctuations in the fair value of our fixed rate long-term debt resulting from changes in market interest rates, but not to fluctuations in our earnings or cash flows. At December 31, 2005, the fair market value of our long-term debt was $200.3 million based upon the quoted market price of the senior notes. A 100 basis point increase in interest rates would not affect our annual interest expense because at December 31, 2005, we had no variable rate borrowings outstanding.

We could, in the future, reduce our exposure to interest rate fluctuations by entering into interest rate hedging arrangements, although those arrangements could result in us incurring higher costs than we would incur without the arrangements.

Environmental Regulation. Our manufacturing operations are subject to extensive regulation by U.S. and Canadian authorities. The company has made significant capital expenditures to comply with environmental laws, rules and regulations. Due to changes in environmental laws and regulations, the application of such regulations and changes in environmental control technology, we are not able to predict with certainty the amount of future capital spending to be incurred for environmental purposes. Taking these uncertainties into account, we anticipate expenditures for major environmental projects during the period 2006 through 2010 will include approximately $20 million to reconfigure the effluent treatment system at the Pictou mill and between $15 million and $25 million for equipment and engineering to abate total sulphur emissions and for other environmental matters at the Pictou and Terrace Bay mills, to remove and replace transformers containing polychlorinated biphenyls at the Terrace Bay mill, and to improve stream crossings in the timberlands licensed from the Province of Ontario.

We believe that these risks can be managed and will not have a material adverse effect on our business or our consolidated financial position, results of operations or cash flows.

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting as defined in Rules 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. Based on our assessment, we believe that, as of December 31, 2005, the Company's internal control over financial reporting is effective based on those criteria.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005, has been audited by Deloitte & Touche, LLP, the independent registered public accounting firm who also audited the Company's consolidated financial statements. Deloitte & Touche's attestation report on management's assessment of the Company's internal control over financial reporting is included herein.

Neenah Paper, Inc.
March 13, 2006

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 sheets of Neenah Paper, Inc. and subsidiaries (the "Company") as of December 31, 2005 and 2004, and the related consolidated and combined statements of operations, cash flows and changes in stockholders' and invested equity, of the Company and the Pulp and Paper Business of Kimberly-Clark Corporation ("Pulp and Paper Business") for each of the three years in the period ended December 31, 2005. 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 generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing 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. 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 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 financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2005 and 2004, and the results of operations and cash flows of the Company and the Pulp and Paper Business for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Deloitte & Touche LLP

Atlanta, Georgia
March 13, 2006

Report of Independent Registered Public Accounting Firm

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF NEENAH PAPER, INC.:

We have audited management's assessment, included in the accompanying "Management's Report on Internal Control Over Financial Reporting," that Neenah Paper, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2005 of the Company and our report dated March 13, 2006 expressed an unqualified opinion on those financial statements.

Deloitte & Touche LLP

Atlanta, Georgia
March 13, 2006

Consolidated and Combined Statements of Operations

(in millions, except share and per share data) *Year Ended December 31,*	2005	2004	2003
Net Sales	$ 733.4	$ 772.1	$ 710.3
Cost of products sold	655.9	647.9	602.4
Gross Profit	77.5	124.2	107.9
Selling, general and administrative expenses	53.2	45.8	34.6
Restructuring costs and asset impairment loss (Note 12)	59.8	112.8	–
Other (income) and expense – net	(4.7)	5.5	10.0
Operating Income (Loss)	(30.8)	(39.9)	63.3
Interest expense	18.2	1.4	–
Income (Loss) Before Income Taxes	(49.0)	(41.3)	63.3
Provision (benefit) for income taxes	(19.3)	(14.9)	24.4
Net Income (Loss)	$ (29.7)	$ (26.4)	$ 38.9
Earnings (Loss) Per Common Share			
Basic	$ (2.02)	$ (1.79)	$ 2.64
Diluted	$ (2.02)	$ (1.79)	$ 2.64
Weighted-average Common Shares Outstanding *(in thousands)*			
Basic	14,739	14,738	14,738
Diluted	14,739	14,738	14,738

See Notes to Consolidated and Combined Financial Statements

Consolidated Balance Sheets

(in millions, except share data) *December 31,*	2005	2004
ASSETS		
Current Assets		
Cash and cash equivalents	$ 12.6	$ 19.1
Accounts receivable, net	79.1	92.4
Inventories	87.1	79.5
Deferred income taxes	1.7	1.2
Prepaid and other current assets	23.8	11.4
Total Current Assets	204.3	203.6
Property, Plant and Equipment – net	213.0	257.6
Timberlands	4.9	5.2
Deferred Income Taxes	27.6	–
Prepaid and Intangible Pension Costs	71.7	72.9
Other Assets	15.5	18.0
Total Assets	$ 537.0	$ 557.3
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Debt payable within one year	$ 1.2	$ –
Accounts payable	40.4	50.6
Accrued expenses	38.8	36.6
Total Current Liabilities	80.4	87.2
Long-Term Debt	226.3	225.0
Noncurrent Employee Benefits and Other Obligations	65.0	48.0
Total Liabilities	371.7	360.2
Commitments and Contingencies (Notes 9 and 10)		
Stockholders' Equity		
Common stock, par value $0.01 – authorized: 100,000,000 shares; issued and outstanding: 14,766,203 shares and 14,763,319 shares	0.1	0.1
Additional paid-in capital	219.4	218.3
Treasury stock, at cost (2005 – 814 shares)	–	–
Retained deficit	(106.3)	(70.7)
Accumulated other comprehensive income	53.9	51.6
Unearned compensation on restricted stock	(1.8)	(2.2)
Total Stockholders' Equity	165.3	197.1
Total Liabilities and Stockholders' Equity	$ 537.0	$ 557.3

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, 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	–	–	–	(12.7)	–	–	–	
Other non-cash transfers to Kimberly-Clark	–	–	–	(1.8)	–	–	–	
Spin-Off payment to Kimberly-Clark	–	–	–	(213.0)	–	–	–	
Transfer to additional paid-in capital	–	–	216.0	(216.0)	–	–	–	
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	218.3	–	(70.7)	51.6	(2.2)	
Net loss	–	–	–	–	(29.7)	–	–	$ (29.7)
Other comprehensive income								
Unrealized foreign currency translation	–	–	–	–	–	10.1	–	10.1
Minimum pension liability	–	–	–	–	–	(12.5)	–	(12.5)
Deferred gain on cash flow hedges	–	–	–	–	–	4.7	–	4.7
Dividends declared	–	–	–	–	(5.9)	–	–	$ (27.4)
Vesting restricted stock units	3	–	–	–	–	–	–	
Stock-based compensation awards, less amortization	–	–	0.4	–	–	–	0.4	
Other (Note 6)	–	–	0.7	–	–	–	–	
Balance, December 31, 2005	14,766	$ 0.1	$ 219.4	$ –	$ (106.3)	$ 53.9	$ (1.8)	

See Notes to Consolidated and Combined Financial Statements

Consolidated and Combined Statements of Cash Flows

(in millions, except share data) *Year Ended December 31,*	2005	2004	2003
OPERATING ACTIVITIES			
Net income (loss)	$ (29.7)	$ (26.4)	$ 38.9
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	29.8	36.0	35.3
Asset impairment loss	54.5	112.8	–
Deferred income tax benefit	(20.1)	(43.6)	(8.2)
Loss on asset dispositions	0.5	3.1	0.1
Net cash provided by (used in) changes in operating working capital			
Accounts receivable	13.3	(14.1)	(3.6)
Inventories	(7.6)	(9.4)	(5.8)
Prepaid and other current assets	(6.9)	2.4	0.5
Accounts payable	(10.1)	11.3	2.1
Accrued expenses	(0.2)	5.6	3.6
Foreign currency effects on working capital	1.4	5.7	13.5
Pension and other postretirement benefits	(2.7)	(7.4)	(1.3)
Other	0.6	–	(1.5)
Net Cash Provided by Operating Activities	22.8	76.0	73.6
INVESTING ACTIVITIES			
Capital expenditures	(25.7)	(19.1)	(24.4)
Proceeds from dispositions of property	–	0.1	1.9
Other	(0.1)	(0.1)	(1.1)
Net Cash (Used in) Investing Activities	(25.8)	(19.1)	(23.6)
FINANCING ACTIVITIES			
Proceeds from issuance of long-term debt	3.6	225.0	–
Debt issuance costs	(0.2)	(12.2)	–
Repayments of long-term debt	(1.1)	–	–
Short-term borrowings	2.5	10.0	–
Repayments of short term borrowings	(2.5)	(10.0)	–
Cash dividends paid	(5.9)	–	–
Spin-Off payment to Kimberly-Clark	–	(213.0)	–
Net transfers to Kimberly-Clark	–	(37.6)	(50.0)
Net Cash (Used in) Financing Activities	(3.6)	(37.8)	(50.0)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	0.1	–	–
Net Increase (Decrease) in Cash and Cash Equivalents	(6.5)	19.1	–
Cash and Cash Equivalents, Beginning of Year	19.1	–	–
Cash and Cash Equivalents, End of Year	$ 12.6	$ 19.1	$ –
Supplemental Disclosure of Cash Flow Information:			
Cash paid during year for interest	$ 15.8	$ –	$ –
Cash paid during year for income taxes	$ 6.6	$ –	$ –
Non-cash transfers (to) from Kimberly-Clark (Note 6)	$ 0.7	$ (14.5)	$ 1.4
Non-cash investing activities:			
Liability for equipment acquired	$ (1.7)	$ –	$ –

See Notes to Consolidated and Combined Financial Statements

(dollars in millions, except as noted)

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 products 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 products business is a leading producer of durable, saturated and coated base papers and films 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 are not indicative of 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 a discussion of 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 "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 ("EPS") were computed by dividing net income (loss) by the number of weighted-average shares of common stock outstanding during 2005 and 2004. Diluted earnings (loss) per share were calculated to give effect to all potentially dilutive common shares applying the "Treasury Stock" method. Outstanding stock options, restricted shares and restricted stock units represent the only potentially dilutive effects on the Company's weighted-average shares. Approximately 789,000 and 875,000 potentially dilutive options in 2005 and 2004, respectively, that were "out-of-the-money" were excluded from the computation of dilutive common shares. In addition, as a result of net losses in 2005 and 2004, 48,000 and 61,000 incremental shares resulting from the assumed exercises of "in-the-money" stock options and 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, basic and diluted EPS 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 and $0.7 million in 2004 and 2003, 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 made 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.

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. With the exception of pulp sales to Kimberly-Clark and certain other customers, the Company's sales terms are FOB shipping point. 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 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.

Financial Instruments

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.

The Company uses derivative instruments to manage exposures to foreign currency and commodity price risks. The Company principally uses foreign currency forward and pulp future contracts to hedge against these exposures. Derivative instruments are recorded on the balance sheet as assets or liabilities and measured at fair market value. Derivative instruments that have been designated as hedges of anticipated future cash flows are marked-to-market through accumulated other comprehensive income (balance sheet adjustments) until such time as the related forecasted transactions affect earnings. Derivatives that are not designated as hedges are adjusted to fair value through Other (income) and expense – net. Fair value estimates are based on relevant market information, including current market rates and prices. The fair value estimates for derivative instruments are provided to the Company by banks known to be high-volume participants in these markets. The Company documents relationships between hedging instruments and hedged items, and link derivatives designated as cash flow hedges to specific forecasted transactions. The Company also assesses and documents, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows associated with the hedged items. Any hedge ineffectiveness is charged to expense in the period incurred.

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 consolidated and combined statements of operations. Net foreign currency transaction losses for 2005, 2004 and 2003 were $0.6 million, $5.1 million and $10.0 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, generally 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 is 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 a discussion of asset impairment losses recorded in 2005 and 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 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 current market prices for the Company's publicly traded debt. The fair value of the Company's long-term debt at December 31, 2005 was $200.3 million compared to the carrying value of $226.3 million. 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 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 balance sheets consists of foreign currency translation, deferred gains and (losses) on cash flow hedges 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:

	2005			2004			2003		
Year Ended December 31,	Pre-tax Amount	Tax Effect	Net Amount	Pre-tax Amount	Tax Effect	Net Amount	Pre-tax Amount	Tax Effect	Net Amount
Unrealized foreign currency translation	$ 10.1	$ –	$ 10.1	$ 24.8	$ –	$ 24.8	$ 59.7	$ –	$ 59.7
Minimum pension liability	(20.5)	8.0	(12.5)	46.3	(16.3)	30.0	(14.5)	5.1	(9.4)
Deferred gain (loss) on cash flow hedges	7.4	(2.7)	4.7	(0.2)	0.1	(0.1)	(0.9)	0.3	(0.6)
Other comprehensive income (loss)	$ (3.0)	$ 5.3	$ 2.3	$ 70.9	$ (16.2)	$ 54.7	$ 44.3	$ 5.4	$ 49.7

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

December 31,	2005	2004
Unrealized foreign currency translation	$ 68.0	$ 57.9
Minimum pension liability (net of income tax benefits of $11.6 million and $3.6 million, respectively)	(18.8)	(6.3)
Deferred gain on cash flow hedges (net of income taxes of $2.7 million)	4.7	–
Accumulated other comprehensive income (loss)	$ 53.9	$ 51.6

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 related to stock option grants has been charged to earnings because the exercise prices of all stock options granted have been equal to the market value of the Company's 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,	2005	2004	2003 [a]
Reported net income (loss)	$ (29.7)	$ (26.4)	$ 38.9
Pro forma compensation expense, net of tax	(2.0)	(1.2)	–
Pro forma net income (loss)	$ (31.7)	$ (27.6)	$ 38.9
Reported net income (loss) per share:			
Basic	$ (2.02)	$ (1.79)	$ 2.64
Diluted [b]	$ (2.02)	$ (1.79)	$ 2.64
Pro forma net income (loss) per share:			
Basic	$ (2.15)	$ (1.87)	$ 2.64
Diluted [b]	$ (2.15)	$ (1.87)	$ 2.64

(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 net losses in 2005 and 2004, 48,000 and 61,000 incremental shares, respectively, resulting from the assumed exercises of 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.

The weighted-average fair value at date of grant for options granted during 2005 was $12.46 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 2005 and 2004 option grants at a weighted-average exercise price of $32.52 per share and $31.81 per share, respectively):

	2005	2004
Expected life in years	5.9	4.7
Interest rate	3.9 %	3.6 %
Volatility	39.0 %	36.3 %
Dividend yield	1.2 %	1.2 %

In December 2004, the Federal Accounting Standards Board ("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 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.

On April 14, 2005, the SEC announced the adoption of a new rule that amended the compliance dates for SFAS 123R. The new rule requires the Company to adopt SFAS 123R by January 1, 2006. The Company will adopt SFAS 123R using a modified prospective transition 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.

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 (loss) and earnings (loss) per share disclosures shown. At December 31, 2005, unearned compensation for the fair value of outstanding employee stock options was approximately $4.8 million and will be recognized as compensation expense in future periods as stock options vest.

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 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 153 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 did not have a material effect on the Company's financial position, results of operations or cash flows.

In March 2005, FASB Interpretation No. 47 ("FIN 47"), *Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143*, was issued. FIN 47 clarifies that the term "conditional asset retirement obligation" as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). The adoption of FIN 47 did not have a material effect on the Company's results of operations or financial position.

3.

RISK MANAGEMENT

The Company is exposed to risks such as changes in foreign currency exchange rates and pulp prices. A variety of practices is 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 and commodity 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 (in Prepaid and other current assets and Other assets) or liabilities (in Accrued expenses or Noncurrent employee benefits and other obligations) 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 related unrealized gain or loss from changes in the fair value of highly effective derivatives designated as cash flow hedges is recorded in Accumulated other comprehensive income (loss) in the period that changes in fair value occur and is reclassified to income in the same period that the hedged item affects income.

Pulp Price and Foreign Currency Risk

The operating results, cash flows and financial condition of the Company are subject to pulp price risk. Because the price of pulp is established in U.S. dollars and the Company's cost of producing pulp is incurred principally in Canadian dollars, the profitability of the Company's pulp operations is subject to foreign currency risk. The Company uses foreign currency forward and pulp futures contracts to manage its foreign currency and pulp price risk. The use of these instruments allows management of this transactional exposure to exchange rate and pulp price fluctuations because the gains or losses incurred on the derivative instruments are intended to offset, in whole or in part, losses or gains on the underlying transactional exposure (See "Cash Flow Hedges" below). The Company's translation exposure related to its net investment in its Canadian subsidiaries is not hedged.

The Company is also subject to price risk for electricity used in its manufacturing operations. At the Spin-Off, Kimberly-Clark transferred to the Company a fixed-price forward purchase contract to hedge fluctuations in the price of electricity at the Terrace Bay mill through December 31, 2005. The contract has matured and has not been replaced.

Cash Flow Hedges

During 2005, the Company entered into a series of foreign currency forward exchange contracts, designated as cash flow hedges, of U.S. dollar denominated pulp sales. At December 31, 2005, the Company had foreign currency contracts outstanding in a notional amount of $213 million Canadian dollars. The fair value of the contracts was $9.3 million U.S. dollars and was reflected on the balance sheet as an asset ($7.2 million of which was current). The weighted-average exchange rate for the foreign currency contracts at December 31, 2005 was $0.820 U.S. dollars per Canadian dollar. The contracts extend through May 2007 with the highest value of contracts maturing in January 2006. The Company recorded net pre-tax gains of $4.3 million on foreign currency contracts as the forecasted transactions occurred in 2005. All realized gains and losses on currency derivatives are recorded in Other (income) expense – net on the consolidated and combined statements of operations.

During 2005, the Company also entered into a series of pulp futures contracts to hedge fluctuations in pulp prices through December 2006. At December 31, 2005, the Company had future contracts for 144,000 metric tons of pulp with a notional amount of approximately $91 million. The fair value of the contracts was $1.2 million and was reflected on the balance sheet as a liability. The weighted-average price for the pulp futures contracts at December 31, 2005 was $631 per metric ton. The contracts expire at the rate of 12,000 metric tons per month in 2006. The Company recorded net pre-tax gains of $0.6 million on pulp futures contracts as the forecasted transactions occurred in 2005. Substantially all realized gains and losses on pulp derivatives are recorded in Net sales on the consolidated statements of operations.

In addition, the Company had a fixed-price forward purchase contract to hedge fluctuations in the price of electricity at the Terrace Bay mill. The contract matured on December 31, 2005. The Company recorded net pre-tax gains of $0.9 million on the forward purchase contract as the forecasted transactions occurred in 2005. In addition, during 2005, the Company recorded a pre-tax gain of approximately $0.5 million related to discontinued cash flow hedges where occurrence of the forecasted transaction was not probable. Realized gains and losses on the electricity derivative and gains and losses on discontinued cash flow hedges are recorded in Cost of product sold on the consolidated statements of operations.

During 2005 the Company's cash flow hedges were effective, and changes in the fair value of the derivative instruments were reflected in other comprehensive income. During the same period in which the hedged forecasted transactions affected earnings, the Company reclassified approximately $(36,000), $(0.6) million and $0.5 million of after-tax gains (losses) from accumulated other comprehensive income to earnings in 2005, 2004 and 2003, respectively. If future market rates are consistent with the rates assumed at December 31, 2005, approximately $6.1 million (or $3.9 million after-tax) of the $8.2 million (or $5.2 million after-tax) unrealized gain included in accumulated other comprehensive income is expected to be recognized in earnings during the next 12 months.

The notional amounts of the Company's hedging instruments do not represent amounts exchanged by the parties and, as such, are not a measure of exposure to credit loss. The amounts exchanged are determined by reference to the notional amounts and the other terms of the contracts.

4.

INCOME TAXES

Income tax expense in the Company's consolidated and combined financial statements has been calculated on a separate tax return basis. Income tax benefits represented 39.4% and 36.1% of pre-tax losses in 2005 and 2004, respectively. In 2003, the income tax provision represented 38.5% of pre-tax income. 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,	2005	2004	2003
U.S. federal statutory income tax rate	(35.0)%	(35.0)%	35.0%
State and local income taxes, net of federal income tax effect	(3.9)	(2.4)	4.2
Other differences – net	(0.5)	1.3	(0.7)
Effective income tax rate	(39.4)%	(36.1)%	38.5%

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,	2005	2004	2003
Income (loss) before income taxes:			
U.S.	$ 44.2	$ 79.2	$ 81.5
Canada	(93.2)	(120.5)	(18.2)
Total	$ (49.0)	$ (41.3)	$ 63.3
Provisions (benefits) for income taxes:			
Current:			
Federal	$ 1.2	$ 26.6	$ 28.5
State and local	(0.4)	2.1	4.5
Canadian	–	–	(0.4)
Subtotal	0.8	28.7	32.6
Deferred:			
Federal	(17.5)	(37.9)	(2.1)
State and local	(2.6)	(3.3)	(0.5)
Canadian	–	(2.4)	(5.6)
Subtotal	(20.1)	(43.6)	(8.2)
Total	$ (19.3)	$ (14.9)	$ 24.4

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 are as follows:

December 31,	2005	2004
Net current deferred income tax assets:		
Accrued liabilities	$ 2.4	$ 2.4
Employee benefits	0.5	–
Other	(1.2)	(1.2)
Net current deferred income tax assets	$ 1.7	$ 1.2
Net noncurrent deferred income tax assets:		
Canadian timberlands	$ 67.7	$ 72.3
Employee benefits	17.3	11.7
Accumulated depreciation	(57.4)	(81.3)
Other	–	(2.7)
Net noncurrent deferred income tax assets	$ 27.6	$ –

No valuation allowance has been provided on deferred income tax assets. In determining the need for valuation allowances, the Company considers many factors, including specific taxing jurisdictions, sources of taxable income, 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 of December 31, 2005, the Company had $24.8 million of Canadian net operating losses, substantially all of which may be carried forward to 2015 to offset future taxable income. Due to the U.S. Dual Consolidated Loss Recapture rules and provisions under SFAS 109, the Company has recorded a corresponding deferred tax liability to offset the deferred tax asset related to the Canadian net operating losses. The Company has no foreign tax credits.

As part of the Spin-Off transaction, the Company made 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 credit to deferred income tax assets of approximately $12.7 million and an offsetting charge to "Kimberly-Clark's net investment" on the statement of changes in stockholders' and invested equity.

Prior to the Spin-Off, 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 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.

For periods subsequent to the Spin-Off, the Company has elected to treat its Canadian operations as a branch for U.S. income tax purposes. Therefore, the amount of income (loss) before income taxes from Canadian operations, generated after the November 30, 2004 Spin-Off date, are included in the Company's consolidated U.S. income tax returns and such amounts are subject to U.S. income taxes. The previously reported deferred income tax liability of $8.4 million at December 31, 2004 has been reclassified to net noncurrent deferred income tax assets to conform to the current year presentation of deferred tax assets and liabilities by tax jurisdiction. In addition, certain amounts of the previously reported components of the current and deferred provision (benefit) for income taxes for the year ended December 31, 2004 have been reclassified to conform to the current year presentation by tax jurisdiction.

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.

Senior Unsecured Notes

On November 30, 2004, the Company completed an underwritten offering of 10-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. Interest payments commenced on May 15, 2005, and the Senior Notes mature on November 15, 2014. The Senior Notes are fully and unconditionally guaranteed by substantially all of the Company's subsidiaries. A registration rights agreement relating to the Senior Notes required the Company to exchange the Senior Notes for registered notes within 270 days from the original issuance of the notes. In August 2005, the Company completed an offer to exchange the unregistered Senior Notes for registered notes with similar terms.

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 (the "Credit Agreement"). Under the Credit Agreement, the Company has a secured revolving credit facility (the "Revolver") that provides for borrowings of up to $150 million. No amounts were outstanding under the Revolver as of December 31, 2005. Borrowing availability under the Revolver is reduced by outstanding letters of credit ("LOCs"). At December 31, 2005, the Company had approximately $5.2 million of LOCs outstanding and $144.8 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 Credit Agreement is secured by substantially all of the Company's assets, including the capital stock of its subsidiaries and is guaranteed by Neenah Paper Company of Canada, a wholly owned subsidiary. The Credit Agreement will terminate on November 30, 2008. Availability under the Credit Agreement will fluctuate over time depending on the value of the Company's 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 indenture governing the Senior Notes and the Credit Agreement 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. In addition, the terms of the Credit Agreement require the Company to achieve and maintain certain specified financial ratios. At December 31, 2005, the Company was in compliance with all 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. At December 31, 2005 under the most restrictive terms of these agreements, the Company's ability to pay cash dividends on its common stock is limited to a total of $10.0 million in a 12-month period.

Other Notes

During the first quarter of 2005, the Company obtained third-party financing to fund its purchase of enterprise resource planning ("ERP") software. At inception, the present value of the financing agreement was $3.6 million (discounted at 7.375%) payable in quarterly installments through January 2008. At December 31, 2005, $2.5 million of such third-party financing was outstanding. In the first quarter of 2005, the Company issued a short-term note for $2.3 million to finance current year insurance premiums. The note was repaid in monthly installments through October 2005 including interest at the rate of 3.9% per annum. At December 31, 2005, the Company had required debt payments under these financing arrangements of $1.2 million and $1.3 million in 2006 and 2007, respectively. The Company has no other required debt payments during the next five years.

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. During 2005, hourly employees at the Pictou pulp mill, represented by Local 440 of the Communications, Energy and Paperworkers Union of Canada and the Company executed a new collective bargaining agreement providing for enhanced pension benefits. The amendment to the plan resulted in an increase of $6.9 million in the Company's projected benefit obligation and did not require a remeasurement of the plan.

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. In the fourth quarter of 2005, the transfer of assets by Kimberly-Clark to the new pension trust for obligations assumed by the Company in the Spin-Off was finalized and resulted in a credit of $0.7 million to Additional paid-in capital.

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. The Company's pension and other postretirement obligations are measured as of December 31. As of December 31, 2005, the Company's plans had cumulative unrecognized investment losses and other actuarial losses of approximately $147.8 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 balance sheets. The minimum pension liability is included in Noncurrent employee benefits and other obligations on the consolidated 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 2005, the additional minimum pension liability increased as the effect of a decrease in the discount rate used to estimate the ABO more than offset the increase in the fair value of pension plan assets.

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

December 31,	2005	2004
Minimum pension liability	$ 42.4	$ 12.0
Less intangible asset	12.0	2.1
Accumulated other comprehensive income	$ 30.4	$ 9.9

Other Postretirement Benefit Plans

Prior to the Spin-Off, the employees of the Pulp and Paper Business participated in Kimberly-Clark's health care and life insurance benefit plans (the "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 on or before December 31, 1992 and contributory for most employees who retire on or 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 and established new health care 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 health care 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 and resulted in a $0.5 million and $0.3 million reduction in postretirement benefit costs for 2005 and 2004, respectively. During 2005, the Company paid less than $0.1 million for prescription drug benefits for retirees who were eligible for Medicare Part D and has not been reimbursed for any such payments.

Prior to 2004, the U.S. benefit plans limited 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 health care benefits to a defined fixed per capita cost for certain employees retiring after April 1, 2004. At December 31, 2005, the assumed inflationary pre-65 and post-65 health care cost trend rates used to determine year-end obligations was 9.8%, decreasing to 8.8% in 2007, and then gradually decreasing to an ultimate rate of 4.8% in 2013. The assumed inflationary pre-65 health care cost trend rate used to determine obligations at December 31, 2004 and cost for the year ended December 31, 2005 was 8.7% in 2005, decreasing to 7.8% in 2006, and gradually decreasing to an ultimate rate of 5.0% in 2011. The assumed inflationary post-65 health care cost trend rate used to determine obligations at December 31, 2004 and cost for the year ended December 31, 2005 was 8.8% in 2005 decreasing to 7.9% in 2006, and gradually decreasing to an ultimate rate of 5.0% in 2011.

In May 2005, the Company closed the No. 1 Mill at the Terrace Bay facility (See Note 12). In conjunction with the closure, the Company recognized a pre-tax charge of approximately $1.6 million related to a partial settlement of certain pension obligations.

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

Year Ended December 31,	Pension Benefits 2005	Pension Benefits 2004	Postretirement Benefits Other than Pensions 2005	Postretirement Benefits Other than Pensions 2004
Change in Benefit Obligation:				
Benefit obligation at beginning of year	$386.1	$328.7	$ 55.0	$ 50.5
Service cost	10.7	9.1	1.5	1.2
Interest cost	21.9	24.2	3.1	3.4
Currency	11.7	23.2	1.9	3.2
Actuarial loss (gain)	34.1	19.5	14.7	(1.8)
Benefit payments from plans	(23.9)	(10.9)	(1.3)	(1.1)
Adjustment related to Spin-Off	–	(8.1)	–	(0.4)
Participant contributions	0.6	0.5	–	–
Special termination benefits	1.6	–	–	–
Plan amendments	6.9	–	1.2	–
Other	0.2	(0.1)	–	–
Benefit obligation at end of year	$449.9	$386.1	$ 76.1	$ 55.0
Change in Plan Assets:				
Fair value of plan assets at beginning of year	$328.5	$275.3	$ –	$ –
Actual gain on plan assets	38.9	35.1	–	–
Employer contributions	18.7	16.6	1.3	1.1
Special termination benefit contributions	1.6	–	–	–
Currency	9.8	19.6	–	–
Benefit payments	(23.9)	(10.9)	(1.3)	(1.1)
Participant contributions	0.6	0.5	–	–
Adjustment related to Spin-Off	0.7	(7.7)	–	–
Other	0.2	–	–	–
Fair value of plan assets at end of year	$375.1	$328.5	$ –	$ –
Funded Status:				
Benefit obligation in excess of plan assets	$ (74.8)	$ (57.6)	$ (76.1)	$ (55.0)
Unrecognized net actuarial loss	147.8	128.3	31.3	14.2
Unrecognized transition amount	(0.6)	(0.7)	–	–
Unrecognized prior service cost	12.4	6.4	(0.8)	0.3
Net amount recognized	$ 84.8	$ 76.4	$ (45.6)	$ (40.5)
Amounts Recognized in the Balance Sheets:				
Prepaid benefit cost	$ 84.8	$ 76.4	$ –	$ –
Intangible asset	12.0	2.1	–	–
Accrued benefit cost	(42.4)	(12.0)	(45.6)	(40.5)
Accumulated other comprehensive income	30.4	9.9	–	–
Net amount recognized	$ 84.8	$ 76.4	$ (45.6)	$ (40.5)

Summary disaggregated information about the pension plans follows:

	Assets Exceed ABO		ABO Exceeds Assets		Total	
December 31,	2005	2004	2005	2004	2005	2004
Projected benefit obligations	$279.5	$333.2	$170.4	$ 52.9	$449.9	$386.1
ABO	227.5	275.8	153.0	46.2	380.5	322.0
Fair value of plan assets	239.4	288.7	135.7	39.8	375.1	328.5

Components of Net Periodic Benefit Cost

	Pension Benefits			Postretirement Benefits Other than Pensions		
Year Ended December 31,	2005	2004	2003	2005	2004	2003
Service cost	$ 10.7	$ 9.1	$ 7.1	$ 1.5	$ 1.2	$ 1.0
Interest cost	21.9	24.2	21.9	3.1	3.4	3.6
Expected return on plan assets [(a)]	(27.7)	(27.7)	(22.4)	–	–	–
Recognized net actuarial loss	7.1	4.7	6.1	0.7	(4.6)	0.2
Amortization of unrecognized transition asset	(0.2)	(0.2)	(0.2)	–	–	–
Amortization of prior service cost	1.4	1.0	0.9	0.1	–	–
Adjustment related to Spin-Off	–	(0.4)	–	–	(0.4)	–
Net periodic benefit cost (credit)	$ 13.2	$ 10.7	$ 13.4	$ 5.4	$ (0.4)	$ 4.8

(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

	Pension Benefits		Postretirement Benefits Other than Pensions	
	2005	2004	2005	2004
Discount rate	5.20%	5.75%	5.22%	5.75%
Rate of compensation increase	3.24%	3.75%	–	–

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

	Pension Benefits			Postretirement Benefits Other than Pensions		
	2005	2004	2003	2005	2004	2003
Discount rate	5.75%	6.21%	6.95%	5.75%	6.17%	6.91%
Expected long-term return on plan assets	8.41%	8.50%	8.50%	–	–	–
Rate of compensation increase	3.75%	3.75%	3.90%	–	–	–

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 60% with equity managers, with expected long-term rates of return of approximately 10%, and 40% 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 2005, 2004 and 2003. 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,	2005	2004	2003
Asset Category			
Equity securities	68 %	66 %	70 %
Debt securities	24 %	24 %	28 %
Real estate	– %	3 %	2 %
Cash and money market funds	8 %	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

Based on December 31, 2005 exchange rates, the Company expects to contribute approximately $12.2 million to its pension trusts in 2006.

Future Benefit Payments

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

	Pension Plans	Other Postretirement Benefits
2006	$ 18.4	$ 1.8
2007	19.8	2.0
2008	21.2	2.3
2009	22.8	2.6
2010	24.6	3.0
Years 2011–2015	158.1	20.6

Health Care Cost Trends

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

	One Percentage Point	
	Increase	Decrease
Effect on total of service and interest cost components	$ 0.7	$ 0.5
Effect on postretirement benefit obligation	9.9	7.9

Defined Contribution Retirement Plans

Kimberly-Clark's contributions to its defined contribution retirement plans were primarily based on the age and compensation of covered employees. 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. Contributions to these plans, all of which were charged to expense, were $1.0 million in 2005 and $0.5 million in each of 2004 and 2003.

Investment Plans

The Company provides voluntary contribution investment plans to substantially all employees. Under the plans, Kimberly-Clark matched a portion of employee contributions. 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 investment plans that provide substantially similar benefits. Costs charged to expense for company matching contributions under these plans were $1.2 million in each of 2005, 2004 and 2003.

7. 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 various types of equity based compensation awards, 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, 2005, a total of 2,154,995 shares of the Company's common stock were reserved for future issuance under the Omnibus Plan.

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

Stock Options

In February 2005, the Company informed participants in its Long-Term Incentive Plan (the "LTIP") of its intention to award nonqualified stock options to purchase a total of 126,100 shares of common stock (subject to forfeitures due to termination of employment and other conditions) during 2005. In February 2005, the Company granted to LTIP participants options to purchase 63,050 shares of common stock at $33.19 per share. In August 2005, the Company granted options to purchase 62,650 shares of common stock at $31.70 per share. The exercise price of the options was equal to the market price of the Company's common stock on the date of grant. The options expire in 10 years and one-third vest on each of the first three anniversaries of the date of grant. In June 2005, the Company awarded options to purchase 11,250 shares of common stock at $33.32 per share to members of its Board of Directors. The options vest one year from the date of grant and expire 10 years from the date of grant.

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.

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 LTIP participants and directors of the Company. The exercise price of the Fresh Start Options was equal to the market value of the Company's common stock on the date of grant. The Fresh Start Options expire 10 years from the date of grant and vest 30%, 30% and 40% on the first, second and third anniversaries of the date of grant, respectively.

Stock options awarded by Kimberly-Clark 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 compensation expense for stock options awarded to employees was recognized 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.

Data concerning stock option activity follows [(a)]:

	2005		2004	
	Number of Options	Weighted-Average Exercise Price	Number of Options	Weighted-Average Exercise Price
Outstanding – Beginning of year	1,166,989	$ 32.84	–	$ –
Options granted	136,950	$ 32.52	442,540	32.60
Conversion of Kimberly-Clark options	–	–	724,449	31.32
Options expired or cancelled	(19,511)	$ 30.61	–	–
Outstanding – End of year	1,284,428	$ 31.90	1,166,989	$ 31.81
Exercisable – End of year	740,284	$ 32.39	532,554	$ 32.84

(a) *Information with respect to the stock option awards to acquire the Company's Common Stock are 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, 2005 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	202,998	$ 24.24	6.7	114,496	$ 24.41
$26.95 – $31.70	144,985	$ 30.15	5.8	82,335	$ 28.97
$32.60 – $37.59	936,445	$ 33.83	7.5	543,453	$ 34.60
	1,284,428	$ 31.90	7.2	740,284	$ 32.39

Other Stock-Based Compensation

In February 2005, the Company granted 38,300 performance shares (subject to forfeitures due to termination of employment and other conditions) to LTIP participants. Based on Company performance compared to revenue growth and return on invested capital targets, Restricted Stock Units ("RSUs") equal to between 30% and 225% of the performance share award would be issued. The measurement period for the performance shares was January 1, 2005 through December 31, 2005. On December 31, 2005, 11,430 RSUs (equal to 30% of the performance shares granted) were awarded. In general, the RSUs become 100% vested three years from the start of the performance period (December 31, 2007) and are subject to an additional two-year holding period before the award recipient can sell or transfer such shares. During the vesting period, but not the performance period, holders of the RSUs are entitled to dividends, but are not permitted to vote such shares, and the RSUs are forfeited in the event of termination of employment (as defined). Compensation expense is recognized pro rata over the three-year vesting period. Upon adoption of SFAS 123R, the Company will be required to recognize compensation expense related to stock-based compensation awards over the shorter of (i) the contractual vesting period of the award or (ii) the period between the grant date for the award and the recipient reaching 55 years of age with five years of vesting service (retirement eligibility). In June 2005, the Company awarded 3,510 RSUs to members of its Board of Directors that vest on the first anniversary of the date of grant.

In December 2004, Neenah awarded 40,800 and 3,450 RSUs to LTIP participants and non-employee members of the 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 LTIP participants 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.

At the time of the Spin-Off, the vesting schedule of Kimberly-Clark 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. In December 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. At December 31, 2005, 22,871 of such restricted shares were outstanding, with 3,681 shares, 2,025 shares, 16,591 shares and 574 shares vesting in 2006, 2007, 2008 and 2009, respectively.

The Company records unearned compensation for the fair value of compensatory stock awards based on the price of the Company's stock on the measurement date (date of grant for RSUs and completion of the measurement period for performance shares). Performance shares, prior to completion of the measurement period, are accounted for as a variable award pursuant to APB 25. As such, the Company recognized unearned compensation for the expected number of shares to be awarded (but not less than 30%). In general, the Company amortizes unearned compensation to expense over the service period (generally the vesting period) for the award.

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. Holders of Kimberly-Clark restricted stock were entitled to dividends and were permitted to vote such awarded shares, but the sale or transfer of such shares was 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 grant as unearned compensation.

Stock-based compensation expense in the Consolidated and Combined Statements of Operations (consisting primarily of amortization of unearned compensation relating to restricted stock and RSUs) was $0.8 million, $0.6 million and $0.9 million in 2005, 2004 and 2003, respectively.

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.

During 2005, the Company acquired 814 shares of Common Stock at a cost of approximately $25,000 for shares sold by employees to pay taxes due on vested restricted stock awards.

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.

9.
COMMITMENTS

Leases
The future minimum obligations under operating leases having a noncancelable term in excess of one year as of December 31, 2005, are as follows:

Year Ending December 31:	
2006	$ 2.6
2007	1.6
2008	1.4
2009	1.3
2010	1.2
Thereafter	7.3
Future minimum obligations	$ 15.4

Rental expense under operating leases was $4.6 million, $3.9 million and $2.7 million in 2005, 2004 and 2003, respectively.

Purchase Commitments
The Company has entered into long-term contracts for the purchase of sawmill wood chips. The minimum purchase commitments extend beyond 2009. Commitments under these contracts are approximately $26.9 million in 2006, $26.7 million in 2007, $26.8 million in 2008, $26.7 million in 2009 and $9.6 million in 2010. Total commitments beyond 2010 are $28.9 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.

10.
CONTINGENCIES AND LEGAL MATTERS

Litigation
During the third quarter of 2005, the Company settled a previously disclosed lawsuit relating to a vehicle accident pending in the Ontario (Canada) Superior Court of Justice. The settlement did not have a material effect on the Company's results of operations or liquidity.

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, 2005, 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 the Company's 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's planned capital expenditures for major environmental projects during the period 2006 through 2010 include approximately $20 million to reconfigure the effluent treatment system at the Pictou mill and between $15 million and $25 million for equipment and engineering to abate total sulphur emissions and for other environmental matters at the Pictou and Terrace Bay mills, to remove and replace transformers containing polychlorinated biphenyls at the Terrace Bay mill, to improve stream crossings in the timberlands licensed from the Province of Ontario. The timing and amount of such expenditures will depend on the outcome of negotiations with regulatory authorities, the results of engineering studies and the remediation methods ultimately selected. These capital expenditures are not expected to have a material adverse effect on our financial condition, results of operations or liquidity.

Employees and Labor Relations

As of December 31, 2005, the Company had approximately 1,900 regular full time employees of whom 620 hourly and 280 salaried employees were located in the United States and 780 hourly and 220 salaried employees were located in Canada.

On June 1, 2005, hourly employees at the Pictou pulp mill, represented by Local 440 of the Communications, Energy and Paperworkers Union of Canada and the Company executed a new collective bargaining agreement expiring on May 31, 2009. Hourly employees at the Terrace Bay pulp mill are represented by locals of the United Steelworkers (the "USW") and the International Brotherhood of Electrical Workers with each collective bargaining agreement expiring on May 1, 2007.

The collective bargaining agreement covering 230 hourly employees at the Longlac, Ontario operations represented by Local 1-2693 of the USW expired on September 1, 2005. On January 30, 2006, the hourly employees working in the Longlac woodlands operations commenced a strike. In February 2006, the Company suspended pulp manufacturing activities at the Terrace Bay pulp mill as a result of a lack of wood fiber for its operations. Most of the approximately 400 hourly and salaried workers employed at the mill were laid off for an indefinite period during the two weeks following the commencement of closure activities. Pursuant to the terms of the Company's labor agreements and Canadian laws, if the work stoppage continues through May 2006, the Company will be required to make payments to laid-off workers of approximately $8 million in the second quarter of 2006. Additional payments of from one to three times that amount could be required dependent upon, among other things, the duration of the work stoppage. An extended work stoppage at the Terrace Bay mill could have a material impact on the liquidity and results of operations of the Company.

Hourly employees at the Munising, Neenah and Whiting paper mills are represented by locals of the USW. On December 23, 2005, hourly employees at the Munising paper mill, represented by Locals 7-0087 and 7-0096 of the USW voted to accept a new collective bargaining agreement expiring on July 15, 2009. On January 8, 2006, hourly employees at the Whiting paper mill, represented by Local 7-370 of the USW voted to accept a new collective bargaining agreement expiring on February 1, 2009. On February 21, 2006, hourly employees at the Neenah paper mill, represented by Local 7-1170 of the USW voted to accept a new collective bargaining agreement expiring on July 1, 2009. Additionally, these mills have bargained jointly with the union on pension matters. The agreements on pension matters for these mills expire June 30, 2007.

11.

TRANSACTIONS WITH KIMBERLY-CLARK

During all periods presented, the Company sold or 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 sold or transferred to Kimberly-Clark were $309 million, $351 million and $305 million for the years ended December 31, 2005, 2004 and 2003, respectively. For periods prior to the Spin-Off, settlement of 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 (the "Pulp Supply Agreement") as described below.

In connection with the Spin-Off, the Company and Kimberly-Clark executed and delivered a 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 the Pulp Supply Agreement pursuant to which the Company agreed to supply and Kimberly-Clark agreed to purchase annually specified minimum tonnages of northern bleached softwood and hardwood kraft pulp. For 2006, the minimum commitment for northern bleached softwood kraft pulp is 440,000 air-dried metric tons ("ADMT"), for 2007 the minimum commitment is 395,000 ADMT and for 2008 and any subsequent years the minimum commitment is 345,000 ADMT. The amounts of those minimum commitments represent approximately 80%, 70%, and 60%, respectively, of the Company's total production of northern bleached softwood kraft pulp in 2005.

The Company's minimum commitment to supply northern bleached hardwood kraft pulp for 2005, 2006, 2007 and 2008 was 80,000, 60,000, 40,000 and 20,000 ADMT, respectively. In May 2005, the Company closed the smaller of the two single-line pulp mills at the Terrace Bay facility (the "No. 1 Mill") and terminated, without penalty, its commitment to supply northern bleached hardwood kraft pulp produced at that facility. Under the terms of the Pulp Supply Agreement, the Company was obligated to provide 40,000, 30,000, 20,000 and 10,000 metric tons of northern bleached hardwood kraft pulp produced at the Terrace Bay mill annually in 2005, 2006, 2007 and 2008, respectively. The Company's commitment to supply and Kimberly-Clark's requirement to purchase, pursuant to the terms of the Pulp Supply Agreement, northern bleached hardwood kraft pulp from the Pictou mill (in annual quantities which are identical to those shown above) are unchanged. The amounts of those minimum commitments represent approximately 100%, 75%, 50% and 25%, respectively; of the Pictou mill's production of northern bleached hardwood kraft pulp in 2005. During 2005, the Company fulfilled its supply commitments pursuant to the Pulp Supply Agreement.

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.

On January 17, 2006, the Company and Kimberly-Clark entered into an amendment (the "PSA Amendment") to the Pulp Supply Agreement. The PSA Amendment provides the Company with the option to reduce its annual softwood and hardwood supply obligation to Kimberly-Clark to 235,000 ADMT in 2006, 235,000 ADMT in 2007 and 215,000 ADMT in 2008. The Company can only exercise such option by giving Kimberly-Clark advance written notice of its election to do so prior to June 30, 2007. The Company's right to give such notice is also subject to certain limitations that affect the timing and the effective date of the notice.

Additionally, the PSA Amendment provides Kimberly-Clark with the option to reduce its annual purchase obligation for North American northern bleached softwood kraft pulp during 2006 by up to 50,000 ADMT. The PSA Amendment also permits Kimberly-Clark to reduce its purchase obligation from the Company's Terrace Bay, Ontario pulp operations ("Terrace Bay"), on one occasion only, by up to an additional 80,000 ADMT in the event that Terrace Bay resumes operations following a Terrace Bay Force Majeure Event (as defined in the PSA Amendment). During the continuance of a Terrace Bay Force Majeure Event, or a different Force Majeure Event (as defined in the Pulp Supply Agreement), the Company is generally excused, without penalty, from its obligations to supply and Kimberly-Clark is excused, also without penalty, from its commitments to purchase pulp under the Pulp Supply Agreement during the continuance, and to the extent of, such event. A strike, labor disturbance and other events beyond the Company's control are considered Force Majeure Events under the Pulp Supply Agreement if such events ultimately prevent the Company from supplying contractually agreed upon quantities of pulp to Kimberly-Clark.

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 ADMT, respectively. If the Company were to choose to reduce its annual supply obligation to Kimberly-Clark, the phase-down commitments in the first and second years would be 165,000 and 101,000 ADMT, 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 United States customs requirements jeopardizes Kimberly-Clark customs certification.

The preceding description is a summary of principal provisions of the Pulp Supply Agreement and the PSA Amendment and is qualified in its entirety by the Pulp Supply Agreement and PSA Amendment.

Corporate Services Agreement

The Company and Kimberly-Clark entered into a Corporate Services Agreement whereby Kimberly-Clark provided 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 was 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 were generally based upon the costs of providing the services. In January 2006, the Company terminated substantially all services provided by Kimberly-Clark pursuant to the corporate services agreement.

Employee Matters Agreement

The Company and Kimberly-Clark 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 employed or offered 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 terms and conditions of their employment with Kimberly-Clark. The Company maintained, subject to applicable laws, 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 or 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 could, 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.

12. RESTRUCTURING COSTS AND ASSET IMPAIRMENT LOSS

Restructuring Activities at Terrace Bay:

The Company closed the No. 1 Mill on May 1, 2005. The No. 1 Mill was originally constructed in 1948 and had annual capacity of approximately 125,000 metric tons of bleached kraft pulp. In conjunction with the closure, the Company offered early retirement and severance packages to approximately 150 employees.

During 2005, the Company recorded approximately $5.0 million for one-time termination benefits related to early retirement, severance and defined benefit pension plans in connection with the closure of the No.1 Mill and approximately $0.3 million for other exit costs. As of December 31, 2005, termination benefits of approximately $4.5 million had been paid to 139 employees and approximately $0.5 million was accrued but unpaid. The Company expects the payment of termination benefits to be substantially complete by March 31, 2006.

During the first quarter of 2005, the Company recorded a pre-tax, non-cash asset impairment loss of approximately $0.8 million related to the remaining value of the long-lived assets of the No. 1 Mill. In addition, the Company recorded $0.4 million of incremental training costs for employees in new positions as a result of the closure in 2005. Such training costs were expensed as incurred. Costs associated with the closure, excluding expenses related to employee training, are recorded in Restructuring costs and asset impairment loss on the consolidated and combined statements of operations.

Asset Impairment Losses:

In December 2004, the Company performed an asset impairment test on the Terrace Bay, Ontario pulp mill under the guidance of SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). The facility had incurred operating losses in each of 2002, 2003 and 2004. The Company anticipated that the facility would continue to incur operating losses in 2005, 2006 and 2007. The principal causes of these projected losses were:

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

An extended period of operating losses is an indicator of impairment under SFAS 144. The results of the impairment test indicated that the carrying amount of the Terrace Bay facility would not be recoverable from estimated future undiscounted cash flows. The Company's estimate of the 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 the Company used to determine the estimate of fair value included its 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 estimated fair value of the Terrace Bay facility also reflected assumed improvements to the facility's cost structure resulting from the Company's plans for future capital projects and a plan for a cogeneration arrangement that would lower the cost of electricity.

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 to its estimated fair value. In addition, in December 2004, in recognition of the probability that the No. 1 mill would be closed, 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 recorded as a result of the impairment losses, resulting in a net after-tax charge of approximately $72.0 million.

In December 2005, due to continued large operating losses at the Terrace Bay facility, a review of strategic alternatives and anticipated continuing losses in 2006, the Company performed another impairment test of the facility which indicated that the carrying value of its long-lived assets was not recoverable from estimated future cash flows. In estimating the impairment loss, the fair value of the facility was determined in a manner consistent with that applied in December 2004. While the significant assumptions used to determine the fair value of the facility were applied in a manner consistent with the prior year, the Company's probability-weighting of the estimated future cash flows were different. The estimated fair value for the facility indicated that its long-lived assets were fully impaired. As a result, the Company recorded a pre-tax, non-cash impairment loss of approximately $53.7 million to reduce the carrying amount of the facility's tangible long-lived assets to zero. A deferred tax benefit of approximately $20.6 million was recorded as a result of the impairment losses, resulting in a net after-tax charge of approximately $33.1 million.

Restructuring costs and asset impairment losses recognized in 2005 and 2004 were recorded in the Pulp segment (See Note 13).

13.
BUSINESS SEGMENT AND GEOGRAPHIC INFORMATION

The Company reports its operations in three segments: Fine Paper, Technical Products and Pulp. The Fine Paper business is a leading producer of premium writing, text, cover and specialty papers. The Technical Products business is a leading producer of durable, saturated and coated base papers and films for a variety of end uses. The Pulp business consists of mills and related timberlands, which produce northern bleached softwood and hardwood kraft pulp. 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

December 31,	2005	2004	2003
Net Sales			
Fine Paper	$222.3	$220.8	$210.4
Technical Products	130.6	132.3	121.6
Pulp	400.7	448.6	405.1
Intersegment sales	(20.2)	(29.6)	(26.8)
Total	$733.4	$772.1	$710.3
Operating Income (Loss)			
Fine Paper	$ 58.4	$ 67.0	$ 63.2
Technical Products	10.5	21.9	16.6
Pulp [(a)]	(93.2)	(120.5)	(16.5)
Unallocated corporate costs	(6.5)	(8.3)	–
Total	$ (30.8)	$ (39.9)	$ 63.3
Depreciation and Amortization			
Fine Paper	$ 9.5	$ 9.7	$ 9.6
Technical Products	4.0	3.7	4.0
Pulp	13.5	22.4	21.7
Unallocated corporate costs	2.8	0.2	–
Total	$ 29.8	$ 36.0	$ 35.3
Capital Expenditures			
Fine Paper	$ 5.5	$ 3.5	$ 2.5
Technical Products	2.4	1.6	2.2
Pulp	9.8	11.0	19.7
Corporate	8.0	3.0	–
Total	$ 25.7	$ 19.1	$ 24.4

(a) Income before income taxes for the pulp business in 2005 and 2004 include restructuring costs and asset impairment losses of $59.8 million ($6.1 million of which represent costs related to the closure of the No. 1 Mill) and $112.8 million, respectively, for the Terrace Bay facility.

December 31,	2005	2004
Total Assets		
Fine Paper	$105.2	$140.9
Technical Products	58.3	49.8
Pulp	352.0	361.4
Unallocated corporate and intersegment items	21.5	5.2
Total	$537.0	$557.3

Geographic Information

December 31,	2005	2004	2003
Net Sales			
United States	$352.9	$354.0	$332.8
Canada	400.7	448.2	404.6
Intergeographic Items	(20.2)	(30.1)	(27.1)
Total	$733.4	$772.1	$710.3

December 31,	2005	2004
Total Assets		
United States	$231.9	$241.8
Canada	305.1	315.5
Total	$537.0	$557.3

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 2005, 2004 and 2003, the Company had pulp sales to Kimberly-Clark of $309 million, $351 million and $305 million, respectively. For the periods presented, other than Kimberly-Clark, no single customer accounted 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 Products, 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 2005, two suppliers provided over 70% of the wood chips used by the Pictou mill and three suppliers provided approximately 50% of the wood chips used by the Terrace Bay mill. 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. In February 2006, the Company suspended pulp manufacturing activities at the Terrace Bay pulp mill as a result of a lack of wood fiber for its operations (See Note 10 – Employees and Labor Relations). An interruption in supply of a latex specialty grade could disrupt and eventually cause a shutdown of production of certain technical products.

14.

SUPPLEMENTAL DATA

Supplemental Statement of Operations Data

Year Ended December 31,	2005	2004	2003
Summary of Advertising and Research Expenses			
Advertising expense	$ 7.9	$ 7.7	$ 5.8
Research expense	2.3	1.7	2.1

Supplemental Balance Sheet Data

December 31,	2005	2004
Summary of Accounts Receivable, net		
Accounts Receivable:		
From customers	$ 76.7	$ 84.9
Other	6.0	11.8
Less allowance for doubtful accounts and sales discounts	(3.6)	(4.3)
Total	$ 79.1	$ 92.4

December 31,	2005	2004
Summary of Inventories		
Inventories by Major Class:		
Raw materials	$ 30.5	$ 31.1
Work in process	8.2	7.7
Finished goods	47.8	42.1
Supplies and other	7.6	5.2
	94.1	86.1
Excess of FIFO cost over LIFO cost	(7.0)	(6.6)
Total	$ 87.1	$ 79.5

The FIFO values of total inventories valued on the LIFO method were $35.2 million and $33.5 million at December 31, 2005 and 2004, respectively.

Certain prior year amounts of Supplies and others, related to inventories of spare parts, have been reclassified to Prepaid and other current assets in the consolidated balance sheet to more closely conform with Accounting Research Bulletin 43, *Restatement and Revision of Accounting Research Bulletins,* definition of inventory as tangible personal property to be currently consumed in the production of goods or services. Accordingly, amounts reflected at December 31, 2004 for "Supplies and other" and "Total Inventories" have been decreased and "Prepaid and other current assets" have been increased from the amounts previously reported by $9.2 million.

December 31,	2005	2004
Summary of Property, Plant and Equipment – Net		
Land and land improvements	$ 2.7	$ 4.8
Buildings	81.2	84.6
Machinery and equipment	478.7	487.9
Roads	23.4	26.5
Construction in progress	15.0	13.6
	601.0	617.4
Less accumulated depreciation	388.0	359.8
Net Property, Plant and Equipment	$213.0	$257.6

Depreciation expense was $27.0 million, $35.8 million and $35.3 million in 2005, 2004 and 2003, respectively. Interest expense capitalized as part of the costs of capital projects was $0.4 million in 2005. No amount of interest expense was capitalized for periods prior to the Spin-Off or in December 2004 following the Spin-Off.

December 31,	2005	2004
Summary of Accrued Expenses		
Accrued salaries and employee benefits	$ 25.8	$ 27.2
Accrued income taxes	–	0.5
Accrued interest	2.1	1.4
Other	10.9	7.5
Total	$ 38.8	$ 36.6

15.

CONDENSED CONSOLIDATING FINANCIAL INFORMATION

Neenah Paper Company of Canada, Neenah Paper Michigan, Inc. and Neenah Paper Sales, Inc. (the "Subsidiary Guarantors") guarantee the Company's Senior Notes. The Subsidiary Guarantors are 100% owned by the Company and all guarantees are full and unconditional. The following condensed consolidating financial information is presented in lieu of consolidated financial statements for the Subsidiary Guarantors as of December 31, 2005 and 2004 and for the year ended December 31, 2005. Condensed consolidating financial information is not included for the years ended December 31, 2004 and 2003 because: (a) historical information required to prepare the comparative consolidating statements was not maintained on a discrete comparable basis within Kimberly-Clark, (b) prior to the Spin-Off, the business operations that now constitute Neenah were not part of separate operating units or divisions of Kimberly-Clark for which discrete financial statements were prepared and (c) the functions and operations of the assets and the related businesses as currently structured are substantially different from that which existed as a part of Kimberly-Clark.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

(in millions) *For the Year Ended December 31, 2005*	Neenah Paper, Inc.	Subsidiary Guarantors	Consolidating Adjustments	Consolidated Amounts
Net sales	$ 78.7	$ 800.8	$ (146.1)	$ 733.4
Cost of products sold	69.3	732.7	(146.1)	655.9
Gross profit	9.4	68.1	–	77.5
Selling, general and administrative expenses	5.8	47.4	–	53.2
Restructuring costs and asset impairment loss	–	59.8	–	59.8
Equity in losses of subsidiaries	21.1	–	(21.1)	–
Other income – net	(0.2)	(4.5)	–	(4.7)
Operating income (loss)	(17.3)	(34.6)	21.1	(30.8)
Interest expense – net	18.1	0.1	–	18.2
Income (loss) before income taxes	(35.4)	(34.7)	21.1	(49.0)
Provision (benefit) for income taxes	(5.7)	(13.6)	–	(19.3)
Net income (loss)	$ (29.7)	$ (21.1)	$ 21.1	$ (29.7)

CONDENSED CONSOLIDATING BALANCE SHEET

(in millions) *As of December 31, 2005*	Neenah Paper, Inc.	Subsidiary Guarantors	Consolidating Adjustments	Consolidated Amounts
ASSETS				
Current assets				
Cash and cash equivalents	$ 12.0	$ 0.6	$ –	12.6
Accounts receivable – net	(5.9)	87.0	(2.0)	79.1
Inventories	0.1	87.0	–	87.1
Intercompany amounts receivable	32.1	–	(32.1)	–
Other current assets	8.7	16.8	–	25.5
Total current assets	47.0	191.4	(34.1)	204.3
Property, plant and equipment, at cost	222.1	394.7	–	616.8
Less accumulated depreciation	127.5	271.4	–	398.9
Property, plant and equipment – net	94.6	123.3	–	217.9
Investments in subsidiaries	288.3	–	(288.3)	–
Prepaid and intangible pension costs	9.8	61.9	–	71.7
Other assets	(10.9)	54.0	–	43.1
Total Assets	$ 428.8	$ 430.6	$ (322.4)	$ 537.0
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities				
Debt payable within one year	$ 1.2	$ –	$ –	$ 1.2
Accounts payable	10.1	32.3	(2.0)	40.4
Intercompany amounts payable	–	32.1	(32.1)	–
Accrued expenses	10.1	28.7	–	38.8
Total current liabilities	21.4	93.1	(34.1)	80.4
Long-term debt	226.3	–	–	226.3
Other noncurrent liabilities	15.8	49.2	–	65.0
Total Liabilities	263.5	142.3	(34.1)	371.7
Stockholders' equity	165.3	288.3	(288.3)	165.3
Total Liabilities and Stockholders' Equity	$ 428.8	$ 430.6	$ (322.4)	$ 537.0

CONDENSED CONSOLIDATING BALANCE SHEET

(in millions) *As of December 31, 2004*	Neenah Paper, Inc.	Subsidiary Guarantors	Consolidating Adjustments	Consolidated Amounts
ASSETS				
Current assets				
Cash and cash equivalents	$ 13.9	$ 5.2	$ –	$ 19.1
Accounts receivable–net	(2.5)	98.1	(3.2)	92.4
Inventories	0.1	79.4	–	79.5
Other current assets	2.5	10.1	–	12.6
Total current assets	14.0	192.8	(3.2)	203.6
Property, plant and equipment, at cost	212.8	419.9	–	632.7
Less accumulated depreciation	120.9	249.0	–	369.9
Property, plant and equipment–net	91.9	170.9	–	262.8
Investments in subsidiaries	362.5	–	(362.5)	–
Prepaid and intangible pension costs	10.4	62.5	–	72.9
Other assets	(20.1)	38.1	–	18.0
Total Assets	$ 458.7	$ 464.3	$ (365.7)	$ 557.3
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities				
Accounts payable	$ 15.1	$ 38.7	$ (3.2)	$ 50.6
Accrued expenses	8.5	28.1	–	36.6
Total current liabilities	23.6	66.8	(3.2)	87.2
Long-term debt	225.0	–	–	225.0
Other noncurrent liabilities	13.0	35.0	–	48.0
Total Liabilities	261.6	101.8	(3.2)	360.2
Stockholders' equity	197.1	362.5	(362.5)	197.1
Total Liabilities and Stockholders' Equity	$ 458.7	$ 464.3	$ (365.7)	$ 557.3

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

(in millions) *As of December 31, 2005*	Neenah Paper, Inc.	Subsidiary Guarantors	Consolidating Adjustments	Consolidated Amounts
OPERATING ACTIVITIES				
Net income (loss)	$ (29.7)	$ (21.1)	$ 21.1	$ (29.7)
Adjustments to reconcile net income to net cash provided by operating activities				
Depreciation and amortization	13.3	16.5	–	29.8
Asset impairment loss	–	54.5	–	54.5
Deferred income tax provision (benefit)	(2.5)	(17.6)	–	(20.1)
Loss on asset dispositions	0.1	0.4	–	0.5
Decrease (increase) in working capital	(36.7)	26.6	–	(10.1)
Equity in earnings of subsidiaries	21.1	–	(21.1)	–
Pension and other postretirement benefits	2.5	(5.2)	–	(2.7)
Other	0.2	0.4	–	0.6
Net Cash Provided by (Used for) Operating Activities	(31.7)	54.5	–	22.8
INVESTING ACTIVITIES				
Capital expenditures	(8.4)	(17.3)	–	(25.7)
Other	(0.3)	0.2	–	(0.1)
Net Cash Used in Investing Activities	(8.7)	(17.1)	–	(25.8)
FINANCING ACTIVITIES				
Proceeds from issuance of long-term debt	3.4	–	–	3.4
Repayments of long-term debt	(1.1)	–	–	(1.1)
Proceeds from issuance of short-term debt	2.5	–	–	2.5
Repayments of short-term debt	(2.5)	–	–	(2.5)
Cash dividends paid	(5.9)	–	–	(5.9)
Other	42.1	(42.1)	–	–
Net Cash Provided by (Used in) Financing Activities	38.5	(42.1)	–	(3.6)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	–	0.1	–	0.1
Net Decrease in Cash and Cash Equivalents	(1.9)	(4.6)	–	(6.5)
Cash and Cash Equivalents, Beginning of Year	13.9	5.2	–	19.1
Cash and Cash Equivalents, End of Year	$ 12.0	$ 0.6	$ –	$ 12.6

16.

UNAUDITED QUARTERLY DATA

	2005 Quarters [a]				
	First	Second	Third	Fourth [c]	Year
Net Sales	$ 196.6	$ 189.3	$ 167.7	$ 179.8	$ 733.4
Gross Profit	25.3	29.5	15.4	7.3	77.5
Operating Income (Loss) [b]	8.9	14.8	1.5	(56.0)	(30.8)
Net Income (Loss) [b]	2.7	6.8	(1.5)	(37.7)	(29.7)
Earnings (Loss) Per Common Share:					
Basic	$ 0.18	$ 0.46	$ (0.10)	$ (2.56)	$ (2.02)
Diluted	$ 0.18	$ 0.46	$ (0.10)	$ (2.56)	$ (2.02)

	2004 Quarters [a]				
	First	Second	Third	Fourth [c]	Year
Net Sales [d]	$ 198.4	$ 207.4	$ 188.9	$ 177.4	$ 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)	(39.9)
Net Income (Loss)	15.1	23.7	4.5	(69.7)	(26.4)
Earnings Per Common Share [e]:					
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)

(a) The annual maintenance shutdowns for the Company's two pulp mills occurred during the third quarter and fourth quarters in 2005 compared to 2004 when both occurred during the third quarter.

(b) Results for the first, second and third quarters of 2005 and for the year include costs associated with the closure of the No. 1 Mill of $4.3 million, $1.7 million, $0.1 million and $6.1 million, respectively.

(c) Includes asset impairment losses of $53.7 million and $112.8 million in December 2005 and 2004, respectively.

(d) 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.

(e) For 2004 prior to the Spin-Off, 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.

Production Notes

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 below.

POSTER:

Side 1:

CLASSIC CREST®,
Solar White,
80 lb. text

Side 2:

CLASSIC CREST®,
Solar White,
80 lb. text

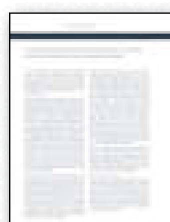
BOOK:

Front Cover:

CLASSIC COLUMNS®,
Red Pepper /
CLASSIC CREST®,
Avalanche White,
120 lb. duplex cover

Page 1:

CLASSIC® Linen,
Solar White,
80 lb. text



Page 2:

CLASSIC® Linen,
Solar White,
80 lb. text

Page 3:

CLASSIC® Linen,
Monterey Sand,
80 lb. text

Page 4:

CLASSIC® Linen,
Monterey Sand,
80 lb. text

Fly Sheet Front:

EAMES™ Architecture,
Case Study Red,
50 lb. text

Production Notes

Fine Paper
Short Sheet Front:
CLASSIC CREST®,
Saw Grass,
80 lb. text

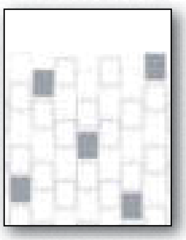
Fine Paper
Short Sheet Back:
CLASSIC CREST®,
Saw Grass,
80 lb. text

Page 5:
CLASSIC® Laid,
Recycled Natural White,
75 lb. text

Page 6:
CLASSIC® Laid,
Recycled Natural White,
75 lb. text

Technical Products
Short Sheet Front:
EAMES™ Painting,
Eames Natural White,
80 lb. text

Technical Products
Short Sheet Back:
EAMES™ Painting,
Eames Natural White,
80 lb. text



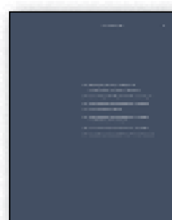
Fly Sheet Front:
EAMES™ Furniture,
Pacific Blue
80 lb. text

Pulp
Short Sheet Front:
ENVIRONMENT®,
Desert Storm,
80 lb. text

Pulp
Short Sheet Back:
ENVIRONMENT®,
Desert Storm,
80 lb. text

Page 7:
EAMES™ Painting,
Brushwork Beige,
80 lb. text

Page 8:
EAMES™ Painting,
Brushwork Beige,
80 lb. text



Pages 9–72:
CLASSIC CREST®,
Potomac Blue,
80 lb. text

Back Cover:
CLASSIC COLUMNS®,
Red Pepper /
CLASSIC CREST®,
Avalanche White,
120 lb. duplex cover

Design and production:
see see eye / Atlanta, Georgia

Copywriting:
Robert Roth

Printing:
Williamson Printing
Corporation

Principal photography:
Greg Neumaier

Executive photography:
Daemon Baizon
Jerry Burns

Additional photography:
Daemon Baizon
Image Studios

Illustrations:
Daniel Chang: Poster, Page 4,
Pulp Short Sheet

Stéphan Daigle: Fine Paper
Short Sheet

Harvey Chan: Technical
Products Short Sheet

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 2006 annual meeting of the shareholders of Neenah Paper, Inc. will be held Thursday, May 4, 2006, at 10:00 a.m., Eastern time at Neenah's headquarters in Alpharetta, Georgia.

Registrar and Transfer Agent

Computershare Trust Company, N.A.
P.O. Box 43010
Providence, RI 02940-3010
www.computershare.com/equiserve
877.498.8847

Financial and Other Company Information

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 is available on our website at www.neenah.com. In addition, financial reports, recent filings with the Securities and Exchange Commission (SEC), news releases and other information are available on our website. For a printed copy of our Form 10-K, without charge, please contact:

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

Certifications

Neenah has included as exhibits to its Annual Report on Form 10-K for the fiscal year ended December 31, 2005 filed with the SEC, certifications of Neenah's Chief Executive Officer and Chief Financial Officer certifying the quality of our public disclosure. Further, Neenah's Chief Executive Officer has certified to the New York Stock Exchange (NYSE) that he is not aware of any violations by Neenah of the NYSE corporate governance listing standards.

Trading and Dividend Information

	Common Stock Market Price		Dividends
	High	Low	Declared
2005			
Fourth quarter	$ 30.52	$ 26.25	$ 0.10
Third quarter	$ 33.58	$ 28.71	$ 0.10
Second quarter	$ 33.90	$ 29.19	$ 0.10
First quarter	$ 36.62	$ 31.03	$ 0.10
2004			
Fourth quarter*	$ 33.50	$ 30.50	None

** Neenah common stock began trading on the New York Stock Exchange on December 1, 2004.*

As of February 28, 2006, Neenah had approximately 12,400 holders of record of its common stock.

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

Neenah Paper, Inc. 2005 Annual Report

3460 Preston Ridge Road
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Alpharetta, GA 30005
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NEENAH PAPER INC