

GLATFELTER P H CO  
Form 10-Q  
November 07, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

or

**TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD**

from \_\_\_ to \_\_\_

For the quarterly period ended **September 30, 2006**

Commission file number **1-3560**

**P. H. Glatfelter Company**

(Exact name of registrant as specified in its charter)

**Pennsylvania**

(State or other jurisdiction of  
incorporation or organization)

**23-0628360**

(IRS Employer Identification No.)

**96 South George Street, Suite 500**

**York, Pennsylvania 17401**

(Address of principal executive offices)

**(717) 225-4711**

(Registrant's telephone number, including area code)

**N/A**

(Former name or former address, if changed since last report)

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

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

Large Accelerated  Accelerated  Non-Accelerated.

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

As of October 31, 2006, P. H. Glatfelter Company had 44,782,582 shares of common stock outstanding.

**P. H. GLATFELTER COMPANY**  
**REPORT ON FORM 10-Q**  
**for the QUARTERLY PERIOD ENDED**  
**SEPTEMBER 30, 2006**  
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**PART I****Item 1 Financial Statements**

**P. H. GLATFELTER COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30</b>		<b>September 30</b>	
<i>In thousands, except per share</i>	<b>2006</b>	2005	<b>2006</b>	2005
Net sales	<b>\$ 277,489</b>	\$ 146,780	<b>\$ 717,815</b>	\$ 435,959
Energy sales net	<b>2,706</b>	2,414	<b>8,010</b>	7,673
Total revenues	<b>280,195</b>	149,194	<b>725,825</b>	443,632
Costs of products sold	<b>242,292</b>	123,578	<b>661,924</b>	369,589
Gross profit	<b>37,903</b>	25,616	<b>63,901</b>	74,043
Selling, general and administrative expenses	<b>24,590</b>	18,061	<b>66,327</b>	52,425
Shutdown and restructuring charges	<b>2,222</b>		<b>28,177</b>	
Gains on dispositions of plant, equipment and timberlands, net	<b>(923)</b>	(1,327)	<b>(2,008)</b>	(1,408)
Gains from insurance recoveries			<b>(205)</b>	(2,200)
Operating income (loss)	<b>12,014</b>	8,882	<b>(28,390)</b>	25,226
Non-operating income (expense)				
Interest expense	<b>(7,012)</b>	(3,331)	<b>(17,575)</b>	(9,881)
Interest income	<b>558</b>	475	<b>2,350</b>	1,532
Other net	<b>704</b>	293	<b>(840)</b>	529
Total other income (expense)	<b>(5,750)</b>	(2,563)	<b>(16,065)</b>	(7,820)
Income (loss) before income taxes	<b>6,264</b>	6,319	<b>(44,455)</b>	17,406
Income tax provision (benefit)	<b>896</b>	2,656	<b>(17,238)</b>	5,744
Net income (loss)	<b>\$ 5,368</b>	\$ 3,663	<b>\$ (27,217)</b>	\$ 11,662
<b>Earnings (loss) per share</b>				
Basic	<b>\$ 0.12</b>	\$ 0.08	<b>\$ (0.61)</b>	\$ 0.27
Diluted	<b>0.12</b>	0.08	<b>(0.61)</b>	0.26
<b>Cash dividends declared per common share</b>	<b>0.09</b>	0.09	<b>0.27</b>	0.27
<b>Weighted average shares outstanding</b>				
Basic	<b>44,749</b>	44,012	<b>44,512</b>	43,986
Diluted	<b>45,247</b>	44,357	<b>44,512</b>	44,298

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

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**P. H. GLATFELTER COMPANY**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(unaudited)

<i>In thousands</i>	<b>September 30 2006</b>	December 31 2005
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 13,881	\$ 57,442
Accounts receivable net	135,476	62,524
Inventories	184,475	81,248
Prepaid expenses and other current assets	32,083	22,343
Total current assets	365,915	223,557
<b>Plant, equipment and timberlands net</b>	<b>526,589</b>	478,828
<b>Other assets</b>	<b>374,380</b>	342,592
Total assets	\$ 1,266,884	\$ 1,044,977
<b>Liabilities and Shareholders Equity</b>		
<b>Current liabilities</b>		
Current portion of long-term debt	\$ 11,250	\$ 19,650
Short-term debt	2,814	3,423
Accounts payable	63,925	31,132
Dividends payable	4,031	3,972
Environmental liabilities	4,720	7,575
Other current liabilities	80,881	74,126
Total current liabilities	167,621	139,878
<b>Long-term debt</b>	<b>400,358</b>	184,000
<b>Deferred income taxes</b>	<b>204,319</b>	206,269
<b>Other long-term liabilities</b>	<b>87,151</b>	82,518
Total liabilities	859,449	612,665
<b>Commitments and contingencies</b>		
<b>Shareholders equity</b>		
Common stock	544	544
Capital in excess of par value	41,945	43,450

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Retained earnings	<b>508,540</b>	547,810
Deferred compensation		(2,295)
Accumulated other comprehensive loss	<b>(1,193)</b>	(5,343)
	<b>549,836</b>	584,166
Less cost of common stock in treasury	<b>(142,401)</b>	(151,854)
Total shareholders' equity	<b>407,435</b>	432,312
Total liabilities and shareholders' equity	<b>\$ 1,266,884</b>	\$ 1,044,977

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

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**P. H. GLATFELTER COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited)

<i>In thousands</i>	<b>Nine months Ended September 30</b>	
	<b>2006</b>	<b>2005</b>
<b>Operating activities</b>		
Net income (loss)	\$ (27,217)	\$ 11,662
Adjustments to reconcile to net cash provided (used) by operations:		
Depreciation, depletion and amortization	37,122	38,186
Pension income	(12,644)	(12,398)
Shutdown and restructuring charges	33,328	
Deferred income tax provision	(10,387)	1,339
Gains on dispositions of plant, equipment and timberlands, net	(2,008)	(1,408)
Other	825	475
Change in operating assets and liabilities		
Accounts receivable	(25,955)	(8,925)
Inventories	(968)	(6,280)
Other assets and prepaid expenses	1,048	1,619
Accounts payable and other liabilities	(38,716)	(12,674)
Net cash (used) provided by operating activities	(45,572)	11,596
<b>Investing activities</b>		
Purchases of plant, equipment and timberlands	(35,225)	(22,033)
Proceeds from disposals of plant, equipment and timberlands	2,975	1,225
Acquisition of Lydney mill and Chillicothe	(158,148)	
Net cash used by investing activities	(190,398)	(20,808)
<b>Financing activities</b>		
Net borrowings (repayments) under revolving credit facility	55,819	(2,019)
Proceeds from \$100 million term loan facility, net of issuance costs	98,829	
Prepayment of principal under term loan facility	(560)	
Net proceeds from \$200 million, 7 <sup>1</sup> / <sub>8</sub> % note offering	196,440	
Repayment of \$150 million 6 <sup>7</sup> / <sub>8</sub> % notes, including early redemption premium	(152,675)	
Payment of dividends	(11,993)	(11,873)
Proceeds from stock options exercised	7,322	785
Net cash provided (used) by financing activities	193,182	(13,107)
Effect of exchange rate changes on cash	(773)	(2,249)
Net decrease in cash and cash equivalents	(43,561)	(24,568)
Cash and cash equivalents at the beginning of period	57,442	39,951
Cash and cash equivalents at the end of period	\$ 13,881	\$ 15,383



**Supplemental cash flow information**

Cash paid for			
Interest		\$ 14,619	\$ 12,090
Income taxes		17,436	15,000

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

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**P. H. GLATFELTER COMPANY AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(unaudited)

**ORGANIZATION**

P. H. Glatfelter Company and subsidiaries ( Glatfelter ) is a manufacturer of specialty papers and engineered products. Headquartered in York, Pennsylvania, our manufacturing facilities are located in Spring Grove, Pennsylvania; Chillicothe and Fremont, Ohio, Germany, France, the United Kingdom and the Philippines. Our products are marketed throughout the United States and in many foreign countries, either through wholesale paper merchants, brokers and agents or directly to customers.

**1. ACCOUNTING POLICIES**

These unaudited condensed consolidated interim financial statements ( Financial Statements ) have been prepared in accordance with accounting principles generally accepted in the United States of America and with the rules and regulations of the Securities and Exchange Commission and include the accounts of Glatfelter and its wholly-owned subsidiaries. These Financial Statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Glatfelter 's 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

These Financial Statements do not include all of the information and notes required for complete financial statements. In management 's opinion, these Financial Statements reflect all adjustments, which are of a normal, recurring nature, necessary for a fair presentation of the results for the interim periods presented. Results for these interim periods are not necessarily indicative of results to be expected for the full year.

**Stock-based Compensation** Effective January 1, 2006, we adopted Statement of Financial Accounting Standards ( SFAS ) No. 123(R), Share-Based Payment utilizing the modified prospective method. This standard requires employee stock options and other stock-based compensation awards to be accounted for under the fair value method, and eliminates the ability to account for these instruments under the intrinsic value method prescribed by APB Opinion No. 25, and allowed under the original provisions of SFAS No. 123. The adoption of SFAS No. 123 (R) did not have a material effect on our consolidated results of operations or financial position.

**2. RECENT PRONOUNCEMENTS**

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that we recognize in our financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of 2007, with the cumulative effect of the change in accounting principle, if any, recorded as an adjustment to retained earnings. We are currently evaluating the impact of adopting FIN 48 on our financial statements.

In September 2006, SFAS No. 157, Fair Value Measurements was issued. SFAS No. 157, which defines fair value, establishes a framework for measurement and requires expanded disclosures about the fair value measurements, is effective for us beginning January 1, 2008. We do not expect the adoption of SFAS No. 157 to have a material impact on our consolidated financial position or results of operations.

In September 2006, SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, was issued. This standard will require us to recognize the overfunded or underfunded status of our defined benefit pension and other postretirement plans as an asset or a liability, respectively, on the balance sheet and recognize changes in that net funded status in the year in which changes occur through other comprehensive income, a component of shareholders ' equity. In accordance with SFAS No. 158, as of December 31, 2006 we will recognize the net funded status of our defined benefit pension and other postretirement plans, which will result in an estimated \$40 million to \$50 million after-tax charge to other comprehensive income.

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### 3. ACQUISITIONS

**Lydney** On March 8, 2006, we entered into two separate definitive agreements to acquire, through Glatfelter-UK Limited ( GLT-UK ), a wholly-owned subsidiary, certain assets and liabilities of J R Crompton Limited ( Crompton ), a global supplier of wet laid non-woven products based in Manchester, United Kingdom. On February 7, 2006, Crompton was placed into Administration, the U.K. equivalent of bankruptcy.

Effective March 13, 2006, we completed our purchase of Crompton s Lydney mill and related inventory, located in Gloucestershire, UK for £37.5 million (US \$65.0 million) in cash in addition to \$3.9 million of transaction costs. The Lydney facility employs about 240 people, produces a broad portfolio of wet laid non-woven products, including tea and coffee filter papers, clean room wipes, lens tissue, dye filter paper, double-sided adhesive tape substrates and battery grid pasting tissue, and had 2005 revenues of approximately £43 million (US \$75 million). The purchase price was financed with existing cash balances and borrowings under our credit facility.

Our completed acquisition of the Lydney mill remains under review by the European Commission, a process with which we are fully cooperating. We believe that the Lydney transaction complies with European competition law, but we are unable at this time to predict the timing or the likely outcome of any Commission decision.

Pursuant to the terms of the agreement, the Company has guaranteed all of the obligations of GLT-UK thereunder.

The following table summarizes the preliminary allocation of the purchase price to assets acquired and liabilities assumed:

*In thousands*

**Assets acquired:**

Inventory	\$ 9,131
Property and equipment	55,443
Intangibles and other assets	5,004
	69,578
Less acquisition related liabilities	(641)
Total	\$ 68,937

The amounts set forth above ascribed to intangible assets and other primarily consist of \$2.8 million of technology and trademarks.

Under terms of the second agreement, we agreed to purchase Crompton s Simpson Clough mill. This agreement was terminated by the Administrators in accordance with contractual provisions due to additional time that may have been required should an in depth regulatory review have been necessary.

**Chillicothe** On April 3, 2006, we completed our acquisition of Chillicothe, the carbonless business operations of NewPage Corporation, for \$83.3 million in cash, in addition to approximately \$5.9 million of transaction and other related costs. The Chillicothe assets consist of paper making facility in Chillicothe, Ohio with annual production capacity approximating 400,000 ton-per-year and coating operations based in Fremont, Ohio. Chillicothe had revenue of \$441.5 million in 2005 and a total of approximately 1,700 employees as of December 31, 2005. The Chillicothe acquisition was financed with existing borrowings under our credit facility.

The following table summarizes the preliminary allocation of the purchase price to assets acquired and liabilities assumed.

*In thousands*

**Assets acquired:**

Accounts receivable	\$ 44,456
Inventory	93,082

Other current	982
Other long-term	14,703
	153,223
Less acquisition related liabilities including accounts payable and accrued expenses	(64,012)
Total	\$ 89,211

The amount set forth above for other long-term assets primarily consist of \$10.7 million of net prepaid pension and \$2.1 million of customer relationships.

**Pro-Forma Financial Information** The information necessary to provide certain pro forma financial data for the Chillicothe acquisition relative to net income and earnings per share is not readily available due to the nature of the accounting and reporting structure of the acquired operation prior to the acquisition date. Pro forma consolidated net sales for the nine months ended September 30, 2006 and 2005 was approximately \$823.7 million and \$751.6 million, respectively, assuming the acquisition occurred at the beginning of the respective period. For the full year 2005, on a pro forma basis, net sales were \$1.0 billion, net income was \$40.9 million and diluted EPS was \$0.92.

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This unaudited pro forma financial information above is not necessarily indicative of what the operating results would have been had the acquisition been completed at the beginning of the respective period nor is it indicative of future results.

#### 4. NEENAH FACILITY SHUTDOWN

In connection with our agreement to acquire the Chillicothe operations, we committed to a plan to permanently shutdown the Neenah, WI facility. Production at this facility ceased effective June 30, 2006 and certain products previously manufactured at the Neenah facility have been transferred to Chillicothe.

The following table summarizes shutdown reserve activity during the nine months ended September 30, 2006:

<i>In thousands</i>	Beg. balance	Amount Accrued	Less Non- Cash- Charges and Cash Payments	Balance
<b>Non-cash charges</b>				
Accelerated depreciation	\$	\$ 22,457	\$ (22,457)	\$
Inventory write-down		3,196	(3,196)	
Pension curtailments and other retirement benefit charges		7,675	(7,675)	
Total non cash charges		33,328	(33,328)	
<b>Cash charges</b>				
Severance and benefit continuation		7,219	(3,432)	3,787
Contract termination costs		11,367	(11,367)	
Other		1,795	(645)	1,150
Total cash charges		20,381	(15,444)	4,937
Total	\$	\$ 53,709	\$ (48,772)	\$ 4,937

The following table summarizes shutdown reserve activity during the three months ended September 30, 2006:

<i>In thousands</i>	Bal June 30, 2006	Amount Accrued	Less Non- Cash- Charges and Cash Payments	Balance
<b>Non-cash charges</b>				
Inventory write-down	\$	\$ 785	\$ (785)	\$
Total non cash charges		785	(785)	
<b>Cash charges</b>				
Severance and benefit continuation	6,592	627	(3,432)	3,787
Contract termination costs	11,386	(19)	(11,367)	
Other	222	1,573	(645)	1,150
Total cash charges	18,200	2,181	(15,444)	4,937

Total	<b>\$ 18,200</b>	<b>\$ 2,966</b>	<b>\$ (16,229)</b>	<b>\$ 4,937</b>
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The Neenah shutdown resulted in the elimination of approximately 200 positions and had been supporting our Specialty Papers business unit. Approximately \$25.7 million of the Neenah shutdown related charges are recorded as part of costs of products sold in the accompanying statements of income. The amounts accrued for severance and benefit continuation and for contract termination costs are recorded as other current liabilities in the accompanying consolidated balance sheets.

As part of the Neenah shutdown, we terminated our long-term steam supply contract, as provided for within the agreement, resulting in a termination fee of approximately \$11.4 million.

We expect to record (in the fourth quarter of 2006) additional shutdown related charges approximating \$1.0 million.

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**5. EARNINGS PER SHARE**

The following table sets forth the details of basic and diluted earnings per share (EPS):

<i>In thousands, except per share</i>	<b>Three Months Ended September 30</b>	
	<b>2006</b>	<b>2005</b>
Net income	<b>\$ 5,368</b>	<b>\$ 3,663</b>
Weighted average common shares outstanding used in basic EPS	<b>44,749</b>	<b>44,012</b>
Common shares issuable upon exercise of dilutive stock options, restricted stock awards and performance awards	<b>498</b>	<b>345</b>
Weighted average common shares outstanding and common share equivalents used in diluted EPS	<b>45,247</b>	<b>44,357</b>
Earnings per share Basic and diluted	<b>\$ 0.12</b>	<b>\$ 0.08</b>
<i>In thousands, except per share</i>	<b>Nine months Ended September 30</b>	
	<b>2006</b>	<b>2005</b>
Net (loss) income	<b>\$ (27,217)</b>	<b>\$ 11,662</b>
Weighted average common shares outstanding used in basic EPS	<b>44,512</b>	<b>43,986</b>
Common shares issuable upon exercise of dilutive stock options, restricted stock awards and performance awards		<b>312</b>
Weighted average common shares outstanding and common share equivalents used in diluted EPS	<b>44,512</b>	<b>44,298</b>
Earnings (loss) per share Basic	<b>\$ (0.61)</b>	<b>\$ 0.27</b>
Diluted	<b>(0.61)</b>	<b>0.26</b>

Approximately 398,810 and 899,682 potential common shares have been excluded from the computation of diluted earnings per share for the three month and nine month periods, respectively, due to their anti-dilutive nature in 2006.

**6. RETIREMENT PLANS AND OTHER POST-RETIREMENT BENEFITS**

We have both funded and, with respect to our international operations, unfunded noncontributory defined benefit pension plans covering substantially all of our employees. The benefits are based, in the case of certain plans, on average salary and years of service and, in the case of other plans, on a fixed amount for each year of service. Plan provisions and funding meet the requirements of the Employee Retirement Income Security Act of 1974. The Company uses a December 31 measurement date for all of its defined benefit plans. In connection with the assumption of certain pension plan benefits related to the Chillicothe acquisition, the related pension plan data was remeasured as of June 30, 2006. With the exception of a change in the discount rate from



5.75% to 6.25%, all other assumptions remained unchanged.

We also provide certain health care benefits to eligible retired employees. These benefits include a comprehensive medical plan for retirees prior to age 65 and fixed supplemental premium payments to retirees over age 65 to help defray the costs of Medicare. The plan is not funded and claims are paid as reported.

The following tables set forth information with respect to our defined benefit plans.

<i>In thousands</i>	<b>Three months ended September 30</b>	
	<b>2006</b>	<b>2005</b>
<b>Pension Benefits</b>		
Service cost	\$ 1,762	\$ 931
Interest cost	5,698	4,132
Expected return on plan assets	(12,717)	(9,853)
Amortization of prior service cost	465	517
Recognized actuarial (gain)/loss	114	121
Net periodic benefit income	\$ (4,678)	\$ (4,152)
<b>Other Benefits</b>		
Service cost	\$ 449	\$ 284
Interest cost	780	674
Amortization of prior service cost	(167)	(185)
Recognized actuarial (gain) loss	329	332
Net periodic benefit cost	\$ 1,391	\$ 1,105
<i>In thousands</i>	<b>Nine months ended September 30</b>	
	<b>2006</b>	<b>2005</b>
<b>Pension Benefits</b>		
Service cost	\$ 4,441	\$ 2,795
Interest cost	15,345	12,441
Expected return on plan assets	(34,483)	(29,560)
Amortization of prior service cost	1,381	1,552
Recognized actuarial (gain) loss	672	374
	(12,644)	(12,398)
Curtailment charge	4,403	
Net periodic benefit income	\$ (8,241)	\$ (12,398)
<b>Other Benefits</b>		
Service cost	\$ 1,203	\$ 852
Interest cost	2,214	2,021
Amortization of prior service cost	(542)	(554)
Recognized actuarial (gain)/loss	977	996

Curtailement charge	<b>3,852</b>	3,315
	<b>3,273</b>	
Net periodic benefit cost	<b>\$ 7,125</b>	<b>\$ 3,315</b>

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As discussed in Note 4, we recorded special termination charges in connection with the curtailment of pension benefits, voluntary early retirement pension benefits, and termination of certain post retirement benefits related to the Neenah facility shutdown.

## 7. COMPREHENSIVE INCOME

The following table sets forth comprehensive income and its components:

<i>In thousands</i>	<b>Three Months Ended</b>	
	<b>September 30</b>	
	<b>2006</b>	<b>2005</b>
Net income	\$ 5,368	\$ 3,663
Foreign currency translation adjustment	856	(17)
Comprehensive income	<b>\$ 6,224</b>	<b>\$ 3,646</b>

<i>In thousands</i>	<b>Nine months Ended</b>	
	<b>September 30</b>	
	<b>2006</b>	<b>2005</b>
Net income (loss)	\$ (27,217)	\$ 11,662
Foreign currency translation adjustment	4,150	(8,858)
Comprehensive income (loss)	<b>\$ (23,067)</b>	<b>\$ 2,804</b>

## 8. INVENTORIES

Inventories, net of reserves, were as follows:

<i>In thousands</i>	<b>September</b>	<b>December</b>
	<b>30</b>	<b>31</b>
	<b>2006</b>	<b>2005</b>
Raw materials	\$ 34,943	\$ 16,392
In-process and finished	100,985	39,930
Supplies	48,547	24,926
Total	<b>\$ 184,475</b>	<b>\$ 81,248</b>

## 9. LONG-TERM DEBT

Long-term debt is summarized as follows:

<i>In thousands</i>	<b>September</b>	<b>December 31</b>
	<b>30</b>	<b>2005</b>
	<b>2006</b>	
New revolving credit facility, due April 2011	\$ 78,168	\$
Term loan, due April 2011	99,440	
Revolving credit facility, due September 2006		19,650

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7 <sup>1</sup> / <sub>8</sub> % Notes, due May 2016	<b>200,000</b>	
6 <sup>7</sup> / <sub>8</sub> % Notes, due July 2007		150,000
Note payable SunTrust, due March 2008	<b>34,000</b>	34,000
Total long-term debt	<b>411,608</b>	203,650
Less current portion	<b>(11,250)</b>	(19,650)
Long-term debt, excluding current portion	<b>\$ 400,358</b>	\$ 184,000

On April 3, 2006, we, along with certain of our subsidiaries as borrowers and certain of our subsidiaries as guarantors, entered into a credit agreement with certain financial institutions. Pursuant to the credit agreement, we may borrow, repay and reborrow revolving credit loans in an aggregate principal amount not to exceed \$200.0 million outstanding at any time. All borrowings under our credit facility are unsecured. The revolving credit commitment expires on April 2, 2011.

In addition, on April 3, 2006, pursuant to the credit agreement, we received a term loan in the principal amount of \$100.0 million. Quarterly repayments of principal outstanding under the term loan begin on March 31, 2007 with the final principal payment due on April 2, 2011.

Borrowings under the credit agreement bear interest, at our option, at either (a) the bank's base rate described in the credit agreement as the greater of the prime rate or the federal funds rate plus 50 basis points, or (b) the EURO rate based generally on the London Interbank Offer Rate, plus an applicable margin that varies from 67.5 basis points to 137.5 basis points according to our corporate credit rating determined by S&P and Moody's.

We have the right to prepay the term loan and revolving credit borrowings in whole or in part without premium or penalty, subject to timing conditions related to the interest rate option chosen. If certain prepayment events occur, such as a sale of assets or the incurrence of additional indebtedness in excess of \$10.0 million in the aggregate, we must repay a specified portion of the term loan within five days of the prepayment event.

The credit agreement contains a number of customary covenants for financings of this type that, among other things, restrict our ability to dispose of or create liens on assets, incur additional indebtedness, repay other indebtedness, create liens on assets, make acquisitions and engage in mergers or consolidations. We are also required to comply with specified financial tests and ratios, each as defined in the credit agreement, including a consolidated minimum net worth test and a maximum debt to earnings before interest, taxes, depreciation and amortization (EBITDA) ratio. A breach of these requirements would give rise to certain remedies under the credit agreement, among which are the termination of the agreement and acceleration of the outstanding borrowings plus accrued and unpaid interest under the credit facility.

This new credit facility replaced our prior credit facility which would have matured in June 2006. A portion of the proceeds from the new credit facility were used to finance the Chillicothe acquisition.

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On April 28, 2006, we completed an offering of \$200.0 million aggregate principal amount of our 7<sup>1</sup>/<sub>8</sub>% Senior Notes due 2016. Net proceeds from this offering totaled approximately \$196.4 million, after deducting the commissions and other fees and expenses relating to the offering. We primarily used the net proceeds to redeem \$150.0 million aggregate principal amount of our outstanding 6<sup>7</sup>/<sub>8</sub>% notes due July 2007, plus the payment of the applicable redemption premium and accrued interest.

Interest on these Senior Notes accrues at the rate of 7<sup>1</sup>/<sub>8</sub>% per annum and is payable semiannually in arrears on May 1 and November 1, commencing on November 1, 2006.

Prior to May 1, 2011, we may redeem all, but not less than all, of the notes at a redemption price equal to 100% of the principal amount thereof plus accrued and unpaid interest, if any, plus a make-whole premium. On or after May 1, 2011, we may redeem some or all of the notes at specified redemption prices. In addition, prior to May 1, 2009, we may redeem up to 35% of the aggregate principal amount of the notes using the net proceeds from certain equity offerings.

The 7<sup>1</sup>/<sub>8</sub>% Senior Note agreement contains a cross-default clause that provides if there were to be an event of default under the credit agreement discussed earlier, we would also be in default under the 7<sup>1</sup>/<sub>8</sub>% Senior Notes.

On March 21, 2003, we sold approximately 25,500 acres of timberlands and received as consideration a \$37.9 million 10-year interest bearing note receivable from the timberland buyer. We pledged this note as collateral under a \$34.0 million promissory note payable to SunTrust Financial (the Note Payable). The Note Payable bears interest at a fixed rate of 3.82% for five years at which time we can elect to renew the obligation.

The following schedule sets forth the maturity of our long-term debt during the indicated year.

*In thousands*

2006	\$
2007	15,000
2008	54,000
2009	25,000
2010	25,000
Thereafter	292,608

P. H. Glatfelter Company guarantees debt obligations of all its subsidiaries. All such obligations are recorded in these condensed consolidated financial statements.

At September 30, 2006 we had \$6.6 million of letters of credit issued to us by a financial institution. The letters of credit are primarily for the benefit of certain state workers compensation insurance agencies in conjunction with our self-insurance program. No amounts were outstanding under the letters of credit. We bear the credit risk on this amount to the extent that we do not comply with the provisions of certain agreements. The letters of credit do not reduce the amount available under our lines of credit.

#### **10. COMMITMENTS, CONTINGENCIES AND LEGAL PROCEEDINGS**

**Ecusta Division Matters** At September 30, 2006, we had reserves for various matters associated with our former Ecusta Division. Activity in these reserves during the periods indicated is summarized below.

<i>In thousands</i>	Ecusta Environmental Matters	Workers' Comp	Other	Total
Balance, Jan. 1, 2006	\$ 8,105	\$ 1,913	\$ 3,300	\$ 13,318
Accruals				
Payments	(673)	(262)	(3,262)	(4,197)
Other Adjustments			(38)	(38)

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Balance, September 30, 2006	\$ 7,432	\$ 1,651	\$	\$ 9,083
Balance, Jan. 1, 2005	\$ 6,391	\$ 2,144	\$ 3,300	\$ 11,835
Accruals	2,700			2,700
Payments	(756)	(21)		(777)
Balance, September 30, 2005	\$ 8,335	\$ 2,123	\$ 3,300	\$ 13,758

With respect to the reserves set forth above as of September 30, 2006, \$1.3 million is recorded under the caption Other current liabilities and \$7.8 million is recorded under the caption Other long-term liabilities in the accompanying condensed consolidated balance sheets.

The following discussion provides more details on each of these matters.

**Background Information** In August 2001, pursuant to an acquisition agreement (the Acquisition Agreement), we sold the assets of our Ecusta Division to four related entities, consisting of Purico (IOM) Limited, an Isle of Man limited liability company ( Purico ), and RF&Son Inc. ( RF ), RFS US Inc. ( RFS US ) and RFS Ecusta Inc. ( RFS Ecusta ), each of which is a Delaware corporation, (collectively, the Buyers ).

In August 2002, the Buyers shut down the manufacturing operation of the pulp and paper mill in Pisgah Forest, North Carolina, which was the most significant operation of the Ecusta Division. On October 23, 2002, RFS Ecusta and RFS US (the Debtors ) filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. The bankruptcy cases were later converted to Chapter 7

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proceedings. In accordance with the provisions of the Acquisition Agreement, we notified the Buyers of third party claims ( Third Party Claims ) made against us for which we sought indemnification from the Buyers. The Third Party Claims primarily relate to certain environmental matters, post-retirement benefits, workers' compensation claims and vendor payables.

Effective August 8, 2003, the assets of RFS Ecusta and RFS US, which substantially consist of the pulp and paper mill and related real property, were sold to several third parties unrelated to the Buyers (the New Buyers ). We understand the New Buyers' business plan was to continue certain mill-related operations and to convert portions of the mill site into a business park.

**Ecusta Environmental Matters** Beginning in April 2003, government authorities, including the North Carolina Department of Environment and Natural Resources ( NCDENR ), initiated discussions with us and the New Buyers regarding, among other environmental issues, certain landfill closure liabilities associated with the Ecusta mill and its properties. The discussions focused on NCDENR's desire to establish a plan and secure financial resources to close three landfills located at the Ecusta facility and to address other environmental matters at the facility. During the third quarter of 2003, the discussions ended with NCDENR's conclusion to hold us responsible for the closure of three landfills. Accordingly, we established reserves approximating \$7.6 million. In March 2004 and September 2005, the NCDENR issued us separate orders requiring the closure of two of the three landfills at issue. We have completed the closure of these two landfills and are in the process of obtaining approved closure plans for the third.

In October 2004, one of the New Buyers entered into a Brownfields Agreement with the NCDENR relating to the Ecusta mill, pursuant to which the New Buyer was to be held responsible for certain specified environmental concerns.

In September 2005, NCDENR sought our participation, pursuant to a proposed consent order, in the evaluation and potential remediation of environmentally hazardous conditions at the former Ecusta mill site. In January 2006, NCDENR modified its proposed consent order to include us and the company (the Prior Owner ) from whom our predecessor, Ecusta Corporation, purchased the Ecusta mill. NCDENR and the United States Environmental Protection Agency ( USEPA ) have indicated that if neither party enters into the proposed consent order EPA will likely list the mill site on the National Priorities List and pursue assessment and remediation of the site under the Comprehensive Environmental Responsibility, Compensation and Liability Act (more commonly known as Superfund ). In

addition to calling for the assessment, closure, and post-closure monitoring and maintenance of the third landfill for which we had previously been held responsible, the proposed consent order asserts concerns regarding:

- i. mercury and certain other contamination on and around the site;
- ii. potentially hazardous conditions existing in the sediment and water column of the site's water treatment and aeration and sedimentation basin (the ASB ); and
- iii. contamination associated with two additional landfills on the site that were not used by us.

With respect to the concerns set forth above (collectively, the NCDENR matters ) we believe the Prior Owner has primary liability for the mercury contamination; that the New Buyers, as owner and operator of the ASB, have primary liability for addressing any issues associated with the ASB, including closure, and that the New Buyers, in a May 2004 agreement, expressly agreed to indemnify and hold us harmless from certain environmental liabilities, which include most, if not all, of the NCDENR matters. We continue to have discussions with NCDENR and USEPA concerning our potential responsibilities and appropriate remedial actions, if any, which may be necessary.

In addition, it is possible the New Buyers may not have sufficient cash flow to continue meeting certain obligations to NCDENR and us. Specifically, the New Buyers are obligated (i) to treat leachate and stormwater runoff from the landfills, which we are currently required to manage, and (ii) to pump and treat contaminated groundwater in the vicinity of a former caustic building at the site. If the New Buyers should default on these obligations, it is possible that NCDENR will require us to make appropriate arrangements for the treatment and disposal of the landfill waste streams and to be responsible for the remediation of certain contamination on and around the site (collectively, the New Buyers Matters ).

As a result of NCDENR's September 2005 communication with us and our assessment of the range of likely outcomes of the NCDENR Matters and the New Buyers Matters, our results of operations for 2005 included a \$2.7 million charge to increase our reserve for estimated costs associated with the Ecusta environmental matters. The addition to the reserve includes estimated operating costs associated with continuing certain water treatment facilities at the site which are necessary to treat leachate discharges from certain of the landfills, the closure for which we had previously reserved, estimated costs to perform an assessment of certain risks posed by the presence of mercury, further characterization of sediment in the ASB and treatment of other contamination.

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The reserves relating to additional environmental assessment activities were premised, in part, on the belief that it might be mutually beneficial to us and NCDENR if we were to agree to perform the assessment activities, without accepting responsibility for any subsequently required remediation. However, it is currently unclear whether NCDENR and EPA will accept such an arrangement. It is equally uncertain what action will be taken by EPA and NCDENR in the absence of a consent order (and against whom) and what remediation, if any, will be required if and when additional assessments are performed.

In addition, it is unclear how liability for any required assessment or remediation will be apportioned among the Prior Owner, Glatfelter, the Buyers and the New Buyers. Therefore, the 2005 charge does not include costs associated with further remediation activities that we may be required to perform, the range of which we are currently unable to estimate, however, they could be significant.

The New Buyers' ability to fulfill their obligations to NCDENR and us, in the absence of sufficient cash flow from their operations, may be dependent on their ability to complete a sale of the site.

Notwithstanding a potential sale of the property, and with respect to alleged mercury contamination at the site, i) the extent of contamination, if any, is unknown, ii) it is unclear whether we will be required to remediate iii) the apportionment of liability amongst us, the Prior Owner and/or the New Buyers is unknown; and iv) the ultimate costs to remedy are not reasonably estimable based on information currently available to us. Accordingly, no amounts for such potential actions have been included in our reserve discussed above. If we are required to complete additional remedial actions, further charges would be required, and such amounts could be material.

We are evaluating potential legal claims and defenses we may have with respect to any other parties including previous owners of the site and their obligations and/or cost recoveries. We are also evaluating options for ensuring that the New Buyers fulfill their obligations with respect to the New Buyers Matters. We are uncertain as to what additional Ecusta-related claims, including, among others, environmental matters, government oversight and/or government past costs, if any, may be asserted against us.

**Workers' Compensation** Prior to 2003, we established reserves related to potential workers' compensation claims associated with the former Ecusta division which at that time were estimated to total approximately \$2.2 million. In the fourth quarter of 2005, the North Carolina courts issued a ruling that held us liable for workers' compensation claims of certain

employees that were injured during their employment at the Ecusta facility prior to our sale of the Division. Since this ruling, we have made payments as indicated in the reserve analysis presented earlier in this Note 10.

**Other** In October 2004, the bankruptcy trustee for the estates of RFS Ecusta and RFS US filed a complaint in the U.S. Bankruptcy Court for the Western District of North Carolina against certain of the Buyers and other related parties ( Defendant Buyers ) and us. The complaint alleged, among other things, that the Defendant Buyers engaged in fraud and fraudulent transfers and breached their fiduciary duties. With respect to Glatfelter, the complaint alleged that we aided and abetted the Defendant Buyers in their purported actions in the structuring of the acquisition of the Ecusta Division and asserts a claim against us under the Bankruptcy Code. The trustee sought damages from us in an amount not less than \$25.8 million, plus interest, and other relief.

The bankruptcy trustee filed another complaint, also in the U.S. Bankruptcy Court for the Western District of North Carolina, against us, certain banks and other parties, seeking, among other things, damages totaling \$6.5 million for alleged breaches of the Acquisition Agreement (the Breach Claims ), release of certain amounts held in escrow totaling \$3.5 million (the Escrow Claims ) and recoveries of unspecified amounts allegedly payable under the Acquisition Agreement and a related agreement. We have previously reserved such escrowed amounts and they were recorded in the accompanying Condensed Consolidated Balance Sheets as Other long-term liabilities.

All of the bankruptcy trustee's actions against us were settled pursuant to an agreement approved by the United States District Court for the Western District of North Carolina on September 8, 2006. Under the terms of the settlement, the trustee received approximately \$3.1 million of the amounts previously held in escrow and for which we had previously reserved. The trustee also retained a \$1.6 million certificate of deposit that one of the Debtors had posted with the State of North Carolina to insure certain workers' compensation obligations. As part of the settlement, we assigned any claims we may have had against the Defendant Buyers to the trustee and will receive a percentage of the trustee's recovery from such parties, if any.

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**Fox River Neenah, Wisconsin** We have previously reported with respect to potential environmental claims arising out of the presence of polychlorinated biphenyls ( PCBs ) in sediments in the lower Fox River and in the Bay of Green Bay, downstream of our Neenah, Wisconsin facility. We acquired the Neenah facility in 1979 as part of the acquisition of the Bergstrom Paper Company. In part, this facility used wastepaper as a source of fiber. At no time did the Neenah facility utilize PCBs in the pulp and paper making process, but discharges from the facility containing PCBs from wastepaper may have occurred from 1954 to the late 1970s. Any PCBs that the Neenah facility discharged into the Fox River resulted from the presence of NCR®-brand carbonless copy paper in the wastepaper that was received from others and recycled.

As described below, various state and federal governmental agencies have formally notified nine potentially responsible parties ( PRPs ), including us, that they are potentially responsible for response costs and natural resource damages ( NRDs ) arising from PCB contamination in the lower Fox River and in the Bay of Green Bay, under the Comprehensive Environmental Response, Compensation and Liability Act ( CERCLA ) and other statutes. The other identified PRPs are NCR Corporation, Appleton Papers Inc., Georgia Pacific Corp. (formerly Fort Howard Corp. and Fort James), WTM I Company (a subsidiary of Chesapeake Corp.), Riverside Paper Corporation, U.S. Paper Mills Corp. (a subsidiary of Sonoco Products Company), Sonoco Products Company, and Menasha Corporation.

CERCLA establishes a two-part liability structure that makes responsible parties liable for (1) response costs associated with the remediation of a release of hazardous substances and (2) NRDs related to that release. Courts have interpreted CERCLA to impose joint and several liabilities on responsible parties for response costs, subject to equitable allocation in certain instances. Prior to a final settlement by all responsible parties and the final cleanup of the contamination, uncertainty regarding the application of such liability will persist.

The areas of the lower Fox River and in the Bay of Green Bay in which the contamination exists are commonly referred to as Operable Unit 1 ( OU1 ), which consists of Little Lake Butte des Morts, the portion of the river that is closest to our Neenah facility, Operable Unit 2 ( OU2 ), which is the portion of the river between dams at Appleton and Little Rapids, and Operable Units 3 through 5 ( OU3-5 ), an area approximately 20 miles downstream of our Neenah facility.

The following summarizes the status of our potential exposure:

***Response Actions***

**OU1 and OU2** On January 7, 2003, the Wisconsin Department of Natural Resources (the Wisconsin DNR ) and the Environmental Protection Agency ( EPA ) issued a Record of Decision ( ROD ) for the cleanup of OU1 and OU2. Subject to extenuating circumstances and alternative solutions that may arise during the cleanup, the ROD requires the removal of approximately 784,000 cubic yards of sediment from OU1 and no active remediation of OU2. The ROD also requires the monitoring of the two operable units. Based on the remediation activities completed to date, contract proposals received for the remaining remediation work, and the potential availability of alternative remedies under the ROD, we believe the total remediation of OU1 will cost between \$61 million and \$137 million.

On July 1, 2003, WTM I Company entered into an Administrative Order on Consent ( AOC ) with EPA and the Wisconsin DNR regarding the implementation of the Remedial Design for OU1.

In the first quarter of 2004, the United States District Court for the Eastern District of Wisconsin approved a consent decree regarding OU1 ( the OU1 Consent Decree ). Under terms of the OU1 Consent Decree, Glatfelter and WTM I Company each agreed to pay approximately \$27 million, of which \$25.0 million from each was placed in escrow to fund response work associated with remedial actions specified in the ROD. The remaining amount that the parties agreed to pay under the Consent Decree includes payments for NRD, and NRD assessment and other past costs incurred by the governments. In addition, EPA agreed to take steps to place \$10 million from another source into escrow for the OU1 cleanup, all of which has been received.

The terms of the OU1 Consent Decree and the underlying escrow agreement restrict the use of the funds to qualifying remediation activities or restoration activities at the lower Fox River site. The response work is being managed and/or performed by Glatfelter and WTM I, with governmental oversight, and funded by the amounts placed in escrow. Beginning in mid 2004, Glatfelter and WTM I have performed activities to remediate OU1, including, among others, construction of de-watering and water-treatment facilities, dredging of portions of OU1, dewatering of the dredged materials, and hauling of the dewatered sediment to an authorized disposal facility. Since the start of these

activities, to date approximately 163,000 cubic yards of contaminated sediment has been dredged.

The terms of the OU1 Consent Decree include provisions to be followed should the escrow account be depleted prior to completion of the response work. In this event, each company would be notified and be provided

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an opportunity to contribute additional funds to the escrow account and to extend the remediation effort. Should the OU1 Consent Decree be terminated due to insufficient funds, each company would lose the protections contained in the settlement and the governments may turn to one or both parties for the completion of OU1 clean up. In such a situation, the governments may also seek response work from a third party, or perform the work themselves and seek response costs from any or all PRPs for the site, including Glatfelter. Based on information currently available to us, and subject to government approval of the use of alternative remedies, we believe the required remedial actions can be completed with the amount of monies committed under the Consent Decree. If the Consent Decree is terminated due to the insufficiency of the escrow funds, Glatfelter and WTM I each remain potentially responsible for the costs necessary to complete the remedial action.

As of September 30, 2006, our portion of the escrow account totaled approximately \$9.5 million, of which \$4.7 million is recorded in the accompanying Consolidated Balance Sheet under the caption Prepaid expenses and other current assets and \$4.8 million is included under the caption Other assets. As of September 30, 2006, our reserve for environmental liabilities, substantially all of which is for OU1 remediation activities, totaled \$10.6 million.

**OUs 3 - 5** On July 28, 2003, the EPA and the Wisconsin DNR issued a ROD (the Second ROD) for the cleanup of OU3 - 5. The Second ROD calls for the removal of 6.5 million cubic yards of sediment and certain monitoring at an estimated cost of \$324.4 million but could, according to the Second ROD, cost within a range from approximately \$227.0 million to \$486.6 million. The most significant component of the estimated costs is attributable to large-scale sediment removal by dredging.

During the first quarter of 2004, NCR Corp. and Georgia Pacific Corp. entered into an AOC with the United States EPA under which they agreed to perform the Remedial Design for OUs 3-5, thereby accomplishing a first step towards remediation.

We do not believe that we have more than a *de minimis* share of any equitable distribution of responsibility for OU3 - 5 after taking into account the location of our Neenah facility relative to the site and considering other work or funds committed or expended by us. However, uncertainty regarding responsibilities for the cleanup of these sites continues due to disagreement over a fair allocation or apportionment of responsibility.

**Natural Resource Damages** The ROD and Second ROD do not place any value on claims for NRDs associated with this matter. As noted above, NRD claims are distinct from costs related to the primary remediation of a Superfund site. Calculating the value of NRD claims is difficult, especially in the absence of a completed remedy for the underlying contamination. The State of Wisconsin, the United States Fish and Wildlife Service (FWS), the National Oceanic and Atmospheric Administration (NOAA), four Indian tribes and the Michigan Attorney General have asserted that they possess NRD claims related to the lower Fox River and the Bay of Green Bay.

In September 1994, FWS notified the then-identified PRPs that it considered them potentially responsible for NRDs. The federal, tribal and Michigan agencies claiming to be NRD trustees have proceeded with the preparation of an NRD assessment. While the final assessment has yet to be completed, the federal trustees released a plan on October 25, 2000 that values NRDs for injured natural resources that allegedly fall under their trusteeship between \$176 million and \$333 million. We believe that the federal NRD assessment is technically and procedurally flawed. We also believe that the NRD claims alleged by the various alleged trustees are legally and factually without merit.

The OU1 Consent Decree required that Glatfelter and WTM I each pay the governments \$1.5 million for NRDs for the Fox River site, and \$150,000 for NRD assessment costs. Each of these payments was made in return for credit to be applied toward each settling company's potential liability for NRDs associated with the Fox River site.

**Other Information** The Wisconsin DNR and FWS have each published studies, the latter in draft form, estimating the amount of PCBs discharged by each identified PRP to the lower Fox River and the Bay of Green Bay. These reports estimate our Neenah facility's share of the volumetric discharge to be as high as 27%. We do not believe the volumetric estimates used in these studies are accurate because (a) the studies themselves disclose that they are not accurate and (b) the volumetric estimates contained in the studies are based on assumptions that are unsupported by existing evidence. We believe that our volumetric contribution is significantly lower than the estimates set forth in these studies. Further, we do not believe that a volumetric allocation would constitute an equitable distribution of the potential liability for the contamination. Other factors, such as the location of contamination, the location of discharge and a party's role in causing discharge must be considered in order for the allocation to be equitable.

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We have entered into interim cost-sharing agreements with four of the other PRPs, pursuant to which such PRPs have agreed to share both defense costs and costs for scientific studies relating to PCBs discharged into the lower Fox River. These interim cost-sharing agreements have no bearing on the final allocation of costs related to this matter. Based upon our evaluation of the magnitude, nature and location of the various discharges of PCBs to the river and the relationship of those discharges to identified contamination, we believe our share of any liability among the identified PRPs is much less than our per capita share of the cost sharing agreement.

We also believe that there exist additional potentially responsible parties other than the identified PRPs. For instance, certain of the identified PRPs discharged their wastewater through public wastewater treatment facilities, which we believe makes the owners of such facilities potentially responsible in this matter. We also believe that entities providing wastepaper-containing PCBs to each of the recycling mills are also potentially responsible for this matter.

While the OU1 Consent Decree clarifies the extent of the exposure that we may have with regard to the Fox River site, it does not completely resolve our potential liability related to this matter. We continue to believe that this matter may result in litigation, but cannot predict the timing, nature, extent or magnitude of such litigation. We currently are unable to predict our ultimate cost related to this matter.

#### **Reserves for Fox River Environmental Liabilities**

We have reserves for environmental liabilities with contractual obligations and for those environmental matters for which it is probable that a claim will be made, that an obligation may exist, and for which the amount of the obligation is reasonably estimable. The following table summarizes information with respect to such reserves.

<i>In millions</i>	<b>September 30, 2006</b>	December 31, 2005
<i>Recorded as:</i>		
Environmental liabilities	\$ 4.7	\$ 7.6
Other long-term liabilities	5.9	9.2
Total	\$ 10.6	\$ 16.8

The classification of our environmental liabilities is based on the development of the underlying Fox River OU1 remediation plan and execution of the related escrow agreement for the funding thereof. The reserve balance declined as a result of payments associated with remediation activities under the OU1 Consent Decree and items related to the Fox River matter. We did not record charges associated with the Fox River matter to our results of operations during the first nine months of 2005 or 2006. The change in the reserve amounts reflects cash payments made.

Other than with respect to the OU1 Consent Decree, the amount and timing of future expenditures for environmental compliance, cleanup, remediation and personal injury, NRDs and property damage liabilities cannot be ascertained with any certainty due to, among other things, the unknown extent and nature of any contamination, the extent and timing of any technological advances for pollution abatement, the response actions that may be required, the availability of qualified remediation contractors, equipment, and landfill space, and the number and financial resources of any other PRPs.

**Range of Reasonably Possible Outcomes** Based on currently available information, including actual remediation costs incurred to date, we believe that the remediation of OU1 can be satisfactorily completed for the amounts provided under the OU1 Consent Decree. Our assessment is dependent, in part, on government approval of the use of alternative remedies in OU1, on the successful negotiation of acceptable contracts to complete remediation activities, and an effective implementation of the chosen technologies by the remediation contractor. However, if we are unsuccessful in managing our costs to implement the ROD or if alternative remedies are not accepted by government authorities, additional charges may be necessary.

The OU1 Consent Decree does not address response costs necessary to remediate the remainder of the Fox River site and only addresses NRDs and claims for reimbursement of government expenses to a limited extent. Due to judicial interpretations that find CERCLA imposes joint and several liability, uncertainty persists regarding our exposure with respect to the remainder of the Fox River site.

Based on our analysis of currently available information and experience regarding the cleanup of hazardous substances, we believe that it is reasonably possible that our costs associated with the lower Fox River and the Bay of Green Bay may exceed our original reserves by amounts that may prove to be insignificant or that could range, in the aggregate, up to approximately \$125 million, over a period that is undeterminable but that could range beyond 20 years. We believe that the likelihood of an outcome in the upper end of the monetary range is significantly less than other possible outcomes within the range and that the possibility of an outcome in excess of the upper end of the monetary range is remote.

In our estimate of the upper end of the range, we have considered: (i) the remedial actions agreed to in the OU1

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Consent Decree and our belief that the required work can be accomplished with the funds to be escrowed under the OU1 Consent Decree; and (ii) no active remediation of OU2. We have also assumed dredging for the remainder of the Fox River site as set forth in the Second ROD, although at a significantly higher cost than estimated in the Second ROD. We have also assumed our share of the ultimate liability to be 18%, which is significantly higher than we believe is appropriate or than we will incur, and a level of NRD claims and claims for reimbursement of expenses from other parties that, although reasonably possible, is unlikely.

In estimating both our current reserves for environmental remediation and other environmental liabilities and the possible range of additional costs, we have assumed that we will not bear the entire cost of remediation and damages to the exclusion of other known PRPs who may be jointly and severally liable. The ability of other PRPs to participate has been taken into account, generally based on their financial condition and probable contribution. Our evaluation of the other PRPs' financial condition included the review of publicly available financial information. Furthermore, we believe certain of these PRPs have corporate or contractual relationships with additional entities that may shift to those entities some or all of the monetary obligations arising from the Fox River site. The relative probable contribution is based upon our knowledge that at least two PRPs manufactured the paper, and arranged for the disposal of the wastepaper, that included the PCBs and consequently, in our opinion, bear a higher level of responsibility.

In addition, our assessment is based upon the magnitude, nature and location of the various discharges of PCBs to the river and the relationship of those discharges to identified contamination. We continue to evaluate our exposure and the level of our reserves, including, but not limited to, our potential share of the costs and NRDs, if any, associated with the Fox River site.

**Summary** Our current assessment is that we should be able to manage these environmental matters without a long-term, material adverse impact on the Company. These matters could, however, at any particular time or for any particular year or years, have a material adverse effect on our consolidated financial position, liquidity and/or results of operations or could result in a default under our loan covenants. Moreover, there can be no assurance that our reserves will be adequate to provide for future obligations related to these matters, that our share of costs and/or damages for these matters will not exceed our available resources, or that such obligations will not have a long-term, material adverse effect on our consolidated financial position, liquidity or results of operations. With regard to the Fox River site, if we are not successful in managing the implementation of the OU1 Consent Decree and/or if we are ordered to implement the remedy proposed in the Second ROD, such developments could have a material adverse effect on our consolidated financial position, liquidity and results of operations and may result in a default under our loan covenants.

In addition to the specific matters discussed above, we are subject to loss contingencies resulting from regulation by various federal, state, local and foreign governments with respect to the environmental impact of our mills. To comply with environmental laws and regulations, we have incurred substantial capital and operating expenditures in past years. We anticipate that environmental regulation of our operations will continue to become more burdensome and that capital and operating expenditures necessary to comply with environmental regulations will continue, and perhaps increase, in the future. In addition, we may incur obligations to remove or mitigate the adverse effects, if any, on the environment resulting from our operations, including the restoration of natural resources and liability for personal injury and for damages to property and natural resources.

We are also involved in other lawsuits that are ordinary and incidental to our business. The ultimate outcome of these lawsuits cannot be predicted with certainty; however, we do not expect that such lawsuits in the aggregate or individually will have a material adverse effect on our consolidated financial position, liquidity or results of operations.

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**11. SEGMENT INFORMATION**

The following table sets forth financial and other information by business unit for the periods indicated:

<b>Business Unit Performance</b>	For the three months ended September 30,							
	Specialty Papers		Composite Fibers		Other and Unallocated		Total	
<i>In thousands</i>	2006	2005	2006	2005	2006	2005	2006	2005
Net sales	\$ 202,096	\$ 100,500	\$ 75,393	\$ 46,259	\$	\$ 21	\$ 277,489	146,780
Energy sales, net	2,706	2,414					2,706	2,414
Total revenue	204,802	102,914	75,393	46,259		21	280,195	149,194
Cost of products sold	183,364	87,808	62,240	39,475	(3,312)	(3,705)	242,292	123,578
Gross profit (loss)	21,438	15,106	13,153	6,784	3,312	3,726	37,903	25,616
SG&A	11,374	9,716	8,023	4,926	5,193	3,419	24,590	18,061
Shutdown and restructuring charges					2,222		2,222	
Gains on dispositions of plant, equipment and timberlands					(923)	(1,327)	(923)	(1,327)
Total operating income (loss)	10,064	5,390	5,130	1,858	(3,180)	1,634	12,014	8,882
Nonoperating income (expense)					(5,750)	(2,563)	(5,750)	(2,563)
Income (loss) before income taxes	\$ 10,064	\$ 5,390	\$ 5,130	\$ 1,858	\$ (8,930)	\$ (929)	\$ 6,264	\$ 6,319
<b>Supplementary Data</b>								
Net tons sold	180,365	119,257	17,919	11,454		9	198,284	130,720
Depreciation expense	\$ 8,163	\$ 8,963	\$ 4,344	\$ 3,567			\$ 12,507	\$ 12,530

<b>Business Unit Performance</b>	For the nine months Ended September 30,							
	Specialty Papers		Composite Fibers		Other and Unallocated		Total	
<i>In thousands</i>	2006	2005	2006	2005	2006	2005	2006	2005
Net sales	\$ 507,906	\$ 287,727	\$ 209,909	\$ 148,183		\$ 49	\$ 717,815	\$ 435,959
Energy sales, net	8,010	7,673					8,010	7,673
Total revenue	515,916	\$ 295,400	209,909	148,183		49	725,825	443,632
Cost of products sold	469,857	257,161	177,962	123,516	14,105	(11,088)	661,924	369,589
Gross profit (loss)	46,059	38,239	31,947	24,667	(14,105)	11,137	63,901	74,043
SG&A	35,361	29,785	20,608	17,196	10,358	5,444	66,327	52,425
					28,177		28,177	

Shutdown and restructuring charges									
Gains on dispositions of plant, equipment and timberlands					<b>(2,008)</b>	(1,408)	<b>(2,008)</b>	(1,408)	
Gain on insurance recoveries					<b>(205)</b>	(2,200)	<b>(205)</b>	(2,200)	
Total operating income (loss)	<b>10,698</b>	8,454	<b>11,339</b>	7,471	<b>(50,427)</b>	9,301	<b>(28,390)</b>	25,226	
Nonoperating income (expense)					<b>(16,065)</b>	(7,820)	<b>(16,065)</b>	(7,820)	
Income (loss) before income taxes	<b>\$ 10,698</b>	\$ 8,454	<b>\$ 11,339</b>	\$ 7,471	<b>\$ (66,492)</b>	\$ 1,481	<b>\$ (44,455)</b>	\$ 17,406	

**Supplementary Data**

Net tons sold	<b>488,305</b>	341,200	<b>50,471</b>	35,181	<b>10</b>	16	<b>538,786</b>	376,397
Depreciation expense	<b>\$ 24,487</b>	\$ 26,832	<b>\$ 12,635</b>	\$ 11,354			<b>\$ 37,122</b>	\$ 38,186

Results of individual business units are presented based on our management accounting practices and management structure. There is no comprehensive, authoritative body of guidance for management accounting equivalent to accounting principles generally accepted in the United States of America; therefore, the financial results of individual business units are not necessarily comparable with similar information for any other company. The management accounting process uses assumptions and allocations to measure performance of the business units. Methodologies are refined from time to time as management accounting practices are enhanced and businesses change. The costs incurred by support areas not directly aligned with the business unit are allocated primarily based on an estimated utilization of support area services or included in Other and Unallocated in the table above. Certain prior period information has been reclassified to conform to the current period presentation.

Management evaluates results of operations of the business units before non-cash pension income, restructuring related charges, unusual items, effects of asset dispositions and insurance recoveries because it believes this is a more meaningful representation of the operating performance of its core papermaking businesses, the profitability of business units and the extent of cash flow generated from core operations. This presentation is closely aligned with the management and operating structure of our company. It is also on this basis that the Company's performance is evaluated internally and by the Company's Board of Directors.

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**12. GUARANTOR FINANCIAL STATEMENTS**

Our 7<sup>1</sup>/<sub>8</sub>% Senior Notes have been fully and unconditionally guaranteed, on a joint and several basis, by certain of our 100%-owned domestic subsidiaries, PHG Tea Leaves, Inc., Mollanvick, Inc., The Glatfelter Pulp Wood Company, GLT International Finance, LLC, Glenn-Wolfe, Inc., Glatfelter Holdings, LLC and Glatfelter Holdings II, LLC.

The following presents our condensed consolidating statements of income and cash flow for the three and nine months ended September 30, 2006 and 2005 and our condensed consolidating balance sheets as of September 30, 2006 and December 31, 2005. These financial statements reflect P. H. Glatfelter Company (the parent), the guarantor subsidiaries (on a combined basis), the non-guarantor subsidiaries (on a combined basis) and elimination entries necessary to combine such entities on a consolidated basis.

**Condensed Consolidating Statement of Income for the  
three months ended September 30, 2006**

<i>In thousand</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
Net sales	\$ 202,096	\$ 8,834	\$ 75,393	\$ (8,834)	\$ 277,489
Energy sales net	2,706				2,706
Total revenues	204,802	8,834	75,393	(8,834)	280,195
Costs of products sold	180,521	8,577	61,795	(8,601)	242,292
Gross profit	24,281	257	13,598	(233)	37,903
Selling, general and administrative expenses	15,982	563	8,045		24,590
Shutdown and restructuring charges	2,181		41		2,222
Gains on dispositions of plant, equipment and timberlands, net	(664)	(514)	255		(923)
Gains from insurance recoveries					
Operating income	6,782	208	5,257	(233)	12,014
Non-operating income (expense)					
Interest expense	(5,888)		(1,124)		(7,012)
Other income (expense) net	1,834	13,693	(1,484)	(12,781)	1,262
Total other income (expense)	(4,054)	13,693	(2,608)	(12,781)	(5,750)
Income (loss) before income taxes	2,728	13,901	2,649	(13,014)	6,264
Income tax provision (benefit)	(2,640)	4,870	(108)	(1,226)	896
Net income (loss)	\$ 5,368	\$ 9,031	\$ 2,757	\$ (11,788)	\$ 5,368

**Condensed Consolidating Statement of Income for the  
three months ended September 30, 2005**

<i>In thousand</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
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Net sales	\$ 100,501	\$ 9,094	\$ 46,279	\$ (9,094)	\$ 146,780
Energy sales net	2,414				2,414
Total revenues	102,915	9,094	46,279	(9,094)	149,194
Costs of products sold	83,983	9,070	39,853	(9,328)	123,578
Gross profit	18,932	24	6,426	234	25,616
Selling, general and administrative expenses	12,745	350	4,966		18,061
Shutdown and restructuring charges					
Gains on dispositions of plant, equipment and timberlands, net	(886)	(480)	39		(1,327)
Gains from insurance recoveries					
Operating income	7,073	154	1,421	234	8,882
Non-operating income (expense)					
Interest expense	(2,695)		(636)		(3,331)
Other income (expense) net	(2,884)	10,792	(301)	(6,839)	768
Total other income (expense)	(5,579)	10,792	(937)	(6,839)	(2,563)
Income (loss) before income taxes	1,494	10,946	484	(6,605)	6,319
Income tax provision (benefit)	(2,169)	4,217	697	(89)	2,656
Net income (loss)	\$ 3,663	\$ 6,729	\$ (213)	\$ (6,516)	\$ 3,663

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**Condensed Consolidating Statement of Income for the nine  
months ended September 30, 2006**

<i>In thousand</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
Net sales	\$ 507,905	\$ 27,041	\$ 209,910	\$ (27,041)	\$ 717,815
Energy sales net	8,010				8,010
Total revenues	515,915	27,041	209,910	(27,041)	725,825
Costs of products sold	485,929	24,775	177,793	(26,573)	661,924
Gross profit	29,986	2,266	32,117	(468)	63,901
Selling, general and administrative expenses	43,231	1,989	21,107		66,327
Shutdown and restructuring charges	28,056		121		28,177
Gains on dispositions of plant, equipment and timberlands, net	(584)	(1,716)	292		(2,008)
Gains from insurance recoveries	(205)				(205)
Operating income	(40,512)	1,993	10,597	(468)	(28,390)
Non-operating income (expense)					
Interest expense	(14,845)	(463)	(2,267)		(17,575)
Other income (expense) net	(2,408)	39,554	(3,410)	(32,226)	1,510
Total other income (expense)	(17,253)	39,091	(5,677)	(32,226)	(16,065)
Income (loss) before income taxes	(57,765)	41,084	4,920	(32,694)	(44,455)
Income tax provision (benefit)	(30,548)	14,622	671	(1,983)	(17,238)
Net income (loss)	\$ (27,217)	\$ 26,462	\$ 4,249	\$ (30,711)	\$ (27,217)

**Condensed Consolidating Statement of Income for the nine  
months ended September 30, 2005**

<i>In thousand</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
Net sales	\$ 287,711	\$ 26,820	\$ 148,287	\$ (26,859)	\$ 435,959
Energy sales net	7,673				7,673
Total revenues	295,384	26,820	148,287	(26,859)	443,632
Costs of products sold	246,670	25,724	124,424	(27,229)	369,589
Gross profit	48,714	1,096	23,863	370	74,043
Selling, general and administrative expenses	33,737	1,364	17,324		52,425

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Shutdown and restructuring charges					
Gains on dispositions of plant, equipment and timberlands, net	(839)	(608)	39		(1,408)
Gains from insurance recoveries	(2,200)				(2,200)
Operating income	18,016	340	6,500	370	25,226
Non-operating income (expense)					
Interest expense	(8,090)		(1,791)		(9,881)
Other income (expense) net	(5,077)	30,433	(950)	(22,345)	2,061
Total other income (expense)	(13,167)	30,433	(2,741)	(22,345)	(7,820)
Income (loss) before income taxes	4,849	30,773	3,759	(21,975)	17,406
Income tax provision (benefit)	(6,813)	11,143	1,884	(470)	5,744
Net income (loss)	\$ 11,662	\$ 19,630	\$ 1,875	\$ (21,505)	\$ 11,662

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**Condensed Consolidating Balance Sheet as of September 30, 2006**

<i>In thousands</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
<b>Assets</b>					
<b>Current assets</b>					
Cash and cash equivalents	\$ (407)	\$ 747	\$ 13,541	\$	\$ 13,881
Other current assets	229,726	9,815	113,477	(984)	352,034
Plant, equipment and timberlands net	306,308	13,825	206,456		526,589
Other assets	1,265,104	922,617	(57,326)	(1,756,015)	374,380
Total assets	\$ 1,800,731	\$ 947,004	\$ 276,148	\$ (1,756,999)	\$ 1,266,884
<b>Liabilities and Shareholders Equity</b>					
Current liabilities	\$ 136,135	\$ 2,957	\$ 36,492	\$ (7,963)	\$ 167,621
Long-term debt	316,321		84,037		400,358
Deferred income taxes	176,723	14,704	23,032	(10,140)	204,319
Other long-term liabilities	764,117	75,491	88,787	(841,244)	87,151
Total liabilities	1,393,296	93,152	232,348	(859,347)	859,449
Shareholders' equity	407,435	853,852	43,800	(897,652)	407,435
Total liabilities and shareholders equity	\$ 1,800,731	\$ 947,004	\$ 276,148	\$ (1,756,999)	\$ 1,266,884

**Condensed Consolidating Balance Sheet as of December 31, 2005**

<i>In thousands</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
<b>Assets</b>					
<b>Current assets</b>					
Cash and cash equivalents	\$ 14,404	\$ 30,615	\$ 12,390	\$ 33	\$ 57,442
Other current assets	90,964	1,936	76,118	(2,903)	166,115
Plant, equipment and timberlands net	322,208	13,537	143,083		478,828
Other assets	1,065,934	746,701	14,677	(1,484,720)	342,592
Total assets	\$ 1,493,510	\$ 792,789	\$ 246,268	\$ (1,487,590)	\$ 1,044,977
<b>Liabilities and Shareholders Equity</b>					



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Current liabilities	\$ 75,465	\$ 2,772	\$ 61,629	\$ 12	\$ 139,878
Long-term debt	150,000		34,000		184,000
Deferred income taxes	174,854	10,585	24,003	(3,173)	206,269
Other long-term liabilities	660,879	36,581	85,441	(700,383)	82,518
Total liabilities	1,061,198	49,938	205,073	(703,544)	612,665
Shareholders' equity	432,312	742,851	41,195	(784,046)	432,312
Total liabilities and shareholders equity	\$ 1,493,510	\$ 792,789	\$ 246,268	\$ (1,487,590)	\$ 1,044,977

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**Condensed Consolidating Statement of Cash Flows for the nine months ended September 30, 2006**

<i>In thousands</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
Net cash provided (used) by Operating Activities	\$ (64,945)	\$ 40,017	\$ (20,611)	\$ (33)	\$ (45,572)
Investing Activities					
Purchase of plant, equipment and timberlands	(29,259)	(999)	(4,967)		(35,225)
Proceeds from disposal plant, equipment and timberlands	2,921	51	3		2,975
Acquisition of Lydney mill and Chillicothe	(89,211)	(68,937)			(158,148)
Total Investing Activities	(115,549)	(69,885)	(4,964)		(190,398)
Financing Activities					
Net (repayments of) proceeds from indebtedness	170,354		27,499		197,853
Payment of Dividends	(11,993)				(11,993)
Proceeds from Stock Options exercised	7,322				7,322
Total Financing Activities	165,683		27,499		193,182
Effect of Exchange Rate on Cash			(773)		(773)
Net Increase (decrease) in cash	(14,811)	(29,868)	1,151	(33)	(43,561)
Cash at the beginning of period	14,404	30,615	12,390	33	57,442
Cash at the end of period	\$ (407)	\$ 747	\$ 13,541		\$ 13,881

**Condensed Consolidating Statement of Cash Flows for the nine months ended September 30, 2005**

<i>In thousands</i>	Parent Company	Guarantors	Non Guarantors	Adjustments/ Eliminations	Consolidated
Net cash provided (used) by Operating Activities	\$ 7,654	\$ 258	\$ 7,531	\$ (3,847)	\$ 11,596
Investing Activities					
Purchase of plant, equipment and timberlands	(12,804)	(1,023)	(8,206)		(22,033)
Proceeds from disposal plant, equipment and timberlands	756	469			1,225
Proceeds from sale of subsidiary, net of cash dividend					
Total Investing Activities	(12,048)	(554)	(8,206)		(20,808)

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Financing Activities					
Net (repayments of) proceeds from indebtedness			(5,607)	3,588	(2,019)
Payment of Dividends	(11,873)				(11,873)
Proceeds from Stock Options exercised	785				785
Total Financing Activities	(11,088)		(5,607)	3,588	(13,107)
Effect of Exchange Rate on Cash			(2,249)		(2,249)
Net decrease in cash	(15,482)	(296)	(8,531)	(259)	(24,568)
Cash at the beginning of period	20,399	412	18,881	259	39,951
Cash at the end of period	\$ 4,917	\$ 116	\$ 10,350		\$ 15,383

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with the information in the unaudited condensed consolidated financial statements and notes thereto included herein and Glatfelter's Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in its 2005 Annual Report on Form 10-K.*

**Forward-Looking Statements** This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding industry prospects and future consolidated financial position or results of operations, made in this Report on Form 10-Q are forward looking. We use words such as "anticipates", "believes", "expects", "future", "intends" and similar expressions to identify forward-looking statements. Forward-looking statements reflect management's current expectations and are inherently uncertain. Our actual results may differ significantly from such expectations. The following discussion includes forward-looking statements regarding expectations of, among others, net sales, costs of products sold, non-cash pension income, environmental costs, capital expenditures and liquidity, all of which are inherently difficult to predict. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations. Accordingly, we identify the following important factors, among others, which could cause our results to differ from any results that might be projected, forecasted or estimated in any such forward-looking statements:

- i. variations in demand for, or pricing of, our products;
- ii. changes in the cost or availability of raw materials we use, in particular market pulp, pulp substitutes, and abaca fiber, and changes in energy-related costs;
- iii. our ability to develop new, high value-added Specialty Papers and Composite Fibers (formerly Long Fiber & Overlay Papers);
- iv. the impact of competition, changes in industry paper production capacity, including the construction of new mills, the closing of mills and incremental changes due to capital expenditures or productivity increases;
- v. cost and other effects of environmental compliance, cleanup, damages, remediation or restoration, or personal injury or property damages related thereto, such as the costs of natural resource restoration or damages related to the presence of polychlorinated biphenyls (PCBs) in the lower Fox River on which our Neenah mill was located; and the costs of environmental matters at our former Ecusta Division mill;
- vi. the gain or loss of significant customers and/or on-going viability of such customers;
- vii. risks associated with our international operations, including local economic and political environments and fluctuations in currency exchange rates;
- viii. geopolitical events, including war and terrorism;
- ix. enactment of adverse state, federal or foreign tax or other legislation or changes in government policy or regulation;
- x. adverse results in litigation;
- xi. disruptions in production and/or increased costs due to labor disputes including the successful negotiation of a new contract for our Chillicothe Union that expired in August 2006;
- xii. the resolution of the European Commission's review of our Lydney mill acquisition;

- xiii. our ability to successfully implement the EURO Program;
  - xiv. our ability to successfully execute our timberland strategy to realize the value of our timberlands;
- and
- xv. our ability to finance, consummate and integrate acquisitions.

**Introduction** We manufacture, both domestically and internationally, a wide array of specialty papers and engineered products. Substantially all of our revenue is earned from the sale of our products to customers in numerous markets, including book publishing, envelope & converting, carbonless papers and forms, food and beverage, decorative laminates for furniture and flooring, and other highly technical niche markets.

**Overview** Our results of operations for the first nine months of 2006 reflect stronger market conditions in each of our business units when compared with 2005. Domestically, the Specialty Papers business unit's results in the comparison are positively influenced by additional volumes associated with the April 2006 Chillicothe acquisition and improved selling prices. However, input costs in 2006 are higher, primarily energy and raw material costs. In addition, our Chillicothe operation did not contribute to increased earnings in the Specialty Paper business unit at the level we expected.

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Our Composite Fibers business unit's results have also been positively influenced by additional volumes associated with the Lydney acquisition as well as improved demand across all of this unit's product categories. Average selling prices, however, have negatively impacted its results.

The analysis of our financial results in the first nine months of 2006 reflects the following significant items:

- 1) We completed our \$65 million acquisition of J R Crompton's Lydney mill on March 13, 2006. This mill's revenue in 2005 was approximately \$75 million;
- 2) On April 3, 2006, we completed our acquisition of Chillicothe, the carbonless paper operation of NewPage Corporation with 2005 revenue of \$441.5 million, for \$83.3 million in cash;
- 3) On June 30, 2006, we ceased production at our Neenah, WI facility and recorded shutdown related charges totaling \$53.7 million;
- 4) In April 2006, we refinanced our bank credit facility with a \$100 million term loan and a \$200 million revolving credit facility in addition to the issuance of \$200 million 7<sup>1</sup>/<sub>8</sub>% bonds to replace our \$150 million 6<sup>7</sup>/<sub>8</sub>% notes due July 2007; and
- 5) We incurred acquisition integration costs totaling \$10.8 million in connection with the Chillicothe and Lydney acquisitions.

**RESULTS OF OPERATIONS**

*Nine months ended September 30, 2006 versus  
the Nine months ended September 30, 2005*

The following table sets forth summarized results of operations:

<i>In thousands, except per share</i>	Nine months ended September 30	
	<b>2006</b>	2005
Net sales	<b>\$ 717,815</b>	\$ 435,959
Gross profit	<b>63,901</b>	74,043
Operating income (loss)	<b>(28,390)</b>	25,226
Net income (loss)	<b>(27,217)</b>	11,662
Earnings (loss) per share	<b>(0.61)</b>	0.26

The consolidated results of operations include the following significant items:

<i>In thousands, except per share</i>	<b>After-tax</b>	<b>Diluted EPS</b>
	<i>Gain (loss)</i>	
<b>2006</b>		
Shutdown and restructuring charges	<b>\$ (34,034)</b>	<b>\$ (0.76)</b>
Acquisition integration related costs	<b>(6,817)</b>	<b>(0.15)</b>
Debt redemption premium	<b>(1,820)</b>	<b>(0.04)</b>
Timberland sales	<b>832</b>	<b>0.02</b>
Insurance recoveries	<b>130</b>	<b>0.00</b>
<b>2005</b>		
Insurance recoveries	1,430	0.03

Timberland sales (259) (0.01)

The above items decreased earnings by \$41.7 million, or \$0.93 per diluted share in the first nine months of 2006. Comparatively, the items identified above positively affected earnings in the same period of 2005 by \$1.2 million, or \$0.02 per diluted share.

**Business Units** Results of individual business units are presented based on our management accounting practices and management structure. There is no comprehensive, authoritative body of guidance for management accounting equivalent to accounting principles generally accepted in the United States of America; therefore, the financial results of individual business units are not necessarily comparable with similar information for any other company. The management accounting process uses assumptions and allocations to measure performance of the business units. Methodologies are refined from time to time as management accounting practices are enhanced and businesses change. The costs incurred by support areas not directly aligned with the business unit are allocated primarily based on an estimated utilization of support area services or included in Other and Unallocated in the table above. Certain prior period information has been reclassified to conform to the current period presentation.

Management evaluates results of operations before non-cash pension income, restructuring related charges, unusual items, effects of asset dispositions and insurance recoveries because it believes this is a more meaningful representation of the operating performance of its core papermaking businesses, the profitability of business units and the extent of cash flow generated from core operations. This presentation is closely aligned with the management and operating structure of our company. It is also on this basis that the Company's performance is evaluated internally and by the Company's Board of Directors.

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The following table sets forth profitability information by business unit and the composition of consolidated income before income taxes:

<b>Business Unit Performance</b>	For the Nine Months Ended September 30,							
	Specialty Papers		Composite Fibers		Other and Unallocated		Total	
<i>In thousands</i>	2006	2005	2006	2005	2006	2005	2006	2005
Net sales	\$ 507,906	\$ 287,727	\$ 209,909	\$ 148,183		\$ 49	\$ 717,815	\$ 435,959
Energy sales, net	8,010	7,673					8,010	7,673
Total revenue	515,916	\$ 295,400	209,909	148,183		49	725,825	443,632
Cost of products sold	469,857	257,161	177,962	123,516	14,105	(11,088)	661,924	369,589
Gross profit (loss)	46,059	38,239	31,947	24,667	(14,105)	11,137	63,901	74,043
SG&A	35,361	29,785	20,608	17,196	10,358	5,444	66,327	52,425
Shutdown and restructuring charges					28,177		28,177	
Gains on dispositions of plant, equipment and timberlands					(2,008)	(1,408)	(2,008)	(1,408)
Gain on insurance recoveries					(205)	(2,200)	(205)	(2,200)
Total operating income (loss)	10,698	8,454	11,339	7,471	(50,427)	9,301	(28,390)	25,226
Nonoperating income (expense)					(16,065)	(7,820)	(16,065)	(7,820)
Income (loss) before income taxes	\$ 10,698	\$ 8,454	\$ 11,339	\$ 7,471	\$ (66,492)	\$ 1,481	\$ (44,455)	\$ 17,406
<b>Supplementary Data</b>								
Net tons sold	488,305	341,200	50,471	35,181	10	16	538,786	376,397
Depreciation expense	\$ 24,487	\$ 26,832	\$ 12,635	\$ 11,354			\$ 37,122	\$ 38,186

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**Sales and Costs of Products Sold**

<i>In thousands</i>	Nine Months Ended September 30		Change
	2006	2005	
Net sales	\$ 717,815	\$ 435,959	\$ 281,856
Energy sales net	8,010	7,673	337
Total revenues	725,825	443,632	282,193
Costs of products sold	661,924	369,589	292,335
Gross profit	\$ 63,901	\$ 74,043	\$ (10,142)
Gross profit as a percent of Net sales	8.9%	17.0%	

The following table sets forth the contribution to consolidated net sales by each business unit:

<b>Business Unit</b>	Percent of Total	
	2006	2005
Specialty Papers	70.8%	66.0%
Composite Fibers	29.2	34.0
Total	100.0%	100.0%

Net sales totaled \$717.8 million for the first nine months of 2006, an increase of \$281.9 million, or 64.7%, compared to the same period a year ago. Net sales from the acquisition of Chillicothe's carbonless and forms business and the Lydney mill totaled \$224.1 million. These acquisitions are reported in the Specialty Papers and Composite Fibers business units, respectively. Organic growth was driven by a 4.9% increase in volume and \$15.8 million from higher average selling prices in the Specialty Papers business unit. Excluding results of the Lydney mill, Composite Fibers volumes shipped increased 20.3%. The translation of foreign currencies unfavorably impacted this business unit's net sales by \$1.8 million and average selling prices declined \$4.4 million compared to the same period a year ago.

In connection with the Chillicothe acquisition, we permanently shutdown our Neenah, WI facility. Products previously manufactured at the Neenah facility have been transferred to Chillicothe. The results of operations for the first nine months of 2006 include related pre-tax charges of \$53.7 million, of which \$25.7 million is reflected in the consolidated income statement as components of cost of products sold and \$28.0 million is reflected as Shutdown and restructuring charges.

Costs of products sold totaled \$661.9 million for the first nine months of 2006, an increase of \$292.3 million compared with the same period a year ago. As discussed above, the 2006 costs of products sold includes a \$25.7 million charge for inventory write-downs and accelerated depreciation on property and equipment abandoned in connection with the Neenah shutdown.

In addition to the shutdown charges, the increase in costs of products sold was primarily due to the inclusion of the Chillicothe and Lydney acquisitions, the effect of increased shipping volumes, and higher raw material and energy prices that increased costs of products sold by approximately \$10.8 million. During the second quarters of 2006 and 2005, the Company completed its annually scheduled maintenance shutdown of its Spring Grove, PA facility, and, in the 2006 second quarter, the annual maintenance shutdown of the Chillicothe facility was completed. These

shutdowns result in increased maintenance spending and reduced production leading to unfavorable manufacturing variances that negatively affect costs of products sold. The combined maintenance shutdowns had an estimated impact on gross profit of approximately \$17.4 million in the first nine months of 2006 and \$5.9 million in the comparable period a year ago, primarily reflecting increased spending at our Spring Grove facility and the impact of the Chillicothe shutdown.

**Non-Cash Pension Income** Non-cash pension income results from the over-funded status of our pension plans. The amount of pension income recognized each year is determined using various actuarial assumptions and certain other factors, including the fair value of our pension assets as of the beginning of the year. The following summarizes non-cash pension income, before the curtailment charges recorded in connection with the Neenah shutdown, for each of the first nine months of 2006 and 2005:

<i>In thousands</i>	Nine Months Ended September 30		Change
	2006	2005	
<i>Recorded as:</i>			
Costs of products sold	\$ 11,545	\$ 11,142	\$ 403
SG&A expense	1,099	1,256	(157)
Total	\$ 12,644	\$ 12,398	\$ 246

**Selling, general and administrative ( SG&A )** expenses totaled \$66.3 million in the first nine months of 2006 compared to \$52.4 million a year ago. The increase was due to approximately \$10.8 million of acquisition integration costs and \$9.3 million from the inclusion of the Chillicothe and Lydney acquisitions in the current period's results of operations. SG&A expenses in 2005 included a \$2.7 million charge for certain matters related to our former Ecusta division. In addition, the comparison was favorably affected by lower professional and legal fees in the period to period comparison.

**Insurance Recoveries** During the first nine months of 2006 and 2005, we reached successful resolution of certain claims under insurance policies related to the Fox River environmental matter. Insurance recoveries included in the results of operations totaled \$0.2 million in the first nine months of 2006 and \$2.2 million in the first nine

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months of 2005. All recoveries were received in cash prior to the end of the applicable period.

**Shutdown and Restructuring Charges – Neenah Facility Shutdown** As discussed above, as of June 30, 2006 we permanently shutdown our Neenah facility. The charge incurred in connection with this action is recorded as follows:

<i>In thousands</i>	Nine Months Ended September 30, 2006
Restructuring initiative: <i>Recorded as:</i>	
Costs of products sold	\$ 25,653
Shutdown and restructuring charge	28,056
<b>Total</b>	<b>\$ 53,709</b>

The following table summarizes shutdown reserve activity during the nine months ended September 30, 2006:

<i>In thousands</i>	Beg. Balance	Amount Accrued	Less Non- Cash- Charges and Cash Payments	Balance
<b>Non-cash charges</b>				
Accelerated depreciation	\$	\$ 22,457	\$ (22,457)	\$
Inventory write-down		3,196	(3,196)	
Pension curtailments and other retirement benefit charges		7,675	(7,675)	
<b>Total non cash charges</b>		<b>33,328</b>	<b>(33,328)</b>	
<b>Cash charges</b>				
Severance and benefit continuation		7,219	(3,432)	3,787
Contract termination costs		11,367	(11,367)	
Other		1,795	(645)	1,150
<b>Total cash charges</b>		<b>20,381</b>	<b>(15,444)</b>	<b>4,937</b>
<b>Total</b>	<b>\$</b>	<b>\$ 53,709</b>	<b>\$ (48,772)</b>	<b>\$ 4,937</b>

The Neenah facility supported our Specialty Papers business unit. Shutdown of this facility resulted in the elimination of approximately 200 positions. We expect to record in the fourth quarter of 2006 additional shutdown related charges totaling approximately \$1.0 million.

As part of the Neenah shutdown, we terminated our long-term steam supply contract, as provided for within the agreement, resulting in a termination fee of approximately \$11.4 million.

The first nine months results of operations also include \$0.1 million of charges related to the European Restructuring and Optimization (EURO) Program.

**Non-operating income (expense)** During April 2006, we completed the placement of a \$200 million bond offering, the proceeds of which were used to redeem the then outstanding \$150 million notes scheduled to mature in July 2007. In connection with the early redemption, a charge of \$2.9 million, related to a redemption premium and the write-off of unamortized debt issuance costs, was recorded in Consolidated Statement of Income as Non-operating expense under the caption Other-net .

**Foreign Currency** We own and operate paper and pulp mills in Germany, France, the United Kingdom and the Philippines. The local currency in Germany and France is the Euro, in the UK the British Pound Sterling, and in the Philippines the currency is the Peso. During the first nine months of 2006, these operations generated approximately 27% of our sales and 26% of operating expenses. The translation of the results from these international operations into U.S. dollars is subject to changes in foreign currency exchange rates. The table below summarizes the effect from foreign currency translation on 2006 reported results compared to 2005:

<i>In Thousands</i>	Nine Months Ended September 30
	Favorable (unfavorable)
Net sales	\$ (1,784)
Costs of products sold	770
SG&A expenses	203
Income taxes and other	69
Net income	\$ (742)

The above table only presents the financial reporting impact of foreign currency translations. It does not present the impact of certain competitive advantages or disadvantages of operating or competing in multi-currency markets.

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**Three months ended September 30, 2006 versus the  
Three months ended September 30, 2005**

The following table sets forth summarized results of operations:

<i>In thousands, except per share</i>	Three Months Ended September 30	
	<b>2006</b>	2005
Net sales	<b>\$ 277,489</b>	\$ 146,780
Gross profit	<b>37,903</b>	25,616
Operating income	<b>12,014</b>	8,882
Net income (loss)	<b>5,368</b>	3,663
Earnings (loss) per share	<b>0.12</b>	0.08

The consolidated results of operations for the three months ended September 30, 2006 includes the following significant items:

<i>In thousands, except per share</i>	<b>2006</b>	After-Tax <i>Gain (loss)</i>	Diluted EPS
Shutdown and restructuring charges		<b>\$ (1,904)</b>	<b>\$ (0.04)</b>
Acquisition integration related costs		<b>(3,560)</b>	<b>(0.08)</b>
Timberland sales		<b>250</b>	
	2005		
Timberland sales, net of tax		(259)	(0.01)

**Business Units** The following table sets forth profitability information by business unit and the composition of consolidated income before income taxes:

<b>Business Unit Performance</b> <i>In thousands, except net tons sold</i>	For the Three Months Ended September 30,							
	Specialty Papers		Composite Fibers		Other and Unallocated		Total	
	<b>2006</b>	2005	<b>2006</b>	2005	<b>2006</b>	2005	<b>2006</b>	2005
Net sales	<b>\$ 202,096</b>	\$ 100,500	<b>\$ 75,393</b>	\$ 46,259	\$ 21		<b>\$ 277,489</b>	146,780
Energy sales, net	<b>2,706</b>	2,414					<b>2,706</b>	2,414
Total revenue	<b>204,802</b>	102,914	<b>75,393</b>	46,259		21	<b>280,195</b>	149,194
Cost of products sold	<b>183,364</b>	87,808	<b>62,240</b>	39,475	<b>(3,312)</b>	(3,705)	<b>242,292</b>	123,578
Gross profit (loss)	<b>21,438</b>	15,106	<b>13,153</b>	6,784	<b>3,312</b>	3,726	<b>37,903</b>	25,616
SG&A	<b>11,374</b>	9,716	<b>8,023</b>	4,926	<b>5,193</b>	3,419	<b>24,590</b>	18,061
Shutdown and restructuring charges					<b>2,222</b>		<b>2,222</b>	

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Gains on dispositions of plant, equipment and timberlands					<b>(923)</b>	(1,327)	<b>(923)</b>	(1,327)
Gain on insurance recoveries								
Total operating income (loss)	<b>10,064</b>	5,390	<b>5,130</b>	1,858	<b>(3,180)</b>	1,634	<b>12,014</b>	8,882
Non-operating income (expense)					<b>(5,750)</b>	(2,563)	<b>(5,750)</b>	(2,563)
Income (loss) before income taxes	\$ <b>10,064</b>	\$ 5,390	\$ <b>5,130</b>	\$ 1,858	\$ <b>(8,930)</b>	\$ (929)	\$ <b>6,264</b>	\$ 6,319

**Supplementary Data**

Net tons sold	<b>180,365</b>	119,257	<b>17,919</b>	11,454		9	<b>198,284</b>	130,720
Depreciation expense	\$ <b>8,163</b>	\$ 8,963	\$ <b>4,344</b>	\$ 3,567			\$ <b>12,507</b>	\$ 12,530

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The following table summarizes sales and costs of products sold for the three months ended September 30, 2006 and 2005.

**Sales and Costs of Products Sold**

<i>In thousands</i>	Three Months Ended September 30		Change
	2006	2005	
Net sales	\$ 277,489	\$ 146,780	\$ 130,709
Energy sales net	2,706	2,414	292
Total revenues	280,195	149,194	131,001
Costs of products sold	242,292	123,578	118,714
Gross profit	37,903	25,616	12,287
Gross profit as a percent of Net sales	13.7%	17.5%	

The following table sets forth the contribution to consolidated net sales by each business unit:

<b>Business Unit</b>	Percent of Total	
	2006	2005
Specialty Papers	72.8%	68.5%
Composite Fibers	27.2	31.5
Total	100.0%	100.0%

Net sales totaled \$277.5 million for the third quarter of 2006, an increase of \$130.7 million, or 89.1%, compared to the same quarter a year ago. Net sales from the acquisitions of Chillicothe's carbonless and forms business and the Lydney mill totaled \$112.9 million. Organic growth was driven by \$5.6 million from higher average selling prices in the Specialty Papers business unit. In the Composite Fibers business unit, volumes shipped increased 20%, excluding volumes at Lydney. The translation of foreign currencies favorably impacted Composite Fibers' net sales by \$2.2 million and this unit's average selling prices declined \$1.5 million compared to the same quarter a year ago.

Costs of products sold totaled \$242.3 million for the third quarter of 2006, an increase of \$118.7 million compared with the same period a year ago. The increase was primarily due to the inclusion of the Chillicothe and Lydney acquisitions, the effect of increased shipping volumes, and a \$3.1 million impact of higher raw material and energy prices. The EURO program benefited cost of products sold by approximately \$1.9 million. The third quarter of 2006 costs of products sold also includes a \$0.8 million charge associated with the Neenah shutdown. The translation of foreign currencies reduced costs of products sold by \$2.8 million.

**Non-Cash Pension Income** Non-cash pension income results from the considerably over-funded status of our pension plans. The amount of pension income recognized each year is determined using various actuarial assumptions and certain other factors, including the fair value of our pension assets as of the beginning of the year. The following summarizes non-cash pension income for each quarter:

<i>In thousands</i>	Three Months Ended September 30		Change
	2006	2005	

*Recorded as:*

Costs of products sold	\$ 4,092	\$ 3,728	\$ 364
SG&A expense	586	424	162
Total	\$ 4,678	\$ 4,152	\$ 526

**Selling, general and administrative ( SG&A )** expenses totaled \$24.6 million in the third quarter of 2006 compared to \$18.1 million in the same quarter a year ago. The increase was due to approximately \$5.6 million of acquisition integration costs and \$4.5 million from the inclusion of the Chillicothe and Lydney acquisitions in the current period's results of operations. SG&A expenses in the third quarter of 2005 included a \$2.7 million charge for certain matters related to the Company's former Ecusta division. In addition, the comparison was favorably affected by lower professional and legal fees.

**Shutdown and restructuring charges - Neenah Facility Shutdown** As discussed earlier, we permanently shutdown our Neenah facility. The following table summarizes shutdown charges incurred in connection with these initiatives:

<i>In thousands</i>	<b>Three Months Ended September 30, 2006</b>
Restructuring initiative:	
<i>Recorded as:</i>	
Costs of products sold	\$ 785
Shutdown and restructuring charges	2,181
Total	\$ 2,966

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The following table summarizes shutdown reserve activity during the three months ended September 30, 2006:

<i>In thousands</i>	Bal June 30, 2006	Amount Accrued	Less Non- Cash- Charges and Cash Payments	Balance
<b>Non-cash charges</b>				
Inventory write-down	\$	\$ 785	\$ (785)	\$
Total non cash charges		785	(785)	
<b>Cash charges</b>				
Severance and benefit continuation	6,592	627	(3,432)	3,787
Contract termination costs	11,386	(19)	(11,367)	
Other	222	1,573	(645)	1,150
Total cash charges	18,200	2,181	(15,444)	4,937
Total	\$ 18,200	\$ 2,966	\$ (16,229)	\$ 4,937

**Income Taxes** Our effective tax rate for the third quarter of 2006 and 2005 was 14% and 42% respectively. The decrease was primarily related to the resolution in the third quarter of 2005 of certain tax matters and the passage in the third quarter of 2006 of certain state income tax law changes that had the effect of reducing our deferred state income tax liability.

**Foreign Currency** We own and operate paper and pulp mills in Germany, France and the United Kingdom as well as the Philippines. The local currency in Germany and France is the Euro, in the UK the British Pound Sterling, and in the Philippines the currency is the Peso. During the third quarter of 2006, these operations generated approximately 25% of our sales and 23% of operating expenses. The translation of the results from these international operations into U.S. dollars is subject to changes in foreign currency exchange rates.

The table below summarizes the effect from foreign currency translation on reported results for the third quarter of 2006 compared to the same quarter of 2005:

<i>In thousands</i>	Three Months Ended September 30
	Favorable (unfavorable)
Net sales	\$ 2,197
Costs of products sold	(2,832)
SG&A expenses	(201)
Income taxes and other	20
Net loss	\$ (816)

The above table only presents the financial reporting impact of foreign currency translations. It does not present the impact of certain competitive advantages or disadvantages of operating or competing in multi-currency markets.

**LIQUIDITY AND CAPITAL RESOURCES**

Our business is capital intensive and requires expenditures for new or enhanced equipment, for environmental compliance matters and to support our business strategy and research and development efforts. The following table summarizes cash flow information for each of the periods presented.

<i>In thousands</i>	Nine Months Ended September 30	
	<b>2006</b>	2005
Cash and cash equivalents at beginning of period	\$ <b>57,442</b>	\$ 39,951
Cash provided by (used for)		
Operating activities	<b>(45,572)</b>	11,596
Investing activities	<b>(190,398)</b>	(20,808)
Financing activities	<b>193,182</b>	(13,107)
Effect of exchange rate changes on cash	<b>(773)</b>	(2,249)
Net cash provided (used)	<b>(43,561)</b>	(24,568)
Cash and cash equivalents at end of period	\$ <b>13,881</b>	\$ 15,383

During the first nine months of 2006 operations used \$53.7 million of cash compared to \$11.6 million of cash provided by operating activities in the prior year period. The change in the comparison was primarily due to \$21.7 million used to settle a cross currency rate swap that matured in June 2006, \$10.0 million used for working capital associated with the Lydney acquisition and increased business activity and \$15.4 million of Neenah shutdown related payments made during the first nine months of 2006.

The changes in investing cash flows reflect the use of approximately \$158.1 million to fund the Chillicothe and Lydney mill acquisitions. The acquisitions were financed with additional borrowings under our revolving credit facility and new term loan.

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The following table sets forth our outstanding long-term indebtedness:

<i>In thousands</i>	<b>September 30, 2006</b>	December 31, 2005
New revolving credit facility, due April 2011	<b>\$ 78,168</b>	\$
Term loan, due April 2011	<b>99,440</b>	
Revolving credit facility, due September 2006		19,650
7 <sup>1</sup> / <sub>8</sub> % Notes, due May 2016	<b>200,000</b>	
6 <sup>7</sup> / <sub>8</sub> % Notes, due July 2007		150,000
Note payable SunTrust, due March 2008	<b>34,000</b>	34,000
Total long-term debt	<b>411,608</b>	203,650
Less current portion	<b>(11,250)</b>	(19,650)
Long-term debt, excluding current portion	<b>\$ 400,358</b>	\$ 184,000

As more fully discussed in Item 1 Financial Statements, Note 9, on April 3, 2006 we refinanced the revolving credit facility set forth in the table above. The significant terms of the new credit facility are also set forth therein. In addition, on April 28, 2006, we completed an offering of \$200.0 million aggregate principal amount of our 7<sup>1</sup>/<sub>8</sub>% Senior Notes due 2016. We used the net proceeds to redeem \$150.0 million aggregate principal amount of our outstanding 6<sup>7</sup>/<sub>8</sub>% notes due July 2007, plus the payment of the applicable redemption premium and accrued interest. We expect to use the remaining net proceeds for working capital and general corporate purposes.

During the first nine months of 2006 and 2005, cash dividends paid on common stock totaled approximately \$12.0 million in each period. Our Board of Directors determines what, if any, dividends will be paid to our shareholders. Dividend payment decisions are based upon then-existing factors and conditions and, therefore, historical trends of dividend payments are not necessarily indicative of future payments.

We are subject to loss contingencies resulting from regulation by various federal, state, local and foreign governmental authorities with respect to the environmental impact of mills we operate, or have operated. To comply with environmental laws and regulations, we have incurred substantial capital and operating expenditures in past years. We anticipate that environmental regulation of our operations will continue to become more burdensome and that capital and operating expenditures necessary to comply with environmental regulations will continue, and perhaps increase, in the future. In addition, we may incur obligations to remove or mitigate any adverse effects on the environment resulting from our operations, including the restoration of natural resources and liability for personal injury and for damages to property and natural resources. Because environmental regulations are not consistent worldwide, our ability to compete in the world marketplace may be adversely affected by capital and operating expenditures required for environmental compliance.

We expect to meet all of our near- and longer-term cash needs from a combination of operating cash flow, cash and cash equivalents, proceeds generated from the execution of our Timberland Strategy existing credit facility or other bank lines of credit and other long-term debt. However, as discussed in Item 1 Financial Statements Note 11, an unfavorable outcome of various environmental matters could have a material adverse impact on our consolidated financial position, liquidity and/or results of operations.

**Off-Balance-Sheet Arrangements** As of September 30, 2006 and December 31, 2005, we had not entered into any off-balance-sheet arrangements. A financial derivative instrument to which we are a party and guarantees of indebtedness, which solely consists of obligations of subsidiaries and a partnership, are reflected in the consolidated balance sheets included herein in Item 1 Financial Statements.

**Outlook** For the fourth quarter of 2006 and into 2007, we expect a stable pricing environment in both Specialty Papers and Composite Fibers. Downtime is expected to be higher in the fourth quarter during the holiday period

compared to the third quarter, but consistent with levels experienced in the fourth quarter of 2005. Shipping volumes are expected to be lower in the fourth quarter compared to the third quarter due to seasonality.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS**

<i>Dollars in thousands</i>	Year Ended December 31					At September 30, 2006	
	2006	2007	2008	2009	2010	Carrying Value	Fair Value
<b>Long-term debt</b>							
Average principal outstanding							
At fixed interest rate Bond	\$ 200,00	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 191,912
At fixed interest rate SunTrust Note	34,000	34,000	8,500			34,000	32,708
At variable interest rates	177,608	171,983	155,108	133,233	108,233	177,608	177,608
						\$ 411,608	\$ 402,228
<b>Weighted-average interest rate</b>							
On fixed interest rate debt Bond	7.13%	7.13%	7.13%	7.13%	7.13%		
On fixed interest rate debt SunTrust Note	3.82	3.82	3.82				
On variable interest rate debt	5.81	5.80	5.77	5.72	5.64		

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Our market risk exposure primarily results from changes in interest rates and currency exchange rates. At September 30, 2006, we had long-term debt outstanding of \$411.6 million, of which \$177.6 million or 43.1% was at variable interest rates.

The table above presents average principal outstanding and related interest rates for the next five years. Fair values included herein have been determined based upon rates currently available to us for debt with similar terms and remaining maturities.

Variable-rate debt outstanding represents borrowings under our revolving credit facility that incur interest based on the domestic prime rate or a Eurocurrency rate, at our option, plus a margin. At September 30, 2006, the interest rate paid was 5.81%. A hypothetical 100 basis point increase or decrease in the interest rate on variable rate debt would increase or decrease annual interest expense by \$1.8 million.

We are subject to certain risks associated with changes in foreign currency exchange rates to the extent our operations are conducted in currencies other than the U.S. Dollar. During the nine months ended September 30, 2006, approximately 73.4% of our net sales were shipped from the United States, 17.9% from Germany, and 8.7% from other international locations.

At September 30, 2006, we had an outstanding foreign exchange forward contract with an established financial institution pursuant to which we agreed to buy \$70.0 million (U.S. dollars) and pay EUROS. The contract, which matures on December 12, 2006, is designed to mitigate the foreign exchange risk associated with a U.S. dollar-denominated intercompany loan for a German subsidiary.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures** Our chief executive officer and our principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of September 30, 2006, have concluded that, as of the evaluation date, our disclosure controls and procedures are effective.

**Changes in Internal Controls** On March 13, 2006, we completed the acquisition of the Lydney mill from J R Crompton Limited and on April 3, 2006, we completed the acquisition of Chillicothe, the carbonless paper operation of NewPage Corporation. We performed due diligence procedures associated with these acquisitions. Subsequent to closing the acquisitions much of the financial accounting functions were completed pursuant to third party servicing agreements between us and the sellers. During the third quarter of 2006, we assumed more complete control for all financial accounting functions related to the acquired operations. We are in the process of more fully integrating the respective financial reporting processes and the related internal controls applicable to these newly acquired entities. There were no other changes in our internal control over financial reporting during the nine months ended September 30, 2006, that have materially affected or is reasonably likely to materially affect our internal control over financial reporting.

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**PART II**

**ITEM 6. EXHIBITS**

*(a) Exhibits*

- 4.3 First Supplemental Indenture, dated as of September 21, 2006 among the registrant, Glatfelter Holdings, LLC Glatfelter Holding II, LLC, the existing Guarantors named therein and SunTrust Bank, incorporated by reference to the registrant's registration statement on Form S-4, file number 333-135808.
- 31.1 Certification of George H. Glatfelter II, Chairman and Chief Executive Officer of Glatfelter, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 31.2 Certification of John P. Jacunski, Senior Vice President and Chief Financial Officer of Glatfelter, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 32.1 Certification of George H. Glatfelter II, Chairman and Chief Executive Officer of Glatfelter, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 18 U.S.C. Section 1350, filed herewith.
- 32.2 Certification of John P. Jacunski, Senior Vice President and Chief Financial Officer of Glatfelter, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 18 U.S.C. Section 1350, filed herewith.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

P. H. GLATFELTER COMPANY  
(Registrant)

November 7, 2006

By /s/ David C. Elder  
David C. Elder  
Corporate Controller

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
4.3	First Supplemental Indenture, dated as of September 21, 2006 among the registrant, Glatfelter Holdings, LLC Glatfelter Holding II, LLC, the existing Guarantors named therein and SunTrust Bank, incorporated by reference to the registrant's registration statement on Form S-4, file number 333-135808.
31.1	Certification of George H. Glatfelter II, Chairman and Chief Executive Officer of Glatfelter, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 Chief Executive Officer, filed herewith.
31.2	Certification of John P. Jacunski, Senior Vice President and Chief Financial Officer of Glatfelter, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Chief Financial Officer, filed herewith.
32.1	Certification of George H. Glatfelter II, Chairman and Chief Executive Officer of Glatfelter, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Chief Executive Officer, filed herewith.
32.2	Certification of John P. Jacunski, Senior Vice President and Chief Financial Officer of Glatfelter, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 Chief Financial Officer, filed herewith.

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