

GLATFELTER P H CO  
Form 10-Q  
August 09, 2006

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

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

or

**o 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 **June 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 July 31, 2006, P. H. Glatfelter Company had 44,736,167 shares of common stock outstanding.

**P. H. GLATFELTER COMPANY**  
**REPORT ON FORM 10-Q**  
**for the QUARTERLY PERIOD ENDED**  
**JUNE 30, 2006**  
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**P. H. GLATFELTER COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(unaudited)

| <i>In thousands, except per share</i>                          | <b>Three Months Ended</b> |            | <b>Six Months Ended</b> |            |
|--|---------------------------|------------|-------------------------|------------|
|  | <b>June 30</b>            |            | <b>June 30</b>          |            |
|  | <b>2006</b>               | 2005       | <b>2006</b>             | 2005       |
| Net sales  | <b>\$ 279,720</b>         | \$ 145,283 | <b>\$ 440,326</b>       | \$ 289,179 |
| Energy sales net   | <b>2,847</b>              | 2,715      | <b>5,304</b>            | 5,259      |
| Total revenues   | <b>282,567</b>            | 147,998    | <b>445,630</b>          | 294,438    |
| Costs of products sold   | <b>276,834</b>            | 128,165    | <b>419,632</b>          | 246,011    |
| Gross profit   | <b>5,733</b>              | 19,833     | <b>25,998</b>           | 48,427     |
| Selling, general and administrative expenses                   | <b>25,040</b>             | 16,974     | <b>41,737</b>           | 34,364     |
| Shutdown and restructuring charges                             | <b>6,657</b>              |            | <b>25,955</b>           |            |
| Gains on dispositions of plant, equipment and timberlands, net | <b>(1,095)</b>            | (21)       | <b>(1,085)</b>          | (81)       |
| Gains from insurance recoveries                                | <b>(205)</b>              | (2,200)    | <b>(205)</b>            | (2,200)    |
| Operating income (loss)  | <b>(24,664)</b>           | 5,080      | <b>(40,404)</b>         | 16,344     |
| Non-operating income (expense)                                 |                           |            |                         |            |
| Interest expense   | <b>(7,170)</b>            | (3,290)    | <b>(10,563)</b>         | (6,550)    |
| Interest income  | <b>1,126</b>              | 559        | <b>1,792</b>            | 1,057      |
| Other net  | <b>(1,896)</b>            | (25)       | <b>(1,546)</b>          | 236        |
| Total other income (expense)                                   | <b>(7,940)</b>            | (2,756)    | <b>(10,317)</b>         | (5,257)    |
| Income (loss) before income taxes                              | <b>(32,604)</b>           | 2,324      | <b>(50,721)</b>         | 11,087     |
| Income tax provision (benefit)                                 | <b>(11,882)</b>           | 615        | <b>(18,134)</b>         | 3,088      |
| Net income (loss)  | <b>\$ (20,722)</b>        | \$ 1,709   | <b>\$ (32,587)</b>      | \$ 7,999   |
| <b>Earnings (loss) per share</b>                               |                           |            |                         |            |
| Basic and diluted  | <b>\$ (0.46)</b>          | \$ 0.04    | <b>\$ (0.73)</b>        | \$ 0.18    |
| <b>Cash dividends declared per common share</b>                | <b>\$ 0.09</b>            | \$ 0.09    | <b>\$ 0.18</b>          | \$ 0.18    |
| <b>Weighted average shares outstanding</b>                     |                           |            |                         |            |
| Basic  | <b>44,571</b>             | 43,983     | <b>44,392</b>           | 43,972     |
| Diluted  | <b>44,571</b>             | 44,294     | <b>44,392</b>           | 44,267     |

*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>June 30<br/>2006</b> | December 31<br>2005 |
|---|-------------------------|---------------------|
| <b>Assets</b>                               |                         |                     |
| <b>Current assets</b>                       |                         |                     |
| Cash and cash equivalents                   | \$ 23,801               | \$ 57,442           |
| Accounts receivable net                     | 131,206                 | 62,524              |
| Inventories                                 | 189,214                 | 81,248              |
| Prepaid expenses and other current assets   | 35,668                  | 22,343              |
| Total current assets                        | 379,889                 | 223,557             |
| <b>Plant, equipment and timberlands net</b> | <b>525,780</b>          | 478,828             |
| <b>Other assets</b>                         | <b>375,663</b>          | 342,592             |
| Total assets                                | \$ 1,281,332            | \$ 1,044,977        |
| <b>Liabilities and Shareholders Equity</b>  |                         |                     |
| <b>Current liabilities</b>                  |                         |                     |
| Current portion of long-term debt           | \$ 7,500                | \$ 19,650           |
| Short-term debt                             | 3,142                   | 3,423               |
| Accounts payable                            | 79,849                  | 31,132              |
| Dividends payable                           | 4,025                   | 3,972               |
| Environmental liabilities                   | 4,720                   | 7,575               |
| Other current liabilities                   | 103,225                 | 74,126              |
| Total current liabilities                   | 202,461                 | 139,878             |
| <b>Long-term debt</b>                       | <b>378,833</b>          | 184,000             |
| <b>Deferred income taxes</b>                | <b>203,545</b>          | 206,269             |
| <b>Other long-term liabilities</b>          | <b>92,182</b>           | 82,518              |
| Total liabilities                           | 877,021                 | 612,665             |
| <b>Commitments and contingencies</b>        |                         |                     |
| <b>Shareholders equity</b>                  |                         |                     |
| Common stock                                | 544                     | 544                 |
| Capital in excess of par value              | 41,620                  | 43,450              |
| Retained earnings                           | 507,203                 | 547,810             |

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|  |                     |              |
|--|---------------------|--------------|
| Deferred compensation                      |                     | (2,295)      |
| Accumulated other comprehensive loss       | <b>(2,049)</b>      | (5,343)      |
|  | <b>547,318</b>      | 584,166      |
| Less cost of common stock in treasury      | <b>(143,007)</b>    | (151,854)    |
| Total shareholders' equity                 | <b>404,311</b>      | 432,312      |
| Total liabilities and shareholders' equity | <b>\$ 1,281,332</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>Six Months Ended June</b> |             |
|---|------------------------------|-------------|
|   | <b>2006</b>                  | <b>2005</b> |
|   | <b>30</b>                    |             |
| <b>Operating activities</b>   |                              |             |
| Net income (loss)   | \$ (32,587)                  | \$ 7,999    |
| Adjustments to reconcile to net cash provided (used) by operations: |                              |             |
| Depreciation, depletion and amortization                            | 22,465                       | 25,656      |
| Pension income  | (7,965)                      | (8,246)     |
| Shutdown and restructuring charges                                  | 50,823                       |             |
| Deferred income tax provision                                       | (8,817)                      | 2,504       |
| Gains on dispositions of plant, equipment and timberlands, net      | (1,095)                      | (81)        |
| Expense related to 401(k) plans and other                           | 426                          | 319         |
| Change in operating assets and liabilities accounts receivable      | (21,901)                     | (6,879)     |
| Inventories   | (7,454)                      | (6,746)     |
| Other assets and prepaid expenses                                   | (14,181)                     | (2,251)     |
| Accounts payable and other liabilities                              | 11,248                       | (7,364)     |
| Net cash (used) provided by operating activities                    | (31,534)                     | 4,911       |
| <b>Investing activities</b>   |                              |             |
| Purchases of plant, equipment and timberlands                       | (25,250)                     | (14,005)    |
| Proceeds from disposals of plant, equipment and timberlands         | 1,092                        | 130         |
| Acquisition of Lydney mill and Chillicothe                          | (151,605)                    |             |
| Net cash used by investing activities                               | (175,763)                    | (13,875)    |
| <b>Financing activities</b>   |                              |             |
| Net borrowings under revolving credit facility                      | 30,901                       | 1,338       |
| Net proceeds from term loan facility                                | 98,269                       |             |
| Net proceeds from 7 <sup>1</sup> / <sub>8</sub> % note offering     | 196,440                      |             |
| Repayment of 6 <sup>7</sup> / <sub>8</sub> % notes                  | (152,675)                    |             |
| Payment of dividends  | (7,967)                      | (7,914)     |
| Proceeds from stock options exercised                               | 7,314                        | 116         |
| Net cash provided (used) by financing activities                    | 172,282                      | (6,460)     |
| Effect of exchange rate changes on cash                             | 1,374                        | (1,878)     |
| Net decrease in cash and cash equivalents                           | (33,641)                     | (17,302)    |
| Cash and cash equivalents at the beginning of period                | 57,442                       | 39,951      |
| Cash and cash equivalents at the end of period                      | \$ 23,801                    | \$ 22,649   |

**Supplemental cash flow information**



|                  |  |           |          |
|------------------|--|-----------|----------|
| Cash paid for    |  |           |          |
| Interest expense |  | \$ 11,648 | \$ 6,327 |
| Income taxes     |  | 17,057    | 12,198   |

*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)

**1. 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.

**2. 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.

**3. 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.

**4. 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 \$2.9 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 the Company s existing 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.

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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               | 56,252    |
| Intangibles and other assets         | 3,537     |
|                                      | 68,920    |
| Less acquisition related liabilities | (1,020)   |
| Total                                | \$ 67,900 |

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 \$81.8 million in cash, subject to certain post-closing working capital adjustments, in addition to approximately \$5.5 million of transaction and other related costs. The Chillicothe assets consist of a 440,000 ton-per-year paper making facility in Chillicothe, Ohio 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 following table summarizes the preliminary allocation of the purchase price to assets acquired and liabilities assumed. This allocation may change as a result of any post-closing working capital adjustments and any resulting final valuations of assets and liabilities acquired:

*In thousands*

**Assets acquired:**

|   |           |
|---|-----------|
| Accounts Receivable   | \$ 44,456 |
| Inventory   | 93,082    |
| Other current assets  | 982       |
| Other non-current assets  | 12,626    |
|   | 151,146   |
| Less acquisition related liabilities, including accounts payable and accrued expenses | (63,803)  |
| Total   | \$ 87,343 |

**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 six months ended June 30, 2006 and 2005 was approximately \$546.2 million and \$492.6 million, respectively, assuming this 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.

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.

#### 5. 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 results of operations in the first six months of 2006 include the following pre-tax charges related to the Neenah shutdown:

| <i>In thousands</i>                                       | <b>Six<br/>Months<br/>Ended<br/>June<br/>30,<br/>2006</b> | Expected in the<br>Third & Fourth<br>Quarters of 2006<br>LOW    HIGH |          |
|---|---|--|----------|
| Accelerated depreciation                                  | <b>\$ 22,457</b>  |  |          |
| Inventory write-down                                      | <b>2,411</b>  |  |          |
| Severance and benefit continuation                        | <b>6,592</b>  |  |          |
| Pension curtailments and other retirement benefit charges | <b>7,675</b>  |  |          |
| Contract termination costs                                | <b>11,386</b>   |  |          |
| Other   | <b>222</b>  | \$ 2,500   | \$ 4,000 |
| Total   | <b>\$ 50,743</b>  | \$ 2,500   | \$ 4,000 |

The Neenah shutdown resulted in the elimination of approximately 200 positions and had been supporting our Specialty Papers business unit. Approximately \$24.9 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 contract, resulting in a termination fee of approximately \$11.4 million.

Through June 30, 2006, approximately \$0.03 million has been paid related to these charges. With the exception of severance and contract termination costs, the balance of the charge represents charges that will not require cash to settle.

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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<br/>June 30</b> |          |
|--|---------------------------------------|----------|
|  | <b>2006</b>                           | 2005     |
| Net (loss) income  | \$ (20,722)                           | \$ 1,709 |
| Weighted average common shares outstanding used in basic EPS   | <b>44,571</b>                         | 43,983   |
| Common shares issuable upon exercise of dilutive stock options, restricted stock awards and performance awards |                                       | 311      |
| Weighted average common shares outstanding and common share equivalents used in diluted EPS                    | <b>44,571</b>                         | 44,294   |
| Earnings (loss) per share<br>Basic and diluted   | <b>\$ (0.46)</b>                      | \$ 0.04  |
|  | <b>Six Months Ended<br/>June 30</b>   |          |
| <i>In thousands, except per share</i>  | <b>2006</b>                           | 2005     |
| Net (loss) income  | \$ (32,587)                           | \$ 7,999 |
| Weighted average common shares outstanding used in basic EPS   | <b>44,392</b>                         | 43,972   |
| Common shares issuable upon exercise of dilutive stock options, restricted stock awards and performance awards |                                       | 295      |
| Weighted average common shares outstanding and common share equivalents used in diluted EPS                    | <b>44,392</b>                         | 44,267   |
| Earnings (loss) per share<br>Basic and diluted   | <b>\$ (0.73)</b>                      | \$ 0.18  |

Approximately 679,440 and 650,205 potential common shares have been excluded from the computation of diluted earnings per share for the three month and six month periods, respectively, due to their anti-dilutive nature in 2006.

**7. 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 a June 30, 2006.

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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<br/>June 30</b> |                |
|------------------------------------|---------------------------------------|----------------|
|                                    | <b>2006</b>                           | <b>2005</b>    |
| <b>Pension Benefits</b>            |                                       |                |
| Service cost                       | \$ 1,650                              | \$ 817         |
| Interest cost                      | 5,402                                 | 4,149          |
| Expected return on plan assets     | (11,846)                              | (9,966)        |
| Amortization of prior service cost | 433                                   | 922            |
| Recognized actuarial (gain) loss   | 117                                   | (288)          |
|                                    | <b>(4,244)</b>                        | <b>(4,366)</b> |
| Curtailment charge                 | 1,372                                 |                |
| Net periodic benefit income        | \$ (2,872)                            | \$ (4,366)     |
| <b>Other Benefits</b>              |                                       |                |
| Service cost                       | \$ 449                                | \$ 279         |
| Interest cost                      | 780                                   | 699            |
| Amortization of prior service cost | (167)                                 | (186)          |
| Recognized actuarial (gain) loss   | 329                                   | 351            |
| Net periodic benefit cost          | \$ 1,391                              | \$ 1,143       |
| <br>                               |                                       |                |
| <i>In thousands</i>                | <b>Six Months Ended<br/>June 30</b>   |                |
|                                    | <b>2006</b>                           | <b>2005</b>    |
| <b>Pension Benefits</b>            |                                       |                |
| Service cost                       | \$ 2,679                              | \$ 1,864       |
| Interest cost                      | 9,648                                 | 8,309          |
| Expected return on plan assets     | (21,766)                              | (19,707)       |
| Amortization of prior service cost | 916                                   | 1,035          |
| Recognized actuarial (gain) loss   | 558                                   | 253            |
|                                    | <b>(7,965)</b>                        | <b>(8,246)</b> |
| Curtailment charge                 | 4,403                                 |                |
| Net periodic benefit income        | \$ (3,562)                            | \$ (8,246)     |
| <b>Other Benefits</b>              |                                       |                |
| Service cost                       | \$ 754                                | \$ 568         |

|                                    |                 |          |
|------------------------------------|-----------------|----------|
| Interest cost                      | <b>1,434</b>    | 1,347    |
| Amortization of prior service cost | <b>(375)</b>    | (370)    |
| Amortization of unrecognized loss  | <b>648</b>      | 664      |
|                                    | <b>2,461</b>    | 2,209    |
| Special termination charge         | <b>3,273</b>    |          |
| Net periodic benefit cost          | <b>\$ 5,734</b> | \$ 2,209 |

As discussed in Note 5, we recorded special termination charges in connection with the curtailment of pension benefits, voluntary early retirement pension

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benefits, and termination of certain post retirement benefits related to the Neenah facility shutdown.

**8. COMPREHENSIVE INCOME**

The following table sets forth comprehensive income and its components:

| <i>In thousands</i>                     | <b>Three Months Ended<br/>June 30</b> |             |
|---|---------------------------------------|-------------|
|   | <b>2006</b>                           | <b>2005</b> |
| Net income (loss)                       | \$ (20,722)                           | \$ 1,709    |
| Foreign currency translation adjustment | <b>1,383</b>                          | (5,602)     |
| Comprehensive loss                      | \$ (19,339)                           | \$ (3,893)  |

| <i>In thousands</i>                     | <b>Six Months Ended<br/>June 30</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2006</b>                         | <b>2005</b> |
| Net income (loss)                       | \$ (32,587)                         | \$ 7,999    |
| Foreign currency translation adjustment | <b>3,294</b>                        | (8,841)     |
| Comprehensive loss                      | \$ (29,293)                         | \$ (842)    |

**9. INVENTORIES**

Inventories, net of reserves, were as follows:

| <i>In thousands</i>     | <b>June 30,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
|-------------------------|--------------------------|----------------------------------|
| Raw materials           | \$ 32,650                | \$ 16,392                        |
| In-process and finished | <b>108,968</b>           | 39,930                           |
| Supplies                | <b>47,596</b>            | 24,926                           |
| Total                   | \$ 189,214               | \$ 81,248                        |

**10. LONG-TERM DEBT**

Long-term debt is summarized as follows:

| <i>In thousands</i>                                  | <b>June 30,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
|--|--------------------------|----------------------------------|
| New revolving credit facility, due April 2011        | \$ 52,893                | \$                               |
| Term loan, due April 2011                            | <b>99,440</b>            |                                  |
| Revolving credit facility, due June 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>386,333</b>    | 203,650    |
| Less current portion                      | <b>(7,500)</b>    | (19,650)   |
| Long-term debt, excluding current portion | <b>\$ 378,833</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 our new 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.

On April 28, 2006, we completed a private placement

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offering of \$200.0 million aggregate principal amount of our 7<sup>1</sup>/<sub>8</sub>% Senior Notes due 2016. Our 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.

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 | 267,333 |

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

At June 30, 2006 we had \$5.3 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.

**11. COMMITMENTS, CONTINGENCIES AND LEGAL PROCEEDINGS**

**Ecusta Division Matters** At June 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<br>Environmental<br>Matters | Workers'<br>Comp | Other    | Total     |
|------------------------|------------------------------------|------------------|----------|-----------|
| Balance, Jan. 1, 2005  | \$ 6,391                           | \$ 2,144         | \$ 3,300 | \$ 11,835 |
| Accruals               |                                    |                  |          |           |
| Payments               | (591)                              | (14)             |          | (605)     |
| Other Adjustments      |                                    |                  |          |           |
| Balance, June 30, 2005 | \$ 5,800                           | \$ 2,130         | \$ 3,300 | \$ 11,230 |

|                        |          |          |          |           |
|------------------------|----------|----------|----------|-----------|
| Balance, Jan. 1, 2006  | \$ 8,105 | \$ 1,913 | \$ 3,300 | \$ 13,318 |
| Accruals               |          |          |          |           |
| Payments               | (478)    | (152)    |          | (630)     |
| Other Adjustments      | 16       |          |          | 16        |
| Balance, June 30, 2006 | \$ 7,643 | \$ 1,761 | \$ 3,300 | \$ 12,704 |

With respect to the reserves set forth above as of June 30, 2006, \$1.3 million is recorded under the caption "Other current liabilities" and \$11.4 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 filed for bankruptcy under Chapter 7 of the U.S. Bankruptcy Code. 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 are seeking indemnification from the Buyers. The Third Party Claims primarily relate to certain environmental matters, post-retirement benefits, workers' compensation claims and vendor payables.

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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 substantially completed the closure of these two landfills and expect to begin closing the third during 2006.

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 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.

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. We believe that outcome may still

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be possible. 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.

Whether we will be required to remediate, the extent of contamination, if any, and the ultimate costs to remedy, are not reasonably estimable based on information currently available to us. Accordingly, no amounts for such 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 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 11.

We continue to believe the Buyers are responsible for the Environmental Matters and the Workers Compensation claims under provisions of the Acquisition Agreement, and believe we have a strong legal basis for indemnification. We are pursuing appropriate avenues to enforce the provisions of the Acquisition Agreement.

**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 alleges, among other things, that the Defendant Buyers engaged in fraud and fraudulent transfers and breached their fiduciary duties. With respect to Glatfelter, the complaint alleges 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 seeks damages from us in an amount not less than \$25.8 million, plus interest, and other relief. We believe these claims are largely without merit and we are vigorously defending ourselves in this action. Accordingly, no amounts have been recorded in the accompanying consolidated financial statements.

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 were first notified of the potential Breach Claims in July 2002, which are primarily related to the physical condition of the Ecusta mill at the time of sale. We believe these claims are without merit. With respect to the Escrow Claims, the trustee seeks the release of certain amounts held in escrow related to the sale of the Ecusta Division, of which \$2.0 million was escrowed at the time of closing in the event of claims arising such as those asserted in the Breach Claim. The Escrow Claims also include amounts alleged to total \$1.5 million arising from sales by us of certain properties at or around the Ecusta mill. We have previously reserved such escrowed amounts and they are recorded in the accompanying Condensed Consolidated Balance Sheets as Other long-term liabilities. We are vigorously defending ourselves in this action.

Both of the above actions have been transferred to the U.S. Federal Court for the Western District of North Carolina, along with another action in which we, the bankruptcy trustee and the Buyers are pursuing claims against one another for determination of ultimate contractual liability for workers compensation benefits referenced above.

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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 131,000 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 June 30, 2006, our portion of the escrow account totaled approximately \$10.8 million, of which \$4.7 million is recorded in the accompanying Consolidated Balance Sheet under the caption "Prepaid expenses and other current assets" and \$6.1 million is included under the caption "Other assets." As of June 30, 2006, our reserve for environmental liabilities, substantially all of which is for OU1 remediation activities, totaled \$11.9 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 June 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>June<br/>30,<br/>2006</b> | December<br>31,<br>2005 |
|-----------------------------|------------------------------|-------------------------|
| <i>Recorded as:</i>         |                              |                         |
| Environmental liabilities   | \$ 4.7                       | \$ 7.6                  |
| Other long-term liabilities | 7.2                          | 9.2                     |
| Total                       | <b>\$ 11.9</b>               | \$ 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 six months of 2005 or 2006.

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 Consent Decree and our belief that the required work can

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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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**Table of Contents****12. SEGMENT AND GEOGRAPHIC 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 June 30, |            |                  |            |                       |          |             |            |
|---|-------------------------------------|------------|------------------|------------|-----------------------|----------|-------------|------------|
|   | Specialty Papers                    |            | Composite Fibers |            | Other and Unallocated |          | Total       |            |
|   | <i>In thousands</i>                 |            |                  |            |                       |          |             |            |
|   | 2006                                | 2005       | 2006             | 2005       | 2006                  | 2005     | 2006        | 2005       |
| Net sales   | \$ 203,461                          | \$ 94,497  | \$ 76,263        | \$ 50,779  | \$ (4)                | \$ 7     | \$ 279,720  | \$ 145,283 |
| Energy sales, net   | 2,847                               | 2,715      |                  |            |                       |          | 2,847       | 2,715      |
| Total revenue   | 206,308                             | 97,212     | 76,263           | 50,779     | (4)                   | 7        | 282,567     | 147,998    |
| Cost of products sold                                     | 197,459                             | 89,202     | 66,693           | 42,831     | 12,682                | (3,868)  | 276,834     | 128,165    |
| Gross profit (loss)                                       | 8,849                               | 8,010      | 9,570            | 7,948      | (12,686)              | 3,875    | 5,733       | 19,833     |
| SG&A  | 14,705                              | 9,707      | 6,504            | 6,125      | 3,831                 | 1,142    | 25,040      | 16,974     |
| Shutdown and restructuring charges                        |                                     |            |                  |            | 6,657                 |          | 6,657       |            |
| Gains on dispositions of plant, equipment and timberlands |                                     |            |                  |            | (1,095)               | (21)     | (1,095)     | (21)       |
| Gain on insurance recoveries                              |                                     |            |                  |            | (205)                 | (2,200)  | (205)       | (2,200)    |
| Total operating income (loss)                             | (5,856)                             | (1,697)    | 3,066            | 1,823      | (21,874)              | 4,954    | (24,664)    | 5,080      |
| Nonoperating income (expense)                             |                                     |            |                  |            | (7,940)               | (2,756)  | (7,940)     | (2,756)    |
| Income (loss) before income taxes                         | \$ (5,856)                          | \$ (1,697) | \$ 3,066         | \$ 1,823   | \$ (29,814)           | \$ 2,198 | \$ (32,604) | \$ 2,324   |
| <b>Supplementary Data</b>                                 |                                     |            |                  |            |                       |          |             |            |
| Net tons sold   | 188,854                             | 111,205    | 17,667           | 12,048     | 10                    | 2        | 206,531     | 123,255    |
| Depreciation expense                                      | \$ 7,679                            | \$ 9,000   | \$ 4,493         | \$ 3,790   |                       |          | \$ 12,172   | \$ 12,790  |
| <b>Business Unit Performance</b>                          |                                     |            |                  |            |                       |          |             |            |
| For The Six Months Ended June 30,                         |                                     |            |                  |            |                       |          |             |            |
| Other and   |                                     |            |                  |            |                       |          |             |            |
| <i>In thousands</i>                                       | Specialty Papers                    |            | Composite Fibers |            | Unallocated           |          | Total       |            |
|   | 2006                                | 2005       | 2006             | 2005       | 2006                  | 2005     | 2006        | 2005       |
| Net sales   | \$ 305,810                          | \$ 187,227 | \$ 134,516       | \$ 101,924 | \$                    | \$ 28    | \$ 440,326  | \$ 289,179 |
| Energy sales, net   | 5,304                               | 5,259      |                  |            |                       |          | 5,304       | 5,259      |
| Total revenue   | 311,114                             | 192,486    | 134,516          | 101,924    |                       | 28       | 445,630     | 294,438    |
| Cost of products sold                                     | 286,493                             | 169,353    | 115,722          | 84,041     | 17,417                | (7,383)  | 419,632     | 246,011    |
| Gross profit (loss)                                       | 24,621                              | 23,133     | 18,794           | 17,883     | (17,417)              | 7,411    | 25,998      | 48,427     |
| SG&A  | 23,987                              | 20,069     | 12,585           | 12,270     | 5,165                 | 2,025    | 41,737      | 34,364     |



|   |               |                 |                 |                 |                    |                 |                    |                  |
|---|---------------|-----------------|-----------------|-----------------|--------------------|-----------------|--------------------|------------------|
| Shutdown and restructuring charges                        |               |                 |                 |                 | <b>25,955</b>      |                 | <b>25,955</b>      |                  |
| Gains on dispositions of plant, equipment and timberlands |               |                 |                 |                 | <b>(1,085)</b>     | (81)            | <b>(1,085)</b>     | (81)             |
| Gain on insurance recoveries                              |               |                 |                 |                 | <b>(205)</b>       | (2,200)         | <b>(205)</b>       | (2,200)          |
| Total operating income (loss)                             | <b>634</b>    | 3,064           | <b>6,209</b>    | 5,613           | <b>(47,247)</b>    | 7,667           | <b>(40,404)</b>    | 16,344           |
| Nonoperating income (expense)                             |               |                 |                 |                 | <b>(10,317)</b>    | (5,257)         | <b>(10,317)</b>    | (5,257)          |
| Income (loss) before income taxes                         | <b>\$ 634</b> | <b>\$ 3,064</b> | <b>\$ 6,209</b> | <b>\$ 5,613</b> | <b>\$ (57,564)</b> | <b>\$ 2,410</b> | <b>\$ (50,721)</b> | <b>\$ 11,087</b> |

**Supplementary Data**

|                      |                  |                  |                 |                 |           |   |                  |                  |
|----------------------|------------------|------------------|-----------------|-----------------|-----------|---|------------------|------------------|
| Net tons sold        | <b>307,940</b>   | 221,943          | <b>32,552</b>   | 23,727          | <b>10</b> | 7 | <b>340,502</b>   | 245,677          |
| Depreciation expense | <b>\$ 16,354</b> | <b>\$ 17,869</b> | <b>\$ 8,291</b> | <b>\$ 7,787</b> |           |   | <b>\$ 24,645</b> | <b>\$ 25,656</b> |

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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**Table of Contents****13. 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 and Glenn-Wolfe, Inc.

The following presents our condensed consolidating statements of income for the three and six months ended June 30, 2006 and 2005 and our condensed consolidating balance sheets as of June 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 June 30, 2006**

| <i>In thousand</i>   | Parent<br>Company | Guarantors | Non<br>Guarantors | Adjustments/<br>Eliminations | Consolidated |
|--|-------------------|------------|-------------------|------------------------------|--------------|
| Net sales  | \$ 203,462        | \$ 8,567   | \$ 84,526         | \$ (16,835)                  | \$ 279,720   |
| Energy sales net   | 2,847             |            |                   |                              | 2,847        |
| Total revenues   | 206,309           | 8,567      | 84,526            | (16,835)                     | 282,567      |
| Costs of products sold   | 210,588           | 7,822      | 75,143            | (16,719)                     | 276,834      |
| Gross profit   | (4,279)           | 745        | 9,383             | (116)                        | 5,733        |
| Selling, general and administrative expenses                   | 17,488            | 987        | 6,566             | (1)                          | 25,040       |
| Shutdown and restructuring charges                             | 6,616             | 506        | (465)             |                              | 6,657        |
| Gains on dispositions of plant, equipment and timberlands, net | 34                | (1,129)    |                   |                              | (1,095)      |
| Gains from insurance recoveries                                | (205)             |            |                   |                              | (205)        |
| Operating income   | (28,212)          | 381        | 3,282             | (115)                        | (24,664)     |
| Non-operating income (expense)                                 |                   |            |                   |                              |              |
| Interest expense   | (6,155)           | (463)      | (553)             | 1                            | (7,170)      |
| Other income (expense) net                                     | (3,036)           | 13,459     | (720)             | (10,473)                     | (770)        |
| Total other income (expense)                                   | (9,191)           | 12,996     | (1,273)           | (10,472)                     | (7,940)      |
| Income (loss) before income taxes                              | (37,403)          | 13,377     | 2,009             | (10,587)                     | (32,604)     |
| Income tax provision (benefit)                                 | (16,681)          | 4,755      | 425               | (381)                        | (11,882)     |
| Net income (loss)  | \$ (20,722)       | \$ 8,622   | \$ 1,584          | \$ (10,206)                  | \$ (20,722)  |

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

| Parent | Non | Adjustments/ |
|--------|-----|--------------|
|--------|-----|--------------|

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| <i>In thousand</i>   | Company   | Guarantors | Guarantors | Eliminations | Consolidated |
|--|-----------|------------|------------|--------------|--------------|
| Net sales  | \$ 94,489 | \$ 8,626   | \$ 55,460  | \$ (13,292)  | \$ 145,283   |
| Energy sales net   | 2,715     |            |            |              | 2,715        |
| Total revenues   | 97,204    | 8,626      | 55,460     | (13,292)     | 147,998      |
| Costs of products sold   | 85,369    | 8,300      | 47,601     | (13,105)     | 128,165      |
| Gross profit   | 11,835    | 326        | 7,859      | (187)        | 19,833       |
| Selling, general and administrative expenses                   | 10,286    | 520        | 6,167      | 1            | 16,974       |
| Shutdown and restructuring charges                             |           |            |            |              |              |
| Gains on dispositions of plant, equipment and timberlands, net | 8         | (68)       | 39         |              | (21)         |
| Gains from insurance recoveries                                | (2,200)   |            |            |              | (2,200)      |
| Operating income   | 3,741     | (126)      | 1,653      | (188)        | 5,080        |
| Non-operating income (expense)                                 |           |            |            |              |              |
| Interest expense   | (2,703)   |            | (587)      |              | (3,290)      |
| Other income (expense) net                                     | (2,028)   | 9,940      | (355)      | (7,023)      | 534          |
| Total other income (expense)                                   | (4,731)   | 9,940      | (942)      | (7,023)      | (2,756)      |
| Income (loss) before income taxes                              | (990)     | 9,814      | 711        | (7,211)      | 2,324        |
| Income tax provision (benefit)                                 | (2,699)   | 3,373      | 228        | (287)        | 615          |
| Net income (loss)  | \$ 1,709  | \$ 6,441   | \$ 483     | \$ (6,924)   | \$ 1,709     |

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**Table of Contents****Condensed Consolidating Statement of Income for the six months ended June 30, 2006**

| <i>In thousand</i>   | Parent Company | Guarantors | Non Guarantors | Adjustments/ Eliminations | Consolidated |
|--|----------------|------------|----------------|---------------------------|--------------|
| Net sales  | \$ 305,809     | \$ 18,207  | \$ 148,325     | \$ (32,015)               | \$ 440,326   |
| Energy sales net   | 5,304          |            |                |                           | 5,304        |
| Total revenues   | 311,113        | 18,207     | 148,325        | (32,015)                  | 445,630      |
| Costs of products sold   | 305,406        | 16,199     | 129,806        | (31,779)                  | 419,632      |
| Gross profit   | 5,707          | 2,008      | 18,519         | (236)                     | 25,998       |
| Selling, general and administrative expenses                   | 27,248         | 1,426      | 13,063         |                           | 41,737       |
| Shutdown and restructuring charges                             | 25,875         | 462        | (382)          |                           | 25,955       |
| Gains on dispositions of plant, equipment and timberlands, net | 80             | (1,202)    | 37             |                           | (1,085)      |
| Gains from insurance recoveries                                | (205)          |            |                |                           | (205)        |
| Operating income   | (47,291)       | 1,322      | 5,801          | (236)                     | (40,404)     |
| Non-operating income (expense)                                 |                |            |                |                           |              |
| Interest expense   | (8,956)        | (463)      | (1,144)        |                           | (10,563)     |
| Other income (expense) net                                     | (4,081)        | 25,391     | (1,456)        | (19,608)                  | 246          |
| Total other income (expense)                                   | (13,037)       | 24,928     | (2,600)        | (19,608)                  | (10,317)     |
| Income (loss) before income taxes                              | (60,328)       | 26,250     | 3,201          | (19,844)                  | (50,721)     |
| Income tax provision (benefit)                                 | (27,741)       | 9,338      | 1,033          | (764)                     | (18,134)     |
| Net income (loss)  | \$ (32,587)    | \$ 16,912  | \$ 2,168       | \$ (19,080)               | \$ (32,587)  |

**Condensed Consolidating Statement of Income for the six months ended June 30, 2005**

| <i>In thousand</i>                           | Parent Company | Guarantors | Non Guarantors | Adjustments/ Eliminations | Consolidated |
|--|----------------|------------|----------------|---------------------------|--------------|
| Net sales                                    | \$ 187,211     | \$ 17,726  | \$ 110,408     | \$ (26,166)               | \$ 289,179   |
| Energy sales net                             | 5,259          |            |                |                           | 5,259        |
| Total revenues                               | 192,470        | 17,726     | 110,408        | (26,166)                  | 294,438      |
| Costs of products sold                       | 162,687        | 16,653     | 92,972         | (26,301)                  | 246,011      |
| Gross profit                                 | 29,783         | 1,073      | 17,436         | 135                       | 48,427       |
| Selling, general and administrative expenses | 20,992         | 1,014      | 12,358         |                           | 34,364       |

|   |          |           |          |             |          |
|---|----------|-----------|----------|-------------|----------|
| Shutdown and restructuring charges                                |          |           |          |             |          |
| Gains on dispositions of plant,<br>equipment and timberlands, net | 18       | (129)     | 30       |             | (81)     |
| Gains from insurance recoveries                                   | (2,200)  |           |          |             | (2,200)  |
| Operating income  | 10,973   | 188       | 5,048    | 135         | 16,344   |
| Non-operating income (expense)                                    |          |           |          |             |          |
| Interest expense  | (5,395)  |           | (1,155)  |             | (6,550)  |
| Other income (expense) net  | (2,223)  | 19,639    | (619)    | (15,504)    | 1,293    |
| Total other income (expense)                                      | (7,618)  | 19,639    | (1,774)  | (15,504)    | (5,257)  |
| Income (loss) before income taxes                                 | 3,355    | 19,827    | 3,274    | (15,369)    | 11,087   |
| Income tax provision (benefit)                                    | (4,644)  | 6,927     | 1,184    | (379)       | 3,088    |
| Net income (loss)   | \$ 7,999 | \$ 12,900 | \$ 2,090 | \$ (14,990) | \$ 7,999 |

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**Table of Contents****Condensed Consolidating Balance Sheet as of June 30, 2006**

| <i>In thousands</i>                                  | Parent<br>Company   | Guarantors        | Non<br>Guarantors | Adjustments/<br>Eliminations | Consolidated        |
|--|---------------------|-------------------|-------------------|------------------------------|---------------------|
| <b>Assets</b>  |                     |                   |                   |                              |                     |
| <b>Current assets</b>                                |                     |                   |                   |                              |                     |
| Cash and cash equivalents                            | \$ (3)              | \$ 225            | \$ 23,579         | \$                           | \$ 23,801           |
| Other current assets                                 | 235,286             | 9,337             | 103,176           | 8,289                        | 356,088             |
| Plant, equipment and timberlands<br>net              | 306,070             | 13,428            | 206,282           |                              | 525,780             |
| Other assets   | 1,246,280           | 896,929           | (56,591)          | (1,710,955)                  | 375,663             |
| <b>Total assets</b>                                  | <b>\$ 1,787,633</b> | <b>\$ 919,919</b> | <b>\$ 276,446</b> | <b>\$ (1,702,666)</b>        | <b>\$ 1,281,332</b> |
| <b>Liabilities and Shareholders<br/>Equity</b>       |                     |                   |                   |                              |                     |
| Current liabilities                                  | \$ 164,111          | \$ 4,080          | \$ 34,270         | \$                           | \$ 202,461          |
| Long-term debt                                       | 300,075             |                   | 78,758            |                              | 378,833             |
| Deferred income taxes                                | 176,729             | 13,972            | 22,774            | (9,930)                      | 203,545             |
| Other long-term liabilities                          | 742,407             | 60,073            | 98,120            | (808,418)                    | 92,182              |
| <b>Total liabilities</b>                             | <b>1,383,322</b>    | <b>78,125</b>     | <b>233,922</b>    | <b>(818,348)</b>             | <b>877,021</b>      |
| Shareholders' equity                                 | 404,311             | 841,794           | 42,524            | (884,318)                    | 404,311             |
| <b>Total liabilities and shareholders<br/>equity</b> | <b>\$ 1,787,633</b> | <b>\$ 919,919</b> | <b>\$ 276,446</b> | <b>\$ (1,702,666)</b>        | <b>\$ 1,281,332</b> |

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

| <i>In thousands</i>                            | Parent<br>Company   | Guarantors        | Non<br>Guarantors | Adjustments/<br>Eliminations | Consolidated        |
|--|---------------------|-------------------|-------------------|------------------------------|---------------------|
| <b>Assets</b>                                  |                     |                   |                   |                              |                     |
| <b>Current assets</b>                          |                     |                   |                   |                              |                     |
| Cash and cash equivalents                      | \$ 14,404           | \$ 30,149         | \$ 12,857         | \$ 32                        | \$ 57,442           |
| Other current assets                           | 90,964              | 462               | 76,118            | (1,429)                      | 166,115             |
| Plant, equipment and timberlands<br>net        | 322,208             | 13,537            | 143,083           |                              | 478,828             |
| Other assets                                   | 1,065,934           | 739,840           | 23,009            | (1,486,191)                  | 342,592             |
| <b>Total assets</b>                            | <b>\$ 1,493,510</b> | <b>\$ 783,988</b> | <b>\$ 255,067</b> | <b>\$ (1,487,588)</b>        | <b>\$ 1,044,977</b> |
| <b>Liabilities and Shareholders<br/>Equity</b> |                     |                   |                   |                              |                     |

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|   |              |            |            |                |              |
|---|--------------|------------|------------|----------------|--------------|
| Current liabilities                       | \$ 75,465    | \$ 999     | \$ 63,400  | \$ 14          | \$ 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      | 30,071     | 91,951     | (700,383)      | 82,518       |
| Total liabilities                         | 1,061,198    | 41,655     | 213,354    | (703,542)      | 612,665      |
| Shareholders' equity                      | 432,312      | 742,333    | 41,713     | (784,046)      | 432,312      |
| Total liabilities and shareholders equity | \$ 1,493,510 | \$ 783,988 | \$ 255,067 | \$ (1,487,588) | \$ 1,044,977 |

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**Table of Contents****Condensed Consolidating Statement of Cash Flows for the six months ended June 30, 2006**

| <i>In thousands</i>  | Parent<br>Company | Guarantors | Non<br>Guarantors | Adjustments/<br>Eliminations | Consolidated |
|--|-------------------|------------|-------------------|------------------------------|--------------|
| Net cash provided (used) by<br>Operating Activities        | \$ (57,331)       | \$ 36,524  | \$ (10,695)       | \$ (32)                      | \$ (31,534)  |
| Investing Activities                                       |                   |            |                   |                              |              |
| Purchase of plant, equipment and<br>timberlands            | (22,233)          | (480)      | (2,537)           |                              | (25,250)     |
| Proceeds from disposal plant,<br>equipment and timberlands | 14                | 1,075      | 3                 |                              | 1,092        |
| Proceeds from sale of subsidiary,<br>net of cash dividend  | (84,562)          | (67,043)   |                   |                              | (151,605)    |
| Total Investing Activities                                 | (106,781)         | (66,448)   | (2,534)           |                              | (175,763)    |
| Financing Activities                                       |                   |            |                   |                              |              |
| Net (repayments of) proceeds from<br>indebtedness          | 150,358           |            | 22,577            |                              | 172,935      |
| Payment of Dividends                                       | (7,967)           |            |                   |                              | (7,967)      |
| Proceeds from Stock Options<br>exercised                   | 7,314             |            |                   |                              | 7,314        |
| Total Financing Activities                                 | 149,705           |            | 22,577            |                              | 172,282      |
| Effect of Exchange Rate on Cash                            |                   |            | 1,374             |                              | 1,374        |
| Net Increase (decrease) in cash                            | (14,407)          | (29,924)   | 10,722            | (32)                         | (33,641)     |
| Cash at the beginning of period                            | 14,404            | 30,149     | 12,857            | 32                           | 57,442       |
| Cash at the end of period                                  | \$ (3)            | \$ 225     | \$ 23,579         | \$                           | \$ 23,801    |

**Condensed Consolidating Statement of Cash Flows for the six months ended June 30, 2005**

| <i>In thousands</i>  | Parent<br>Company | Guarantors | Non<br>Guarantors | Adjustments/<br>Eliminations | Consolidated |
|--|-------------------|------------|-------------------|------------------------------|--------------|
| Net cash provided (used) by<br>Operating Activities        | \$ 480            | \$ 371     | \$ 4,319          | \$ (259)                     | \$ 4,911     |
| Investing Activities                                       |                   |            |                   |                              |              |
| Purchase of plant, equipment and<br>timberlands            | (8,180)           | (638)      | (5,187)           |                              | (14,005)     |
| Proceeds from disposal plant,<br>equipment and timberlands | 130               |            |                   |                              | 130          |
| Proceeds from sale of subsidiary, net<br>of cash dividend  |                   |            |                   |                              |              |
| Total Investing Activities                                 | (8,050)           | (638)      | (5,187)           |                              | (13,875)     |



|  |          |        |           |       |           |
|--|----------|--------|-----------|-------|-----------|
| Financing Activities                           |          |        |           |       |           |
| Net (repayments of) proceeds from indebtedness |          |        | 1,338     |       | 1,338     |
| Payment of Dividends                           | (7,914)  |        |           |       | (7,914)   |
| Proceeds from Stock Options exercised          | 116      |        |           |       | 116       |
| Total Financing Activities                     | (7,798)  |        | 1,338     |       | (6,460)   |
| Effect of Exchange Rate on Cash                |          |        | (1,878)   |       | (1,878)   |
| Net decrease in cash                           | (15,368) | (267)  | (1,408)   | (259) | (17,302)  |
| Cash at the beginning of period                | 20,399   | 412    | 18,881    | 259   | 39,951    |
| Cash at the end of period                      | \$ 5,031 | \$ 145 | \$ 17,473 | \$    | \$ 22,649 |

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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 is 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 expires in August;

- 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;
- xv. our ability to execute the planned shutdown of the Neenah facility in an orderly manner; and
- xvi. 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** The analysis of our financial results for the first six months of 2006 versus the first six months of 2005 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 \$81.8 million in cash, subject to post-closing working capital adjustments;
- 3) On June 30, 2006, we ceased production at our Neenah, WI facility and recorded shutdown related charges totaling \$50.7 million;

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- 4) 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.
- 5) During the second quarter we completed the regularly scheduled annual maintenance outages at our Chillicothe and Spring Grove facilities;
- 6) Demand for products in our North America-based Specialty Papers business unit remained strong as our domestic mills operated at or near capacity and selling prices strengthened;
- 7) The results of our Composite Fibers business unit, based in Europe, improved due to strengthening order patterns, although selling prices declined moderately;

**RESULTS OF OPERATIONS**

*Six Months Ended June 30, 2006 versus the  
Six Months Ended June 30, 2005*

The following table sets forth summarized results of operations:

| <i>In thousands, except per share</i> | Six Months Ended<br>June 30 |            |
|---------------------------------------|-----------------------------|------------|
|                                       | <b>2006</b>                 | 2005       |
| Net sales                             | \$ <b>440,326</b>           | \$ 289,179 |
| Gross profit                          | <b>25,998</b>               | 48,427     |
| Operating income (loss)               | <b>(40,404)</b>             | 16,344     |
| Net income (loss)                     | <b>(32,587)</b>             | 7,999      |
| Earnings per share                    | <b>(0.73)</b>               | 0.18       |

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

| <i>In thousands, except per share</i> | <b>After-tax</b>       | <b>Diluted<br/>EPS</b> |
|---------------------------------------|------------------------|------------------------|
|                                       | <i>Gain<br/>(loss)</i> |                        |
| <b>2006</b>                           |                        |                        |
| Shutdown and restructuring charges    | \$ <b>(32,506)</b>     | \$ <b>(0.73)</b>       |
| Acquisition integration related costs | <b>(3,263)</b>         | <b>(0.07)</b>          |
| Redemption premium                    | <b>(1,820)</b>         | <b>(0.04)</b>          |
| Timberland sales                      | <b>590</b>             | <b>0.01</b>            |
| Insurance recoveries                  | <b>130</b>             | <b>0.00</b>            |
| <b>2005</b>                           |                        |                        |
| Insurance recoveries                  | \$ 1,430               | \$ 0.03                |

The above items decreased earnings by \$36.9 million, or \$0.83 per diluted share in the first six months of 2006.

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

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**Business Unit Performance**

| <i>In thousands</i>                                       | For The Six Months Ended June 30, |            |                   |            |                          |          |                    |            |
|---|-----------------------------------|------------|-------------------|------------|--------------------------|----------|--------------------|------------|
|   | Specialty Papers                  |            | Composite Fibers  |            | Other and<br>Unallocated |          | Total              |            |
|   | 2006                              | 2005       | 2006              | 2005       | 2006                     | 2005     | 2006               | 2005       |
| Net sales   | \$ <b>305,810</b>                 | \$ 187,227 | \$ <b>134,516</b> | \$ 101,924 | \$ <b>0</b>              | \$ 28    | \$ <b>440,326</b>  | \$ 289,179 |
| Energy sales, net   | <b>5,304</b>                      | 5,259      |                   |            |                          |          | <b>5,304</b>       | 5,259      |
| Total revenue   | <b>311,114</b>                    | 192,486    | <b>134,516</b>    | 101,924    | <b>0</b>                 | 28       | <b>445,630</b>     | 294,438    |
| Cost of products sold                                     | <b>286,493</b>                    | 169,353    | <b>115,722</b>    | 84,041     | <b>17,417</b>            | (7,383)  | <b>419,632</b>     | 246,011    |
| Gross profit (loss)                                       | <b>24,621</b>                     | 23,133     | <b>18,794</b>     | 17,883     | <b>(17,417)</b>          | 7,411    | <b>25,998</b>      | 48,427     |
| SG&A  | <b>23,987</b>                     | 20,069     | <b>12,585</b>     | 12,270     | <b>5,165</b>             | 2,025    | <b>41,737</b>      | 34,364     |
| Shutdown and restructuring charges                        |                                   |            |                   |            | <b>25,955</b>            |          | <b>25,955</b>      |            |
| Gains on dispositions of plant, equipment and timberlands |                                   |            |                   |            | <b>(1,085)</b>           | (81)     | <b>(1,085)</b>     | (81)       |
| Gain on insurance recoveries                              |                                   |            |                   |            | <b>(205)</b>             | (2,200)  | <b>(205)</b>       | (2,200)    |
| Total operating income (loss)                             | <b>634</b>                        | 3,064      | <b>6,209</b>      | 5,613      | <b>(47,247)</b>          | 7,667    | <b>(40,404)</b>    | 16,344     |
| Nonoperating income (expense)                             |                                   |            |                   |            | <b>(10,317)</b>          | (5,257)  | <b>(10,317)</b>    | (5,257)    |
| Income (loss) before income taxes                         | \$ <b>634</b>                     | \$ 3,064   | \$ <b>6,209</b>   | \$ 5,613   | \$ <b>(57,564)</b>       | \$ 2,410 | \$ <b>(50,721)</b> | \$ 11,087  |
| <b>Supplementary Data</b>                                 |                                   |            |                   |            |                          |          |                    |            |
| Net tons sold   | <b>307,940</b>                    | 221,943    | <b>32,552</b>     | 23,727     | <b>10</b>                | 7        | <b>340,502</b>     | 245,677    |
| Depreciation expense                                      | \$ <b>16,354</b>                  | \$ 17,869  | \$ <b>8,291</b>   | \$ 7,787   |                          |          | \$ <b>24,645</b>   | \$ 25,656  |

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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.

**Sales and Costs of Products Sold**

| <i>In thousands</i>                    | Six Months Ended  |            | Change      |
|--|-------------------|------------|-------------|
|  | 2006              | 2005       |             |
|  | June 30           |            |             |
| Net sales                              | <b>\$ 440,326</b> | \$ 289,179 | \$ 151,147  |
| Energy sales net                       | <b>5,304</b>      | 5,259      | 45          |
| Total revenues                         | <b>445,630</b>    | 294,438    | 151,192     |
| Costs of products sold                 | <b>419,632</b>    | 246,011    | 173,621     |
| Gross profit                           | <b>\$ 25,998</b>  | \$ 48,427  | \$ (22,429) |
| Gross profit as a percent of Net sales | <b>5.9%</b>       | 16.7%      |             |

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     | <b>69.5%</b>     | 64.7%  |
| Composite Fibers     | <b>30.5</b>      | 35.3   |
| Total                | <b>100.0%</b>    | 100.0% |

Net sales totaled \$440.3 million for the first six months of 2006, an increase of \$151.1 million, or 52.3%, compared to the same period a year ago. Net sales from the Chillicothe and Lydney mill acquisitions totaled \$127.6 million. These acquisitions are reported in the Specialty Papers and Composite Fibers business units, respectively. Organic growth was driven by a 3.8% increase in volume and \$8.8 million from higher average selling prices in the Specialty Papers business unit. Excluding results of the Lydney mill, Composite Fibers volumes shipped increased 20.7%. The translation of foreign currencies unfavorably impacted this business unit's net sales by \$4.0 million and average selling prices declined \$3.9 million compared to the same period a year ago.

In connection with the Chillicothe acquisition, the Company permanently shutdown its Neenah, WI facility. Products previously manufactured at the Neenah facility have been transferred to Chillicothe. The results of operations for the first six months of 2006 include related pre-tax charges of \$50.7 million, of which \$24.8 million is reflected in the consolidated income statement as components of cost of products sold and \$25.9 million is reflected as Shutdown and restructuring charges.

Costs of products sold totaled \$419.6 million for the six months of 2006, an increase of \$173.6 million compared with the same quarter a year ago. As discussed above, the 2006 costs of products sold includes a \$24.8 million charge for inventory write-downs and accelerated depreciation on property and equipment to be abandoned in connection with the Neenah shutdown. Excluding these charges, the increase in costs of products sold was primarily due to the inclusion of the Chillicothe and Lydney acquisitions, a \$22.5 million effect of increased shipping volumes, as well as higher raw material and energy prices that increased costs of products sold by approximately \$8.1 million. The translation of foreign currencies reduced costs of products sold by \$3.6 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 second quarter of 2006 and \$5.9 million in the comparable quarter a year ago.

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**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 for each of the first six months of 2006 and 2005:

| <i>In thousands</i>    | Six Months Ended<br>June 30 |          | Change   |
|------------------------|-----------------------------|----------|----------|
|                        | 2006                        | 2005     |          |
| <i>Recorded as:</i>    |                             |          |          |
| Costs of products sold | \$ 7,453                    | \$ 7,413 | \$ 40    |
| SG&A expense           | 512                         | 833      | (321)    |
| Total                  | \$ 7,965                    | \$ 8,246 | \$ (281) |

**Selling, general and administrative ( SG&A )** expenses totaled \$41.7 million in for the first six months of 2006 compared to \$34.4 million a year ago. SG&A expenses increased due to approximately \$5.1 million of acquisition integration costs and \$4.9 million from the inclusion of the Chillicothe and Lydney acquisitions in the current period s results of operations. Lower professional and legal fees favorably impacted the period to period comparison.

**Insurance Recoveries** During the first six 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 six months of 2006 and \$2.2 million in the first six 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, in the first six months of 2006 we committed to a plan to permanently shutdown our Neenah facility. The following table summarizes restructuring charges incurred in connection with these initiatives:

| <i>In thousands</i>               | Six Months<br>Ended<br>June 30,<br>2006 |
|-----------------------------------|---|
| Restructuring initiative:         |   |
| <i>Recorded as:</i>               |   |
| Costs of products sold            | \$ 24,868                               |
| Shutdown and restructuring charge | 25,875                                  |
| Total                             | \$ 50,743                               |

The components of the charge are as follows:

| <i>In thousands</i>                | Six Months<br>Ended<br>June 30,<br>2006 |
|------------------------------------|---|
| Accelerated depreciation           | \$ 22,457                               |
| Inventory write-down               | 2,411                                   |
| Severance and benefit continuation | 6,592                                   |



|  |           |
|--|-----------|
| Pension and other retirement benefits curtailments | 7,675     |
| Contract termination costs                         | 11,386    |
| Other  | 222       |
| Total  | \$ 50,743 |

The Neenah facility supported our Specialty Papers business unit. Shutdown of this facility resulted in the elimination of approximately 200 positions. As part of the Neenah shutdown, we terminated our long-term steam supply contract, as provided for within the contract, resulting in a termination fee of approximately \$11.4 million. Through June 30, 2006, approximately \$0.03 million has been paid related to these charges.

The first six months results of operations also include \$0.08 million of charges related to the European Restructuring and Optimization (EURO) Program.

We expect to record in the third and fourth quarters additional shutdown related charges totaling approximately \$2.5 million and \$4.0 million.

**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 and Unallocated .

**Income Taxes** Our results of operations for the first six months of 2006 reflects an effective tax rate of 35.8% compared to 27.9% in the same period a year ago. The increase in the effective tax rate is primarily due to a higher effective state tax rate due to the Chillicothe acquisition and the absence of tax credits associated with the expiration of the research and development tax credit law at the end of 2005. In addition, the lower rate in 2005 reflects the resolution of certain state tax matters.

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**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 first six months of 2006, these operations generated approximately 28% of our sales and 27% 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:

| In thousands           | Six Months<br>Ended June<br>30     |
|------------------------|------------------------------------|
|                        | <b>Favorable<br/>(unfavorable)</b> |
| Net sales              | <b>(\$3,981)</b>                   |
| Costs of products sold | <b>3,602</b>                       |
| SG&A expenses          | <b>404</b>                         |
| Income taxes and other | <b>49</b>                          |
| Net income             | <b>\$ 74</b>                       |

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.

***Three Months Ended June 30, 2006 versus the  
Three Months Ended June 30, 2005***

The following table sets forth summarized results of operations:

| <i>In thousands, except per share</i> | Three Months Ended<br>June 30 |            |
|---------------------------------------|-------------------------------|------------|
|                                       | <b>2006</b>                   | 2005       |
| Net sales                             | <b>\$ 279,720</b>             | \$ 145,283 |
| Gross profit                          | <b>5,733</b>                  | 19,833     |
| Operating income                      | <b>(24,664)</b>               | 5,080      |
| Net income (loss)                     | <b>(20,722)</b>               | 1,709      |
| Earnings (loss) per share             | <b>(0.46)</b>                 | 0.04       |

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

| <i>In thousands, except per share</i> | <b>After-tax</b>       | <b>Diluted<br/>EPS</b> |
|---------------------------------------|------------------------|------------------------|
|                                       | <i>Gain<br/>(loss)</i> |                        |
| <b>2006</b>                           |                        |                        |
| Shutdown and restructuring charges    | <b>\$ (14,901)</b>     | <b>\$(0.33)</b>        |
| Acquisition integration related costs | <b>(2,319)</b>         | <b>(0.05)</b>          |
| Redemption premium                    | <b>(1,820)</b>         | <b>(0.04)</b>          |
| Timberland sales                      | <b>590</b>             | <b>0.01</b>            |
| Insurance recoveries                  | <b>130</b>             | <b>0.00</b>            |

2005

Insurance recoveries \$ 1,430 \$ 0.03

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

**Business Unit Performance**

| <i>In thousands, except net tons sold</i>                 | For the Three Months Ended June 30, |            |                  |           |                       |          |             |            |
|---|-------------------------------------|------------|------------------|-----------|-----------------------|----------|-------------|------------|
|   | Specialty Papers                    |            | Composite Fibers |           | Other and Unallocated |          | Total       |            |
|   | 2006                                | 2005       | 2006             | 2005      | 2006                  | 2005     | 2006        | 2005       |
| Net sales   | \$ 203,461                          | \$ 94,497  | \$ 76,263        | \$ 50,779 | \$ (4)                | \$ 7     | \$ 279,720  | \$ 145,283 |
| Energy sales, net   | 2,847                               | 2,715      |                  |           |                       |          | 2,847       | 2,715      |
| Total revenue   | 206,308                             | 97,212     | 76,263           | 50,779    | (4)                   | 7        | 282,567     | 147,998    |
| Cost of products sold                                     | 197,459                             | 89,202     | 66,693           | 42,831    | 12,682                | (3,868)  | 276,834     | 128,165    |
| Gross profit (loss)                                       | 8,849                               | 8,010      | 9,570            | 7,948     | (12,686)              | 3,875    | 5,733       | 19,833     |
| SG&A  | 14,705                              | 9,707      | 6,504            | 6,125     | 3,831                 | 1,142    | 25,040      | 16,974     |
| Shutdown and restructuring charges                        |                                     |            |                  |           | 6,657                 |          | 6,657       |            |
| Gains on dispositions of plant, equipment and timberlands |                                     |            |                  |           | (1,095)               | (21)     | (1,095)     | (21)       |
| Gain on insurance recoveries                              |                                     |            |                  |           | (205)                 | (2,200)  | (205)       | (2,200)    |
| Total operating income (loss)                             | (5,856)                             | (1,697)    | 3,066            | 1,823     | (21,874)              | 4,954    | (24,664)    | 5,080      |
| Non-operating income (expense)                            |                                     |            |                  |           | (7,940)               | (2,756)  | (7,940)     | (2,756)    |
| Income (loss) before income taxes                         | \$ (5,856)                          | \$ (1,697) | \$ 3,066         | \$ 1,823  | \$ (29,814)           | \$ 2,198 | \$ (32,604) | \$ 2,324   |
| <b>Supplementary Data</b>                                 |                                     |            |                  |           |                       |          |             |            |
| Net tons sold   | 188,854                             | 111,205    | 17,667           | 12,048    | 10                    | 2        | 206,531     | 123,255    |
| Depreciation expense                                      | \$ 7,679                            | \$ 9,000   | \$ 4,493         | \$ 3,790  |                       |          | \$ 12,172   | \$ 12,790  |

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

**Sales and Costs of Products Sold**

| <i>In thousands</i>                    | Three Months Ended<br>June 30 |            | Change      |
|--|-------------------------------|------------|-------------|
|  | 2006                          | 2005       |             |
| Net sales                              | \$ 279,720                    | \$ 145,283 | \$ 134,437  |
| Energy sales net                       | 2,847                         | 2,715      | 132         |
| Total revenues                         | 282,567                       | 147,998    | 134,569     |
| Costs of products sold                 | 276,834                       | 128,165    | 148,669     |
| Gross profit                           | \$ 5,733                      | \$ 19,833  | \$ (14,100) |
| Gross profit as a percent of Net sales | 2.0%                          | 13.7%      |             |

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     | 72.7%            | 65.0%  |
| Composite Fibers     | 27.3             | 35.0   |
| Total                | 100.0%           | 100.0% |

Net sales totaled \$279.7 million for the second quarter of 2006, an increase of \$134.4 million, or 92.5%, compared to the same quarter a year ago. Net sales from the Chillicothe and Lydney mill acquisitions totaled \$124.1 million. These acquisitions are reported in the Specialty Papers and Composite Fibers business units, respectively. Organic growth, was driven by a 3.0% increase in volume and \$5.6 million from higher average selling prices in the Specialty Papers business unit. Excluding results of the Lydney mill, Composite Fibers volumes shipped increased 20%. The translation of foreign currencies unfavorably impacted this business unit's net sales by \$2.5 million and average selling prices declined \$1.3 million compared to the same quarter a year ago.

Costs of products sold totaled \$276.8 million for the second quarter of 2006, an increase of \$148.7 million compared with the same quarter a year ago. As discussed above, the 2006 second quarter costs of products sold includes a \$16.6 million pre-tax charge for inventory write-downs and accelerated depreciation on property and equipment to be abandoned in connection with the Neenah shutdown. Excluding these charges, the increase in costs of products sold was primarily due to the inclusion of the Chillicothe and Lydney acquisitions, an \$8.3 million effect of increased shipping volumes, as well as higher raw material and energy prices that increased costs of products sold by approximately \$4.4 million. The translation of foreign currencies reduced costs of products sold by \$2.1 million. During the second quarters of 2006 and 2005, we completed our annually scheduled maintenance shutdown of the 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 second quarter of 2006 and \$5.9 million in the comparable quarter a year

ago.

**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<br>June 30 |          | Change   |
|------------------------|-------------------------------|----------|----------|
|                        | 2006                          | 2005     |          |
| <i>Recorded as:</i>    |                               |          |          |
| Costs of products sold | \$ 3,964                      | \$ 3,877 | \$ 87    |
| SG&A expense           | 280                           | 489      | (209)    |
| Total                  | \$ 4,244                      | \$ 4,366 | \$ (122) |

**Selling, general and administrative ( SG&A )** expenses totaled \$25.0 million in the second quarter of 2006 compared with \$17.0 million in the year-earlier second quarter. The amounts reported for the second quarter of 2006 include approximately \$3.7 million of acquisition integration related expenses. Excluding these non-recurring costs, the balance of the increase in SG&A expenses, is primarily due to the inclusion of the Chillicothe and Lydney acquisitions in the current quarter's results of operations.

**Shutdown and restructuring charges - Neenah Facility Shutdown** As discussed above, in the first six months of 2006 we committed to a plan to permanently shutdown our Neenah facility. The following table summarizes restructuring charges incurred in connection with these initiatives:

| <i>In thousands</i>                | Three<br>Months<br>Ended<br>June 30,<br>2006 |
|------------------------------------|--|
| Restructuring initiative:          |  |
| <i>Recorded as:</i>                |  |
| Costs of products sold             | \$ 16,645                                    |
| Shutdown and restructuring charges | 6,616  |
| Total                              | \$ 23,261                                    |

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The components of the charge are as follows:

| <i>In thousands</i>                                | <b>Three<br/>Months<br/>Ended<br/>June 30,<br/>2006</b> |
|--|---|
| Accelerated depreciation                           | \$ 16,645   |
| Inventory write-down                               | -   |
| Severance and benefit continuation                 | 4,831   |
| Pension and other retirement benefits curtailments | 1,372   |
| Contract termination costs                         | 277   |
| Other  | 136   |
| <b>Total</b>                                       | <b>\$ 23,261</b>  |

**Income Taxes** Our results of operations for the second quarter of 2006 reflects an effective tax rate of 36.4% compared to 26.5% in the same period a year ago. The increase in the effective tax rate is primarily due to a higher effective state tax rate due to the Chillicothe acquisition and the absence of tax credits associated with the expiration of the research and development tax credit law at the end of 2005.

**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 second quarter of 2006, these operations generated approximately 25% of our sales and 24% 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 second quarter of 2006 compared to the same quarter of 2005:

| <i>In thousands</i>    | <b>Three<br/>Months<br/>Ended<br/>June 30,<br/>2006</b> |
|------------------------|---|
|                        | <b>Favorable<br/>(unfavorable)</b>                      |
| Net sales              | \$ (2,467)  |
| Costs of products sold | 2,075   |
| SG&A expenses          | 258   |
| Income taxes and other | (29)  |
| <b>Net income</b>      | <b>\$ (163)</b>   |

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. Nor does it reflect the impact of making certain A/R, A/P and other transactions to market at the end of the period.

**LIQUIDITY AND CAPITAL RESOURCES**

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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>                              | Six Months Ended<br>June 30 |           |
|--|-----------------------------|-----------|
|  | 2006                        | 2005      |
| Cash and cash equivalents at beginning of period | \$ 57,442                   | \$ 39,951 |
| Cash provided by (used for)                      |                             |           |
| Operating activities                             | (31,534)                    | 4,911     |
| Investing activities                             | (175,763)                   | (13,875)  |
| Financing activities                             | 172,282                     | (6,460)   |
| Effect of exchange rate changes on cash          | 1,374                       | (1,878)   |
| Net cash provided (used)                         | (33,641)                    | (17,302)  |
| Cash and cash equivalents at end of period       | \$ 23,801                   | \$ 22,649 |

During the first six months of 2006 operations used \$31.5 million of cash compared to \$4.9 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 and \$17.1 million of income tax payments made during the first six months of 2006.

The changes in investing cash flows reflects the use of approximately \$151.6 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.

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

| <i>In thousands</i>                                  | June 30,<br>2006 | December<br>31,<br>2005 |
|--|------------------|-------------------------|
| New revolving credit facility, due April 2011        | \$ 52,893        | \$                      |
| Term loan, due April 2011                            | 99,440           |                         |
| Revolving credit facility, due June 2006             |                  | 19,650                  |
| 7 <sup>1</sup> / <sub>8</sub> % Notes, due May 2016  | 200,000          |                         |
| 6 <sup>1</sup> / <sub>8</sub> % Notes, due July 2007 |                  | 150,000                 |
| Note payable SunTrust, due March 2008                | 34,000           | 34,000                  |
| Total long-term debt                                 | 386,333          | 203,650                 |
| Less current portion                                 | (7,500)          | (19,650)                |
| Long-term debt, excluding current portion            | \$ 378,833       | \$ 184,000              |

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As more fully discussed in Item 1 Financial Statements, Note 10, 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 a private placement 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 six months of 2006 and 2005, cash dividends paid on common stock totaled \$7.9 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 June 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** We expect orders for our product offerings in the North America-based Specialty Papers business unit to be at or near capacity. In addition, pricing has strengthened and is expected to remain at or above these levels. We expect these conditions to prevail through most of 2006.

In our Composite Fibers business unit we expect order patterns to continue to improve and pricing conditions are expected to remain stable.

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**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS**

| <i>Dollars in thousands</i>    | 2006       | Year Ended December 31 |            |            |            | At June 30, 2006 |            |
|--------------------------------|------------|------------------------|------------|------------|------------|------------------|------------|
|                                |            | 2007                   | 2008       | 2009       | 2010       | Carrying Value   | Fair Value |
| <b>Long-term debt</b>          |            |                        |            |            |            |                  |            |
| Average principal outstanding  |            |                        |            |            |            |                  |            |
| At fixed interest rates        | \$ 234,000 | \$ 234,000             | \$ 208,500 | \$ 200,000 | \$ 200,000 | \$ 234,000       | \$ 222,931 |
| At variable interest rates     | 152,333    | 146,709                | 129,834    | 107,959    | 82,959     | 152,333          | 152,333    |
| Weighted-average interest rate |            |                        |            |            |            |                  |            |
| On fixed interest rate debt    | 6.64%      | 6.64%                  | 6.99%      | 7.13%      | 7.13%      |                  |            |
| On variable interest rate debt | 5.49       | 5.47                   | 5.47       | 5.25       | 4.99       |                  |            |

Our market risk exposure primarily results from changes in interest rates and currency exchange rates. At June 30, 2006, we had long-term debt outstanding of \$386.3 million, of which \$152.3 million or 39.4% 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 June 30, 2006, the interest rate paid was 5.49%. A hypothetical 100 basis point increase or decrease in the interest rate on variable rate debt would increase or decrease annual interest expense by \$1.5 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 six months ended June 30, 2006, approximately 72.0% of our net sales were shipped from the United States, 19.5% from Germany, and 8.5% from other international locations.

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***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 June 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 and are in the process of evaluating how the separate financial reporting processes applicable to these newly acquired entities will be incorporated into our internal control structure. There were no other changes in our internal control over financial reporting during the six months ended June 30, 2006, that have materially affected or is reasonably likely to materially affect our internal control over financial reporting.

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**Table of Contents****PART II****ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of holders of Glatfelter common stock was held on April 26, 2006. At this meeting, shareholders voted on the following matters (with the indicated tabulated results).

- i. The election of two members of the Board of Directors to serve for full three-year terms expiring in 2009.

| Director                | For        | Withheld |
|-------------------------|------------|----------|
| George H. Glatfelter II | 38,223,792 | 241,283  |
| Ronald J. Naples        | 38,111,900 | 353,175  |
| Richard J. Smoot        | 37,556,332 | 908,743  |

**ITEM 6. EXHIBITS****(a) Exhibits**

The following exhibits are filed herewith.

- 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.
- 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.
- 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.
- 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.

**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)

August 9, 2006

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

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**EXHIBIT INDEX**

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 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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