

SCHWEITZER MAUDUIT INTERNATIONAL INC

Form 10-Q

August 06, 2008

[Table of Contents](#)

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2008

---

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

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

For the quarterly period ended June 30, 2008

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

1-13948

(Commission file number)

---

# SCHWEITZER-MAUDUIT INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**62-1612879**  
(I.R.S. Employer  
Identification No.)

**100 North Point Center East, Suite 600**  
**Alpharetta, Georgia**  
(Address of principal executive offices)

**30022**  
(Zip code)

**1-800-514-0186**

(Registrant's telephone number, including area code)

---

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

There were 15,668,322 shares of common stock, par value \$0.10 per share, of the registrant outstanding as of July 31, 2008.

**Table of Contents**

**TABLE OF CONTENTS**

		<b>Page</b>
<b><u>Part I</u></b>	<b><u>FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u>	<u>Financial Statements</u>	1
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
<u>Item 4.</u>	<u>Controls and Procedures</u>	33
<b><u>Part II</u></b>	<b><u>OTHER INFORMATION</u></b>	
<u>Item 1.</u>	<u>Legal Proceedings</u>	34
<u>Item 1A.</u>	<u>Risk Factors</u>	34
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	34
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	34
<u>Item 5.</u>	<u>Other Information</u>	34
<u>Item 6.</u>	<u>Exhibits</u>	35
<b><u>SIGNATURES</u></b>		36
<b><u>GLOSSARY OF TERMS</u></b>		

---

**Table of Contents**

**PART I**

**ITEM 1. FINANCIAL STATEMENTS**

**SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

**(dollars in millions, except per share amounts)**

**(Unaudited)**

Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Net Sales	\$ 202.0	\$ 171.8	\$ 391.8	\$ 342.1
Cost of products sold	177.8	145.8	347.6	287.8
Gross Profit	24.2	26.0	44.2	54.3
Selling expense	5.8	5.4	12.2	11.0
Research expense	2.5	2.0	4.5	4.0
General expense	7.4	9.2	17.0	18.1
Total nonmanufacturing expenses	15.7	16.6	33.7	33.1
Restructuring expense (Note 4)	3.7	3.4	5.7	6.1
Operating Profit	4.8	6.0	4.8	15.1
Interest expense	2.8	1.5	5.2	2.8
Other income (expense), net	0.6	(0.2)	(1.0)	(0.1)
Income (Loss) Before Income Taxes, Minority Interest and Loss from Equity Affiliates	2.6	4.3	(1.4)	12.2
Provision (benefit) for income taxes (Note 8)		1.2	(2.6)	3.1
Minority interest in earnings of subsidiaries (Note 9)		2.1	0.2	3.8
Loss from equity affiliates	0.6		0.2	0.1
Net Income	\$ 2.0	\$ 1.0	\$ 0.8	\$ 5.2
Net Income Per Share:				
Basic	\$ 0.13	\$ 0.06	\$ 0.05	\$ 0.33
Diluted	\$ 0.13	\$ 0.06	\$ 0.05	\$ 0.33
Cash Dividends Declared Per Share	\$ 0.15	\$ 0.15	\$ 0.30	\$ 0.30
Weighted Average Shares Outstanding:				
Basic	15,395,900	15,605,300	15,402,000	15,551,500
Diluted	15,702,100	15,887,800	15,658,200	15,803,800

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

Table of Contents**SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(dollars in millions, except per share amounts)****(Unaudited)**

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 9.4	\$ 4.0
Accounts receivable	103.1	100.6
Inventories	126.7	131.2
Other current assets	11.8	11.4
Total Current Assets	251.0	247.2
Property, Plant and Equipment, net	493.9	456.0
Intangible Assets and Goodwill (Note 9)	19.0	2.8
Investment in Equity Affiliates	19.1	15.4
Deferred Income Tax Benefits	16.9	15.2
Other Assets	40.6	38.4
Total Assets	\$ 840.5	\$ 775.0
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities		
Current debt	\$ 16.2	\$ 13.6
Accounts payable	84.4	84.3
Accrued income taxes payable	1.8	8.4
Accrued expenses	98.2	102.9
Current deferred revenue	6.0	6.0
Total Current Liabilities	206.6	215.2
Long-Term Debt	171.8	87.3
Pension and Other Postretirement Benefits	39.9	38.9
Deferred Income Tax Liabilities	25.8	25.0
Deferred Revenue	15.0	18.1
Other Liabilities	22.8	22.7
Total Liabilities	481.9	407.2
Minority Interest (Note 9)		26.0
Stockholders Equity:		
Preferred stock, \$0.10 par value; 10,000,000 shares authorized; none issued or outstanding		
Common stock, \$0.10 par value; 100,000,000 shares authorized; 16,078,733 shares issued; 15,666,928 and 15,508,397 shares outstanding at June 30, 2008 and December 31, 2007, respectively	1.6	1.6
Additional paid-in-capital	64.3	68.0
	(9.0)	(12.3)

Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

Common stock in treasury, at cost, 411,805 and 570,336 shares at June 30, 2008 and December 31, 2007, respectively			
Retained earnings		260.7	264.6
Accumulated other comprehensive income, net of tax		41.0	19.9
Total Stockholders Equity		358.6	341.8
Total Liabilities and Stockholders Equity	\$	840.5	\$ 775.0

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

Table of Contents

## SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS

## EQUITY AND COMPREHENSIVE INCOME

(dollars in millions, except per share amounts)

(Unaudited)

	Common Stock Issued Shares	Amount	Additional Paid-In Capital	Treasury Stock Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance, December 31, 2006</b>	<b>16,078,733</b>	<b>\$ 1.6</b>	<b>\$ 63.3</b>	<b>561,343</b>	<b>\$ (11.4)</b>	<b>\$ 270.6</b>	<b>\$ (21.1)</b>	<b>\$ 303.0</b>
Net income for the six months ended June 30, 2007						5.2		5.2
Adjustments to unrealized foreign currency translation, net of tax							11.8	11.8
Amortization of postretirement benefit plans costs, net of tax							0.8	0.8
Comprehensive income, net of tax								17.8
Dividends declared (\$0.30 per share)						(4.7)		(4.7)
Restricted stock issuances, net			(0.6)	(29,960)	0.6			
Stock-based employee compensation expense			0.4					0.4
Stock issued to directors as compensation				(2,908)	0.1			0.1
Excess tax benefits of stock-based awards			0.3					0.3
Purchases of treasury stock				4,340	(0.1)			(0.1)
Issuance of shares for options exercised			0.3	(204,807)	4.1			4.4
<b>Balance, June 30, 2007</b>	<b>16,078,733</b>	<b>\$ 1.6</b>	<b>\$ 63.7</b>	<b>328,008</b>	<b>\$ (6.7)</b>	<b>\$ 271.1</b>	<b>\$ (8.5)</b>	<b>\$ 321.2</b>
<b>Balance, December 31, 2007</b>	<b>16,078,733</b>	<b>\$ 1.6</b>	<b>\$ 68.0</b>	<b>570,336</b>	<b>\$ (12.3)</b>	<b>\$ 264.6</b>	<b>\$ 19.9</b>	<b>\$ 341.8</b>
Net income for the six months ended June 30, 2008						0.8		0.8
Adjustments to unrealized foreign currency translation,							20.6	20.6

Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

net of tax														
Amortization of postretirement benefit plans costs, net of tax							0.5			0.5				
Comprehensive income, net of tax										21.9				
Dividends declared (\$0.30 per share)							(4.7)			(4.7)				
Restricted stock issuances, net	(4.3)	(197,965)				4.3								
Stock-based employee compensation expense	0.6									0.6				
Stock issued to directors as compensation			(3,466)			0.1				0.1				
Purchases of treasury stock			48,900			(1.2)				(1.2)				
Issuance of shares for options exercised			(6,000)			0.1				0.1				
<b>Balance, June 30, 2008</b>	<b>16,078,733</b>	<b>\$</b>	<b>1.6</b>	<b>\$</b>	<b>64.3</b>	<b>411,805</b>	<b>\$</b>	<b>(9.0)</b>	<b>\$</b>	<b>260.7</b>	<b>\$</b>	<b>41.0</b>	<b>\$</b>	<b>358.6</b>

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

Table of Contents**SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOW****(dollars in millions)****(Unaudited)**

	<b>Six Months Ended</b>	
	<b>June 30,</b>	<b>June 30,</b>
	<b>2008</b>	<b>2007</b>
<b>Operations</b>		
Net income	\$ 0.8	\$ 5.2
Non-cash items included in net income:		
Depreciation and amortization	23.8	19.4
Restructuring related impairment charges and accelerated depreciation	3.0	1.5
Amortization of deferred revenue	(3.1)	(3.2)
Deferred income tax benefit	(11.8)	(4.0)
Minority interest in earnings of subsidiaries	0.2	3.8
Pension and other postretirement benefits	0.7	(2.1)
Other items	0.8	2.4
Net changes in operating working capital	(2.1)	(1.1)
Cash Provided by Operations	12.3	21.9
<b>Investing</b>		
Capital spending	(24.0)	(18.3)
Capitalized software costs	(2.2)	(4.5)
LTRI minority interest acquisition (Note 9)	(51.3)	
Investment in equity affiliates	(1.9)	(6.5)
Other	(3.7)	(1.0)
Cash Used for Investing	(83.1)	(30.3)
<b>Financing</b>		
Cash dividends paid to SWM stockholders	(4.7)	(4.7)
Changes in short-term debt	2.9	2.4
Proceeds from issuances of long-term debt	100.1	13.0
Payments on long-term debt	(20.9)	(12.6)
Purchases of treasury stock	(1.2)	(0.1)
Proceeds from exercise of stock options	0.1	4.4
Excess tax benefits of stock-based awards		0.3
Cash Provided by Financing	76.3	2.7
Effect of Exchange Rate Changes on Cash	(0.1)	0.5
Increase (Decrease) in Cash and Cash Equivalents	5.4	(5.2)
Cash and Cash Equivalents at beginning of period	4.0	13.7
Cash and Cash Equivalents at end of period	\$ 9.4	\$ 8.5

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



Table of Contents

**NOTE 1. GENERAL**

**Nature of Business**

Schweitzer-Mauduit International, Inc., or the Company, is a multinational diversified producer of premium specialty papers headquartered in the United States of America and is the world's largest supplier of fine papers to the tobacco industry. The Company manufactures and sells paper and reconstituted tobacco products to the tobacco industry as well as specialized paper products for use in other applications. Tobacco industry products comprised approximately 90 percent of the Company's consolidated net sales in each of the three and six month periods ended June 30, 2008 and 2007. The primary products in the group include cigarette, plug wrap and tipping papers, or Cigarette Papers, used to wrap various parts of a cigarette, reconstituted tobacco leaf, or RTL, which is used as a blend with virgin tobacco in cigarettes and reconstituted tobacco wrappers and binders for machine-made cigars. These products are sold directly to the major tobacco companies or their designated converters in the Americas, Europe, Asia and elsewhere. Non-tobacco industry products are a diverse mix of products, certain of which represent commodity paper grades produced to maximize machine operations.

The Company is a manufacturer of high porosity papers, which are used in manufacturing ventilated cigarettes, banded papers for the production of lower ignition propensity, or LIP, cigarettes and the leading independent producer of RTL used in producing blended cigarettes. The Company conducts business in over 90 countries and currently operates 11 production locations worldwide, with mills in the United States, France, the Philippines, Indonesia and Brazil. The Company also has a 50 percent equity interest in a mill in China currently in operational start-up.

**Basis of Presentation**

The accompanying unaudited consolidated financial statements and the notes thereto have been prepared in accordance with the instructions of Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission, or the SEC, and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America, or GAAP. However, such information reflects all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of results for the interim periods.

The results of operations for the three and six month periods ended June 30, 2008 are not necessarily indicative of the results to be expected for the full-year. The unaudited consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and the notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 as filed with the SEC on March 7, 2008.

**Principles of Consolidation**



## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

The consolidated financial statements include the accounts of the Company and wholly-owned, majority-owned and controlled subsidiaries. Minority interest represents minority stockholders' proportionate share of the equity in Schweitzer-Mauduit do Brasil S.A., or SWM-B, and LTR Industries S.A., or LTRI, the Company's French RTL operations. In January 2008, the Company acquired the minority interest in LTRI, subsequent to which it owns 100 percent of the outstanding shares. See Note 9, Acquisition, of the Notes to Consolidated Financial Statements. The Company's share of the net loss of its 50 percent owned joint venture in China is included in the consolidated statements of income as loss from equity affiliates. All significant intercompany balances and transactions have been eliminated.

### **Use of Estimates**



## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

The preparation of financial statements in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, inventory valuation, depreciable lives, amortization lives, fair values in purchase allocations, sales returns, receivables valuation, pension, postretirement and other benefits, restructuring, taxes and contingencies. Actual results could differ materially from those estimates.

Table of Contents

**Fair Value**

Effective January 1, 2008, the Company adopted the provisions related to financial assets and liabilities of Financial Accounting Standards Board, or FASB, Statement of Financial Accounting Standards, or SFAS, No. 157, *Fair Value Measurement*. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 also expands disclosure requirements to include: (a) the fair value measurements of assets and liabilities at the reporting date, (b) segregation of assets and liabilities between fair value measurements based on quoted market prices and those based on other methods and (c) information that enables users to assess the method or methods used to estimate fair value when no quoted price exists. Adoption of SFAS No. 157 related to financial assets and liabilities on January 1, 2008 had no effect on the Company's consolidated financial position at January 1, 2008 or June 30, 2008 or its results of operations for the three and six month periods ended June 30, 2008. The provisions of SFAS No. 157 related to nonfinancial assets and liabilities will become effective for fiscal years beginning after November 15, 2008. The Company is currently in the process of reviewing the provisions of SFAS No. 157 related to nonfinancial assets and liabilities to determine the impact on its consolidated financial position and results of operation.

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of SFAS No. 115*. SFAS No. 159 permits entities to choose to measure financial instruments and certain other items at fair value that are not currently required to be measured at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option was elected shall be recognized in earnings as incurred and not deferred. Adoption of SFAS No. 159 on January 1, 2008 had no effect on the Company's consolidated financial position at January 1, 2008 or June 30, 2008 or its results of operations for the three or six month periods ended June 30, 2008 as the Company has elected not to measure any of its financial instruments or certain commitments at fair value.

**Recent Accounting Pronouncements**



## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

In December 2007, the FASB issued SFAS No. 141R, which is a revision of SFAS No. 141, *Business Combinations*. SFAS No. 141R applies prospectively to business combinations after the beginning of the first annual reporting period beginning on or after December 15, 2008. The objective of SFAS No. 141R is to improve the reporting requirements of business combinations and their effects. To accomplish this, SFAS No. 141R establishes the principles and requirements for how the acquirer: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and noncontrolling interest in the acquiree, (b) recognizes and measures goodwill in the business combination or a gain from a bargain purchase and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The impact of this standard on the Company's consolidated financial statements will depend on the nature, terms and size of acquisitions entered into on or after January 1, 2009.

During December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The objective of SFAS No. 160 is to improve the reporting requirements for noncontrolling or minority interests by requiring: (a) the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled and presented in the consolidated statement of financial position within equity, but separate from the parent's equity, (b) the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated income statement, (c) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently, (d) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value and (e) sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The Company is currently in the process of reviewing this guidance to determine the impact on its consolidated financial position and results of operation.

Table of Contents

In March 2008, the FASB issued SFAS No. 161, *Disclosures About Derivative Instruments and Hedging Activities*, an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 161 is effective for fiscal years and interim periods beginning on or after November 15, 2008. SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows.

**NOTE 2. NET INCOME PER SHARE**



## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

Basic net income per common share is computed based on net income divided by the weighted average number of common shares outstanding. Diluted net income per common share is computed based on net income divided by the weighted average number of common and potential common shares outstanding. Potential common shares during the respective periods are those related to stock options outstanding, restricted stock outstanding, directors' accumulated deferred stock compensation which may be received by the directors in the form of stock or cash and restricted stock estimated to be earned as part of the long-term incentive plan. A reconciliation of the average number of common and potential common shares outstanding used in the calculations of basic and diluted net income per share follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Average number of common shares outstanding	15,395.9	15,605.3	15,402.0	15,551.5
Dilutive effect of:				
- stock options	8.2	79.6	15.9	69.6
- restricted stock	271.0	175.7	214.1	156.2
- directors' deferred stock compensation	27.0	27.2	26.2	26.5
Average number of common and potential common shares outstanding	15,702.1	15,887.8	15,658.2	15,803.8

Certain stock options outstanding during the periods presented were not included in the calculations of diluted net income per share because the exercise prices of the options were greater than the average market prices of the common shares during the respective periods. The average number of share equivalents resulting from these anti-dilutive stock options not included in the computations of diluted net income per share for the three and six month periods ended June 30, 2008 were approximately 713,400 and 627,200, respectively, and for the three and six month periods ended June 30, 2007 were approximately 358,800 and 370,300, respectively.

### NOTE 3. INVENTORIES

The following schedule details inventories by major class (dollars in millions):

	June 30, 2008		December 31, 2007	
Raw materials	\$ 34.2	\$	39.5	
Work in process	28.0		25.4	
Finished goods	37.8		44.8	
Supplies and other	26.7		21.5	
Total	\$ 126.7	\$	131.2	

Table of Contents

**NOTE 4. RESTRUCTURING ACTIVITIES**

On July 1, 2008, the Company announced the exit of the coated papers business in the Brazilian market and a resulting decrease of approximately 100 employees, or 16 percent, of the current workforce in Brazil, both effective immediately. These actions resulted in restructuring expense of \$1.9 million for asset impairment charges in the second quarter of 2008, and \$1.3 to \$1.5 million of employee severance and other cash expenses are expected, primarily in the third quarter of 2008.

The Company had previously initiated restructuring activities, discussed further below, during 2006 and 2007 in France and the United States and during 2007 in Brazil. Restructuring expenses related to all these actions totaled \$3.7 million and \$3.4 million for the three month periods ended June 30, 2008 and 2007, respectively, and \$5.7 million and \$6.1 million for the six month periods ended June 30, 2008 and 2007, respectively.

During 2006, the Company authorized approximately \$26 million in capital investments at Papeteries de Mauduit S.A.S., or PdM, as part of its restructuring plan, including the rebuild of 1 of PdM's 2 large cigarette paper machines and installation of additional robotized, high-speed converting units and other related manufacturing support assets. All of these capital investments were made to replace older, less efficient equipment.

In October 2007, the Company initiated a 3-part restructuring plan to reduce production capacity for tobacco-related papers in both France and the United States as well as to reduce employment levels in Brazil. The 3-part plan included the expected idling of a base tipping paper machine at Papeteries de Malaucène S.A.S., or PdMal, in Malaucène, France by the end of 2008 and the shutdown of the Company's entire operation in Lee, Massachusetts which began in May 2008 and is nearly complete. The Company is in the process of transferring production from PdMal and the Lee Mills to other of its facilities, primarily in Santanésia, Brazil, and has discontinued the sale of the majority of commercial and industrial papers formerly produced at the Lee Mills.

As a result of these restructuring actions, including the latest action in Brazil announced July 1, 2008, employment at the affected locations is expected to decrease by approximately 800 employees, over 20 percent from 2006 levels. The announced restructuring activities are expected to be completed during 2008.

The following table summarizes the associated cash and non-cash pretax restructuring expense for the three and six month periods ended June 30, 2008 and 2007 and the associated cumulative cash and non-cash pretax restructuring expense from the 2006 inception of restructuring activities to June 30, 2008 (dollars in millions):

Table of Contents

	Three Months Ended		Six Months Ended		Cumulative
	June 30,	June 30,	June 30,	June 30,	2006 to
	2008	2007	2008	2007	June 30, 2008
<b>France</b>					
<b>Cash Expense</b>					
Severance and other employee related costs	\$ 0.6	\$ 2.6	\$ 1.7	\$ 4.6	\$ 23.9
Other					0.9
<b>Non-cash Expense</b>					
Accelerated depreciation	0.4	0.4	0.9	0.8	4.0
<b>Total France Restructuring Expense</b>	<b>1.0</b>	<b>3.0</b>	<b>2.6</b>	<b>5.4</b>	<b>28.8</b>
<b>United States</b>					
<b>Cash Expense</b>					
Severance and other employee related costs	0.5		0.9		2.9
Other	0.1		0.1		0.2
<b>Non-cash Expense</b>					
Asset impairment charges	0.2		0.2		11.4
Accelerated depreciation		0.4		0.7	5.2
<b>Total United States Restructuring Expense</b>	<b>0.8</b>	<b>0.4</b>	<b>1.2</b>	<b>0.7</b>	<b>19.7</b>
<b>Brazil</b>					
<b>Cash Expense</b>					
Severance and other employee related costs					0.4
<b>Non-cash Expense</b>					
Asset impairment charges	1.9		1.9		1.9
<b>Total Brazil Restructuring Expense</b>	<b>1.9</b>		<b>1.9</b>		<b>2.3</b>
<b>Summary</b>					
Total Cash Expense	1.2	2.6	2.7	4.6	28.3
Total Non-cash Expense	2.5	0.8	3.0	1.5	22.5
<b>Total Restructuring Expense</b>	<b>\$ 3.7</b>	<b>\$ 3.4</b>	<b>\$ 5.7</b>	<b>\$ 6.1</b>	<b>\$ 50.8</b>

The Company currently estimates pre-tax expenses from 2006 through 2008 for all announced restructuring activities to be in the range of \$54 to \$57 million, comprised of \$30 to \$32 million in severance and other cash costs and \$24 to \$25 million in asset impairment charges, accelerated depreciation and other non-cash costs. Restructuring expenses of \$50.8 million, or approximately 90 percent of the total projected, have been recognized through June 30, 2008.

Restructuring liabilities were classified within accrued expenses in the consolidated balance sheets as of June 30, 2008 and December 31, 2007. Changes in the restructuring liabilities during the six month period ended June 30, 2008 and the twelve month period ended December 31, 2007 are summarized as follows (dollars in millions):

	Six Months Ended		Year Ended	
	June 30,	June 30,	December 31,	December 31,
	2008	2007	2007	2007
Balance at beginning of year	\$ 16.4	\$ 16.4	\$ 13.9	\$ 13.9
Accruals for announced programs	2.7	2.7	10.2	10.2
Cash payments	(6.6)	(6.6)	(9.5)	(9.5)
Exchange rate impacts	2.0	2.0	1.8	1.8
Balance at end of period	\$ 14.5	\$ 14.5	\$ 16.4	\$ 16.4



Table of Contents

Restructuring severance costs were accounted for in accordance with SFAS No. 112, *Employers Accounting for Postretirement Benefits - An Amendment of FASB Statements No. 5 and 15*, SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* and SFAS No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans for Termination Benefits*.

**NOTE 5. DEBT**



Total debt is summarized in the following table (dollars in millions):

	June 30, 2008	December 31, 2007
<b>Credit Agreement</b>		
U. S. Revolver	\$ 92.0	\$ 69.0
Euro Revolver	64.7	
French Employee Profit Sharing	13.1	17.0
Bank Overdrafts	7.6	6.7
Other	10.6	8.2
<b>Total Debt</b>	<b>188.0</b>	<b>100.9</b>
Less: Current debt	16.2	13.6
<b>Long-Term Debt</b>	<b>\$ 171.8</b>	<b>\$ 87.3</b>

### Credit Agreement

The Company's Credit Agreement provides for a \$95 million U.S. dollar revolving credit facility, or U.S. Revolver, and an 80 million euro revolving credit facility, or Euro Revolver. Borrowings under the U.S. Revolver increased to \$92.0 million as of June 30, 2008 from \$69.0 million as of December 31, 2007. Availability under the U.S. Revolver decreased to \$3.0 million as of June 30, 2008 from \$26.0 million as of December 31, 2007. Borrowings under the Euro Revolver increased to 41.0 million euros, or \$64.7 million, as of June 30, 2008 from zero as of December 31, 2007. Availability under the Euro Revolver decreased to 39.0 million euros as of June 30, 2008 from 80.0 million euros as of December 31, 2007.

The Credit Agreement contains representations and warranties which are customary for facilities of this type and covenants and provisions that, among other things, require the Company to maintain (a) a net debt to equity ratio not to exceed 1.0 and (b) a net debt to adjusted EBITDA ratio not to exceed 3.0. Under the Credit Agreement, interest rates are at market rates, based on the London Interbank Offered Rate, or LIBOR, for U.S. dollar borrowings and the Euro Interbank Offered Rate, or EURIBOR, for euro borrowings, plus an applicable margin that varies from 0.35 percent to 0.75 percent per annum depending on the Net Debt to Adjusted EBITDA Ratio, as defined in the Credit Agreement. The Company incurs commitment fees at an annual rate of either 0.30 or 0.35 percent of the applicable margin on the committed amounts not drawn, depending on the Net Debt to Adjusted EBITDA Ratio as defined in the Credit Agreement. The Company also incurs utilization fees of 0.25 percent per annum when outstanding borrowings exceed 50 percent of the total credit facility. The Company was in compliance with all the financial covenants of the Credit Agreement as of June 30, 2008.

### Bank Overdraft



## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

The Company had bank overdraft facilities totaling \$40.9 million as of June 30, 2008. Bank overdraft obligations outstanding increased to \$7.6 million as of June 30, 2008 from \$6.7 million as of December 31, 2007, which reduced availability under bank overdrafts to \$33.3 million as of June 30, 2008.

### **Interest Rate Swap Agreements**



## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

The Company maintains interest rate swap agreements on a portion of its long-term debt. As of June 30, 2008, the LIBOR rates on \$30.0 million and \$8.0 million of the Company's variable-rate long-term debt were fixed at 5.13 percent and 4.99 percent, respectively. The impact of the swap agreements on the consolidated financial statements was not material for either of the three or six month periods ended June 30, 2008.

Table of Contents



**NOTE 6. COMMITMENTS AND CONTINGENCIES**



## Litigation

The Company is involved in various legal proceedings and disputes (see Note 8, Commitments and Contingencies, of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007). There have been no material developments to these matters during the quarter ended June 30, 2008.

## Environmental Matters

The Company's operations are subject to federal, state and local laws, regulations and ordinances relating to various environmental matters. The nature of the Company's operations exposes it to the risk of claims with respect to environmental matters, and there can be no assurance that material costs or liabilities will not be incurred in connection with such claims. While the Company has incurred in the past several years, and will continue to incur, capital and operating expenditures in order to comply with environmental laws and regulations, it believes that its future cost of compliance with environmental laws, regulations and ordinances, and its exposure to liability for environmental claims and its obligation to participate in the remediation and monitoring of certain hazardous waste disposal sites, will not have a material adverse effect on its financial condition or results of operations. However, future events, such as changes in existing laws and regulations, or future claims for remediation of contamination of sites presently or previously owned, operated or used for waste disposal by the Company (including contamination caused by prior owners and operators of such sites or other waste generators) may give rise to additional costs which could have a material adverse effect on its financial condition or results of operations.

## NOTE 7. POSTRETIREMENT AND OTHER BENEFITS

The Company sponsors pension benefits in the United States, France, the Philippines and Canada and postretirement healthcare and life insurance, or OPEB, benefits in the United States and Canada. The Company's Canadian and Philippines pension and OPEB benefits are not material and therefore are not included in the following disclosures.

### Pension and OPEB Benefits

The components of net pension and OPEB benefit costs for U.S. employees and net pension benefit costs for French employees during the three and six month periods ended June 30, 2008 and 2007 were as follows (dollars in millions):

	U.S. Pension Benefits		Three Months Ended June 30,				U.S. OPEB Benefits	
	2008	2007	French Pension Benefits		2008	2007	2008	2007
Service cost	\$ 0.1	\$ 0.2	\$ 0.4	\$ 0.5	\$ 0.1	\$ 0.1	\$ 0.2	
Interest cost	1.7	1.7	0.6	0.5	0.1	0.2		
Expected return on plan assets	(2.0)	(1.9)	(0.3)	(0.4)				
Amortizations and other	0.2	0.6	0.1	0.1				
Net periodic benefit cost	\$ 0.6	\$ 0.6	\$ 0.8	\$ 0.7	\$ 0.2	\$ 0.2	\$ 0.2	

Six Months Ended June 30,

**French Pension**

	<b>U.S. Pension Benefits</b>		<b>French Pension Benefits</b>				<b>U.S. OPEB Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Service cost	\$ 0.2	\$ 0.5	\$ 0.8	\$ 1.0	\$ 0.2	\$ 0.1		
Interest cost	3.3	3.3	1.1	0.9	0.3	0.4		
Expected return on plan assets	(4.0)	(3.8)	(0.6)	(0.7)				
Amortizations and other	0.5	1.1	0.3	0.3				
Net periodic benefit cost	\$	\$ 1.1	\$ 1.6	\$ 1.5	\$ 0.5	\$ 0.5		

Table of Contents

During the full-year 2008, the Company expects to recognize approximately \$1 million for amortization of accumulated other comprehensive loss related to its U.S. pension and OPEB plans and approximately \$1 million for its French pension plans. The Company recognized amortization of \$0.2 million and \$0.5 million for its U.S. pension plans and \$0.1 million and \$0.3 million for its French pension plans during the three and six month periods ended June 30, 2008, respectively.

The Company made \$0.7 million in pension contributions to its pension plans during the six month period ended June 30, 2008, and currently expects to contribute a total of \$3 to \$6 million to its pension plans during the full-year 2008. The Company paid \$0.4 million and \$0.8 million for its U.S. OPEB benefits during the three and six month periods ended June 30, 2008, respectively, and expects to pay a total of \$1 to \$2 million during the full-year 2008.

**NOTE 8. INCOME TAXES**

A reconciliation of income taxes computed at the U.S. federal statutory income tax rate to the provision (benefit) for income taxes is as follows (dollars in millions):

	Three Months Ended				Six Months Ended							
	June 30, 2008		June 30, 2007		June 30, 2008		June 30, 2007					
Tax provision (benefit) at U.S. statutory rate	\$	0.9	35.0%	\$	1.5	35.0%	\$	(0.5)	35.0%	\$	4.3	35.0%
Tax benefits of foreign legal structure		(1.1)	(42.3)		(0.6)	(14.0)		(2.1)	150.7		(1.7)	(13.9)
Other, net		0.2	7.3		0.3	6.9					0.5	4.3
Provision (benefit) for income taxes	\$		%	\$	1.2	27.9%	\$	(2.6)	185.7%	\$	3.1	25.4%

Tax benefits of foreign legal structure result from net foreign tax deductions from the restructuring of the Company's foreign operations in 2003. The proportionate effect of this item on the overall effective income tax rate decreases as earnings increase.

The Company records and maintains income tax valuation allowances as necessary to reduce net deferred income tax assets to an amount which is estimated more likely than not to be realizable in accordance with SFAS No. 109, *Accounting for Income Taxes*.

Deferred income tax assets include net operating loss carry forwards ( NOLs ) in Brazil, France, and the Philippines at June 30, 2008. Operating losses have been incurred in recent periods in Brazil, France and the Philippines as a result of lower operating earnings together with substantial restructuring expenses incurred in Brazil and France. Under current tax laws, NOLs in Brazil and France carry forward indefinitely and in the Philippines expire 3 years subsequent to the year generated.

## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

As of June 30, 2008, the Company had net deferred tax assets of \$3.9 million and \$1.1 million in Brazil and the Philippines, respectively. In France, at June 30, 2008, the Company had a net deferred tax liability, however that consisted of a net deferred tax asset of \$20.1 million in one tax group and net deferred tax liabilities of \$2.0 million and \$41.1 million in another tax group and LTRI, respectively.

The Company's assumptions, judgments and estimates relative to the valuation of net deferred tax assets take into account available positive and negative evidence of realizability, including recent financial performance, the ability to realize benefits of restructuring and other recent actions, projections of the amount and category of future taxable income and tax planning strategies. Actual future operating results and the underlying amount and category of income in future periods could differ from the Company's current assumptions, judgments and estimates. Although realization is not assured, the Company believes it is more likely than not that the net deferred tax assets at June 30, 2008 will be realized. However, continued operating losses, particularly in Brazil and the Company's paper operations in France, increase the possibility of recording a valuation allowance in a future period. If at a future date the Company determines that it will not be able to realize all or part of its deferred tax assets, or if in the Company's judgment the weight of the positive evidence is not sufficient to overcome the negative evidence, a valuation allowance against the Company's deferred tax assets would be recorded in the period any such determination is made to reduce the net deferred tax asset to an amount deemed to be more likely than not realizable.

Table of Contents

The Company adopted the provisions of FASB Interpretation No. 48, or FIN 48, *Accounting for Uncertainty in Income Taxes* effective January 1, 2007. FIN 48 is an interpretation of SFAS No. 109, which seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties and accounting in interim periods and requires expanded disclosure with respect to the uncertainty in income taxes. The adoption of FIN 48 had no cumulative effect on the Company's consolidated financial position at January 1, 2007. At June 30, 2008 and December 31, 2007, the Company had no significant unrecognized tax benefits related to income taxes.

The Company's policy with respect to penalties and interest in connection with income tax assessments or related to unrecognized tax benefits is to classify penalties as provision for income taxes and interest as interest expense in its consolidated income statement. There were no material income tax penalties or interest accrued during either of the three or six month periods ended June 30, 2008 or 2007.

The Company files income tax returns in the U.S. Federal and several state jurisdictions as well as in many foreign jurisdictions. With certain exceptions, the Company is no longer subject to U.S. Federal, state and local, or foreign income tax examinations for years before 2004.

**NOTE 9. ACQUISITION**

In January 2008, 2 of the Company's French subsidiaries purchased the 28 percent minority interest in LTRI owned by Société Nationale d'Exploitation Industrielle des Tabacs et Allumettes, S.A., a subsidiary of Altadis, S.A., subsequent to which the Company owns 100 percent of LTRI's outstanding shares. The purchase price of 35.0 million euros was funded by borrowings under the Company's Euro Revolver. The following table summarizes the allocation, of the 35.0 million euros, or \$51.3 million, purchase price for the acquisition (dollars in millions):

Purchase Price (35 million euros)	\$	51.3
Carrying Value		26.2
Step-Up in Basis	\$	25.1
Allocation of Step-Up in Basis:		
Inventories	\$	0.1
Land		2.1
Tangible depreciable assets		16.2
Amortizable intangibles		10.0
Goodwill		6.4
Deferred income tax liability		(9.7)
Total Step-Up in Basis	\$	25.1

The Company is amortizing LTRI's customer related intangibles using the 150 percent declining balance method over a 6-year amortizable life. The Company recorded amortization expense of \$0.7 million and \$1.3 million for the customer related intangibles during the three and six month periods ended June 30, 2008, respectively. Additionally, the Company recorded \$0.4 million and \$0.8 million of incremental depreciation as a result of the stepped-up bases in depreciable property, plant and equipment during the three and six month periods ended June 30, 2008, respectively.

Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

The increased bases in the LTRI assets are not tax deductible in France. In accordance with SFAS No. 109, a deferred income tax liability was recorded for the nondeductible purchase allocations to inventories, land, tangible depreciable assets and amortizable intangibles, but no deferred income tax balance was recorded related to goodwill.

Table of Contents

The following unaudited pro forma condensed consolidated statement of income data for the three and six month periods ended June 30, 2007 are presented for illustrative purposes only as a comparison versus the actual 2008 periods reported herein. This pro forma data was prepared as though the minority interest acquisition had occurred on January 1, 2007, the beginning of the periods presented. It is not necessarily indicative of the operating results that would have been achieved if the LTRI minority interest acquisition had occurred on January 1, 2007, nor is it indicative of future operating results. Pro forma financial information for the 2008 periods is not presented since such pro forma income statement information is not materially different from the actual reported statements of income included herein.

(dollars in millions, except per share amounts)	Three Months Ended June 30, 2007			Six Months Ended June 30, 2007		
	Historical	(Unaudited) Pro Forma		Historical	(Unaudited) Pro Forma	
		Adjustments *	Pro Forma Results		Adjustments *	Pro Forma Results
Net sales	\$ 171.8	\$	\$ 171.8	\$ 342.1	\$	\$ 342.1
Gross profit	26.0	(1.0)	25.0	54.3	(2.0)	52.3
Operating profit	6.0	(1.0)	5.0	15.1	(2.0)	13.1
Interest expense	1.5	0.5	2.0	2.8	1.0	3.8
Income before income taxes, minority interest and income from equity affiliates	4.3	(1.5)	2.8	12.2	(3.0)	9.2
Provision for income taxes	1.2	(0.5)	0.7	3.1	(1.1)	2.0
Minority interest in earnings of subsidiaries	2.1	(2.1)		3.8	(3.8)	
Net income	\$ 1.0	\$ 1.1	\$ 2.1	\$ 5.2	\$ 1.9	\$ 7.1
Basic net income per share	\$ 0.06	\$ 0.07	\$ 0.13	\$ 0.33	\$ 0.12	\$ 0.45
Diluted net income per share	\$ 0.06	\$ 0.07	\$ 0.13	\$ 0.33	\$ 0.12	\$ 0.45

\* Pro forma adjustments primarily consist of incremental depreciation expense, amortization expense on intangible assets, interest expense, related income tax effects of these expenses and reversal of minority interest in earnings of subsidiaries.

**NOTE 10. SEGMENT INFORMATION**

The Company operates and manages 3 reportable segments: United States, or U.S., France and Brazil. These segments are based on the geographical location of the Company's manufacturing operations. These business segments manufacture and sell Cigarette Papers used to wrap various parts of a cigarette and reconstituted tobacco products, as well as certain non-tobacco industry products. While the products are similar in each segment, they vary based on customer requirements and the manufacturing capabilities of each of the operations. Sales by a segment into markets primarily served by a different segment occur where specific product needs cannot be cost-effectively met by the manufacturing operations domiciled in that segment.

The accounting policies of these segments are the same as those described in Note 2, Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. The Company primarily evaluates segment performance and allocates resources based on operating profit and cash flow.

## Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

For purposes of the segment disclosure in the following tables, the term "United States" includes operations in the United States and Canada. The Canadian operations only produce flax fiber used as raw material in the U.S. operations. The term "France" includes operations in France, the Philippines and Indonesia because the results of the Philippine and Indonesian operations are not material for segment reporting purposes and their sales are integrated with sales of the Company's French operations in southeast Asia. Sales of products between segments are made at market prices and elimination of these sales is referred to in the following tables as intersegment sales. Expense amounts not associated with segments are referred to as unallocated expenses.

Table of Contents**Net Sales**

(dollars in millions)

	Three Months Ended				Six Months Ended			
	June 30, 2008		June 30, 2007		June 30, 2008		June 30, 2007	
France	\$ 129.2	64.0%	\$ 102.7	59.8%	\$ 250.0	63.8%	\$ 203.0	59.3%
United States	57.7	28.6	56.2	32.7	113.2	28.9	113.1	33.1
Brazil	20.3	10.0	17.1	9.9	38.2	9.8	34.5	10.1
Subtotal	207.2	102.6	176.0	102.4	401.4	102.5	350.6	102.5
Intersegment sales by								
France	(0.7)	(0.4)	(1.3)	(0.7)	(1.3)	(0.4)	(2.3)	(0.7)
United States	(1.6)	(0.8)	(0.7)	(0.4)	(2.3)	(0.6)	(1.5)	(0.4)
Brazil	(2.9)	(1.4)	(2.2)	(1.3)	(6.0)	(1.5)	(4.7)	(1.4)
Subtotal	(5.2)	(2.6)	(4.2)	(2.4)	(9.6)	(2.5)	(8.5)	(2.5)
Consolidated	\$ 202.0	100.0%	\$ 171.8	100.0%	\$ 391.8	100.0%	\$ 342.1	100.0%

**Operating Profit (Loss)**

(dollars in millions)

	Three Months Ended				Six Months Ended			
	June 30, 2008		June 30, 2007		June 30, 2008		June 30, 2007	
France	\$ 6.5	135.4%	\$ 6.0	100.0%	\$ 5.6	116.7%	\$ 13.2	87.4%
United States	3.9	81.3	3.4	56.7	9.3	193.7	7.9	52.3
Brazil	(4.4)	(91.7)	(0.4)	(6.7)	(6.1)	(127.1)	(0.2)	(1.3)
Unallocated	(1.2)	(25.0)	(3.0)	(50.0)	(4.0)	(83.3)	(5.8)	(38.4)
Consolidated	\$ 4.8	100.0%	\$ 6.0	100.0%	\$ 4.8	100.0%	\$ 15.1	100.0%

Table of Contents

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

*The following is a discussion of our results of operations, current financial position and cash flows. This discussion should be read in conjunction with our unaudited consolidated financial statements and related notes included elsewhere in this report and the audited consolidated financial statements and related notes and the selected financial data included in Item 6 of our Annual Report on Form 10-K for the year ended December 31, 2007. The discussion of our results of operations and financial position includes various forward-looking statements about our markets, the demand for our products and our future results. These statements are based on certain assumptions that we consider reasonable. For information about risks and exposures relating to our business and our company, you should read the section entitled "Factors That May Affect Future Results" included in our Annual Report on Form 10-K for the year ended December 31, 2007. Unless the context indicates otherwise, references to we, us, our, or similar terms include Schweitzer-Mauduit International, Inc. and our consolidated subsidiaries.*

**Introduction**

**This Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to provide the reader with an understanding of our recent performance, our financial condition and our prospects. The following will be discussed and analyzed:**

- Executive Summary
- Recent Developments
- Results of Operations
- Liquidity and Capital Resources
- Other Factors Affecting Liquidity and Capital Resources
- Outlook
- Forward-Looking Statements

**Executive Summary**

**(dollars in millions, except per share amounts)**

	<b>Three Months Ended</b>				<b>Six Months Ended</b>							
	<b>June 30, 2008</b>		<b>June 30, 2007</b>		<b>June 30, 2008</b>		<b>June 30, 2007</b>					
Net sales	\$	202.0	100.0%	\$	171.8	100.0%	\$	391.8	100.0%	\$	342.1	100.0%

Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

Gross profit	24.2	12.0	26.0	15.1	44.2	11.3	54.3	15.9
Restructuring expense	3.7	1.8	3.4	2.0	5.7	1.5	6.1	1.8
Operating profit	4.8	2.4	6.0	3.5	4.8	1.2	15.1	4.4
Interest expense	2.8	1.4	1.5	0.9	5.2	1.3	2.8	0.8
Other income (expense), net	0.6	0.3	(0.2)	(0.1)	(1.0)	(0.2)	(0.1)	
Minority interest			2.1	1.2	0.2	0.1	3.8	1.1
Net income	\$ 2.0	1.0%	\$ 1.0	0.6%	\$ 0.8	0.2%	\$ 5.2	1.5%
Diluted earnings per share	\$ 0.13		\$ 0.06		\$ 0.05		\$ 0.33	
Cash provided by operations	\$ 20.3		\$ 11.8		\$ 12.3		\$ 21.9	
Capital spending	\$ 5.4		\$ 9.3		\$ 24.0		\$ 18.3	

*Second Quarter Highlights*

Net sales were \$202.0 million for the three month period ended June 30, 2008, a 17.6 percent increase over the prior-year quarter. Net sales increased \$15.1 million as a result of favorable foreign currency exchange rate impacts, \$10.1 million due to higher average selling prices, primarily due to an improved mix of products sold, and \$5.0 million from increased sales volumes. Gross profit was \$24.2 million during the three month period ended June 30, 2008, a decrease of \$1.8 million from the prior-year quarter. The gross profit margin was 12.0 percent, decreasing

Net sales were \$202.0 million for the three month period ended June 30, 2008, a 17.6 percent increase over the pri

**Table of Contents**

from 15.1 percent for the prior-year quarter. Restructuring expenses were \$3.7 million and \$3.4 million for the three month periods ended June 30, 2008 and 2007, respectively. During the three months ended June 30, 2008, we recorded an asset impairment charge of \$1.9 million in Brazil due to our exit of the coated papers business. Operating profit was \$4.8 million for the three month period ended June 30, 2008 versus an operating profit of \$6.0 million for the prior-year quarter. Gross profit and operating profit both decreased primarily due to inflationary cost increases of \$9.0 million, start-up costs associated with PdM's paper machine rebuild of \$3.9 million, unfavorable fixed cost absorption of \$1.8 million, primarily due to decreased paper machine production volume in the United States, and unfavorable foreign currency impacts of \$0.6 million. Partially offsetting these negative impacts were higher average selling prices of \$7.6 million, primarily due to an improved mix of products sold, increased sales volumes of \$3.7 million and lower nonmanufacturing expenses. Interest expense was higher by \$1.3 million as a result of increased average debt levels. Other income (expense), net resulted in \$0.6 million of income during the second quarter of 2008 versus \$0.2 million of expense during the same period in 2007, primarily due to foreign currency transaction gains and losses. Minority interest in earnings of subsidiaries declined from \$2.1 million in 2007 to zero in 2008 as a result of our purchase of the 28 percent minority interest in LTRI during January 2008. Net income and diluted net income per share were higher than the comparable periods of the prior-year by \$1.0 million and \$0.07, respectively.

from 15.1 percent for the prior-year quarter. Restructuring expenses were \$3.7 million and \$3.4 million for the three months ended June 30, 2008 and 2007, respectively. During the three months ended June 30, 2008, we recorded an asset impairment charge of \$1.9 million in Brazil due to our exit of the coated papers business. Operating profit was \$4.8 million for the three month period ended June 30, 2008 versus an operating profit of \$6.0 million for the prior-year quarter. Gross profit and operating profit both decreased primarily due to inflationary cost increases of \$9.0 million, start-up costs associated with PdM's paper machine rebuild of \$3.9 million, unfavorable fixed cost absorption of \$1.8 million, primarily due to decreased paper machine production volume in the United States, and unfavorable foreign currency impacts of \$0.6 million. Partially offsetting these negative impacts were higher average selling prices of \$7.6 million, primarily due to an improved mix of products sold, increased sales volumes of \$3.7 million and lower nonmanufacturing expenses. Interest expense was higher by \$1.3 million as a result of increased average debt levels. Other income (expense), net resulted in \$0.6 million of income during the second quarter of 2008 versus \$0.2 million of expense during the same period in 2007, primarily due to foreign currency transaction gains and losses. Minority interest in earnings of subsidiaries declined from \$2.1 million in 2007 to zero in 2008 as a result of our purchase of the 28 percent minority interest in LTRI during January 2008. Net income and diluted net income per share were higher than the comparable periods of the prior-year by \$1.0 million and \$0.07, respectively.



*Year-To-Date Highlights*

Net sales were \$391.8 million during the six month period ended June 30, 2008, a 14.5 percent increase over the prior-year period. Net sales increased \$26.5 million as a result of favorable foreign currency exchange rate impacts, \$17.8 million due to higher average selling prices, primarily due to an improved mix of products sold, and \$5.4 million from increased sales volumes. Restructuring expenses were \$5.7 million and \$6.1 million for the six months periods ended June 30, 2008 and 2007, respectively. Gross profit was \$44.2 million for the six month period ended June 30, 2008, a decrease of \$10.1 million from the prior-year period. The gross profit margin was 11.3 percent, decreasing from 15.9 percent during the prior-year period. Operating profit was \$4.8 million for the six month period ended June 30, 2008 versus an operating profit of \$15.1 million for the prior-year period. Lower gross profit and operating profit were both primarily due to inflationary cost increases of \$16.3 million, start-up costs of \$9.2 million related to the rebuild of a paper machine at PdM, unfavorable foreign currency impacts of \$4.6 million and unfavorable fixed cost absorption of \$2.8 million. These unfavorable impacts were partially offset by the benefits of higher average selling prices of \$12.7 million, primarily due to an improved mix of products sold, increased sales volumes which benefited operating profit by \$5.9 million and lower nonmanufacturing expenses. Interest expense was higher by \$2.4 million as a result of significantly increased average debt levels. Minority interest in earnings of subsidiaries declined from \$3.8 million in 2007 to \$0.2 million in 2008 as a result of our purchase of the 28 percent minority interest in LTRI during January 2008. Net income and diluted net income per share were lower than the comparable periods of the prior-year by \$4.4 million and \$0.28, respectively.



Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

Capital spending was \$24.0 million and \$18.3 million for the six month periods ended June 30, 2008 and 2007, respectively. Capital spending in the 2008 period primarily consisted of \$11.0 million incurred at PdM for a paper machine rebuild and improvements to the bobbin slitting process.

Capital spending was \$24.0 million and \$18.3 million for the six month periods ended June 30, 2008 and 2007, resp



**Recent Developments**



*Price Increases*

During June 2008, we announced price increases approaching 20 percent for paper products sold in North, Central and South America, effective beginning in July 2008. These price increases are necessary to partially recover significant acceleration in costs due to higher purchase prices for wood pulp, energy, chemicals and transportation along with the negative earnings impact of foreign currency changes. The price increases do not apply to customers that have long-term contracts containing specific terms regarding price revisions.

*Operational Changes Brazil*

On July 1, 2008, we announced the exit of the coated papers business in the Brazilian market and a resulting decrease of approximately 100 employees, or 16 percent, of the current workforce in Brazil, both effective immediately. Our Brazilian coated papers business had experienced increased inflationary cost pressures that we were not able to offset with selling price increases. Due to the devaluation of the U.S. dollar against the Brazilian real, lower cost imported coated papers gained an approximate 43 percent share of the local market. As a result of these factors, we decided to exit the coated papers business in Brazil and to concentrate on our core tobacco-related fine papers business.

Table of Contents

These actions are expected to result in restructuring expenses totaling \$3.2 to \$3.4 million, including \$1.9 million realized in the second quarter of 2008 for asset impairment charges, and \$1.3 to \$1.5 million expected during the third quarter of 2008 for employee severance and other cash expenses.

Management continues to evaluate how to optimize the efficiency and cost competitiveness of our worldwide production facilities as demand for our products continues to undergo volume and geographic changes.

*Lower Ignition Propensity Cigarette Papers*

Based upon the states that have passed LIP regulations, demand for these products is expected to grow from the current level of approximately 32 percent of North American cigarette consumption to approximately 80 percent by early 2010. Additionally, jurisdictions representing essentially all of North American consumption have either passed or proposed LIP regulations, and several cigarette producers have announced voluntary national distribution of this technology, supporting the likelihood that LIP cigarettes will be sold nationwide in the United States by late 2009 or early 2010. As a result, we expect to realize continued growth in demand for cigarette paper used in LIP cigarettes, which we expect will continue to benefit our U.S. business unit's results.

International LIP efforts continue, especially in the European Union, or EU. In late 2007, the EU's 27 member states approved its Product Safety Commission to mandate the CEN (Standardization European Committee) to define standards for reduced ignition propensity for cigarettes. It is our understanding that in June 2008, the CEN received this mandate as planned, which directs it to develop an ignition propensity standard for use in the EU, with possible implementation of the legislation by 2011. There is increased probability that Finland could introduce LIP legislation ahead of the planned EU implementation. Finland issued a draft text in February 2008 of its proposed LIP legislation to the World Trade Organization stating that all the cigarettes sold in Finland should have to be tested and comply with the fire safety requirements. Australia and South Africa are also considering LIP legislation to be implemented by 2010. These actions indicate that it is increasingly likely that LIP cigarette regulations outside of North America will become effective in the next 2 to 4 years, thus increasing demand for cigarette paper used in these cigarettes.

These legislative developments involving LIP cigarettes are positive for us given the current level of commercial acceptance of our Alginex banded papers and our ability to provide 1 or more commercially proven alternative solutions to cigarette manufacturers in addressing LIP requirements.

*China Joint Venture*

The construction of a new state-of-the-art paper mill by our joint venture with the China National Tobacco Corporation to produce tobacco-related papers in China was completed during the second quarter of 2008 and is currently in operational start-up.



Table of ContentsResults of Operations

This section presents a discussion and analysis of our net sales, operating profit and other information relevant to an understanding of the results of operations versus the prior-year quarter. The following table presents financial data from the unaudited consolidated statements of operations for the periods indicated (dollars in millions, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Net Sales	\$ 202.0	\$ 171.8	\$ 391.8	\$ 342.1
Cost of products sold	177.8	145.8	347.6	287.8
Gross Profit	24.2	26.0	44.2	54.3
Nonmanufacturing expenses	15.7	16.6	33.7	33.1
Restructuring expense	3.7	3.4	5.7	6.1
Operating Profit	4.8	6.0	4.8	15.1
Interest expense	2.8	1.5	5.2	2.8
Other income (expense), net	0.6	(0.2)	(1.0)	(0.1)
Income (Loss) Before Income Taxes, Minority Interest and Loss from Equity Affiliates	2.6	4.3	(1.4)	12.2
Provision (benefit) for income taxes		1.2	(2.6)	3.1
Minority interest in earnings of subsidiaries		2.1	0.2	3.8
Loss from equity affiliates	0.6		0.2	0.1
Net Income	\$ 2.0	\$ 1.0	\$ 0.8	\$ 5.2
Diluted Net Income Per Share	\$ 0.13	\$ 0.06	\$ 0.05	\$ 0.33

Three Months Ended June 30, 2008 Compared with the Three Months Ended June 30, 2007**Net Sales**

(dollars in millions)

	Three Months Ended		Change	Percent Change	Consolidated Sales Volume Change
	June 30, 2007	June 30, 2008			
France	\$ 129.2	\$ 102.7	\$ 26.5	25.8%	11.9%
United States	57.7	56.2	1.5	2.7	(16.0)
Brazil	20.3	17.1	3.2	18.7	10.1

Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

Subtotal		207.2		176.0		31.2		
Intersegment		(5.2)		(4.2)		(1.0)		
Total	\$	202.0	\$	171.8	\$	30.2	17.6%	6.2%

Net sales were \$202.0 million for the three month period ended June 30, 2008 compared with \$171.8 million for the prior-year quarter. The increase of \$30.2 million, or 17.6 percent, consisted of the following (dollars in millions):

		Amount	Percent
Changes in currency exchange rates	\$	15.1	8.8%
Changes in selling prices and product mix		10.1	5.9
Changes in sales volumes		5.0	2.9
Total	\$	30.2	17.6%

Table of Contents

- Changes in currency exchange rates had a favorable impact on net sales of \$15.1 million, or 8.8 percent, for the three month period ended June 30, 2008 and primarily reflected the impact of a stronger euro compared with the U.S. dollar. The euro was 15.3 percent stronger against the U.S. dollar compared to the second quarter of 2007.
- Higher average selling prices had a favorable \$10.1 million, or 5.9 percent, impact on the net sales comparison. The increase in average selling prices primarily reflected an improved mix of products sold in the United States and France, primarily due to increased sales of cigarette paper for LIP cigarettes in the United States and higher sales of RTL products.
- Unit sales volumes increased by 6.2 percent for the three month period ended June 30, 2008 compared with the prior-year quarter, resulting in a favorable effect on net sales of \$5.0 million, or 2.9 percent.
- Sales volumes for the French segment increased by 11.9 percent, primarily as a result of higher sales volumes of RTL products, partially offset by decreased tobacco-related papers sales volumes.
- The Brazil segment's sales volumes increased by 10.1 percent, primarily due to continued growth in tobacco-related paper sales volumes.
- Sales volumes in the United States decreased by 16.0 percent, reflecting reduced sales of commercial and industrial products associated with the shutdown of the Lee Mills and reduced sales volumes of certain tobacco-related products.

*The French* segment net sales of \$129.2 million for the three month period ended June 30, 2008 increased by \$26.5 million, or 25.8 percent, versus \$102.7 million for the prior-year quarter. The increase in net sales was primarily the result of a stronger euro, higher sales volumes and, to a lesser extent, higher average selling prices including an improved mix of products sold.

*The U.S.* segment net sales of \$57.7 million for the three month period ended June 30, 2008 increased by \$1.5 million, or 2.7 percent, compared with \$56.2 million for the prior-year quarter. The increase in net sales of the U.S. segment resulted from higher average selling prices, primarily due to an improved mix of products sold, partially offset by lower sales volumes.

*The Brazil* segment net sales of \$20.3 million for the three month period ended June 30, 2008 increased by \$3.2 million, or 18.7 percent, from \$17.1 million for the prior-year quarter. The increase was primarily due to increased sales volumes and a stronger Brazilian real versus the U.S. dollar. The Brazilian real strengthened by 20.0 percent against the U.S. dollar compared to the second quarter of 2007.

**Gross Profit**

(dollars in millions)

**Three Months Ended**

Gross Profit

Edgar Filing: SCHWEITZER MAUDUIT INTERNATIONAL INC - Form 10-Q

	June 30, 2008		June 30, 2007		Change	Percent Change	Percent of Net Sales	
							2008	2007
Net Sales	\$	202.0	\$	171.8	\$	30.2	17.6%	
Cost of products sold		177.8		145.8		32.0	88.0%	84.9%
Gross Profit	\$	24.2	\$	26.0	\$	(1.8)	(6.9)%	12.0% 15.1%

Gross profit was \$24.2 million for the three month period ended June 30, 2008, a decrease of \$1.8 million, or 6.9 percent, from \$26.0 million for the prior-year quarter. The gross profit margin was 12.0 percent of net sales for the three month period ended June 30, 2008, decreasing from 15.1 percent for the prior-year quarter. Gross profit was unfavorably impacted by inflationary cost increases of \$9.0 million, start-up costs related to the paper machine rebuild at PdM of \$3.9 million, unfavorable fixed cost absorption of \$1.8 million, primarily in the United States, and unfavorable foreign currency impacts. Gross profit was favorably impacted by higher average selling prices, primarily due to an improved mix of products sold, which benefited the gross profit comparison by \$7.6 million, and increased sales volumes, which benefited gross profit by \$3.7 million.

Inflationary cost increases, primarily related to higher purchased energy costs, increased per ton wood pulp prices and higher labor rates combined to unfavorably impact operating results by \$9.0 million during the three month period ended June 30, 2008. Increased energy rates, primarily in the United States and France, unfavorably impacted operating results by \$4.8 million during the three month period ended June 30, 2008. Changes in per ton

Table of Contents

wood pulp prices, primarily in France and Brazil, increased operating expenses by \$2.7 million compared with the prior-year quarter. The average per ton list price of northern bleached softwood kraft pulp in the United States was \$880 per metric ton during the three month period ended June 30, 2008 compared with \$810 per metric ton during the prior-year quarter.

During the first quarter of 2008, the rebuilt paper machine at PdM initiated operations as part of the plan to restructure the PdM operation. The start-up continued to negatively impact second quarter operating profit by \$3.9 million.

The effects of decreased machine operating schedules and lower production volumes for tobacco-related papers and commercial and industrial products, primarily in the United States and France, were partially offset by increased production volumes in the French RTL operation.

Higher average selling prices, which resulted primarily from an improved mix of products sold in the United States and France, increased operating results by \$7.6 million during the three month period ended June 30, 2008 versus the prior-year quarter. Higher sales volumes increased operating results by \$3.7 million, primarily in the French segment, compared with the prior-year quarter.

**Nonmanufacturing Expenses**

(dollars in millions)

	Three Months Ended		Change	Percent Change	Percent of Net Sales	
	June 30, 2008	June 30, 2007			2008	2007
Selling expense	\$ 5.8	\$ 5.4	\$ 0.4	7.4%	2.9%	3.1%
Research expense	2.5	2.0	0.5			