

SCHWEITZER MAUDUIT INTERNATIONAL INC

Form 10-Q

November 05, 2008

[Table of Contents](#)

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2008

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Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

**x**

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

For the quarterly period ended September 30, 2008

OR

**o**

**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)

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**SCHWEITZER-MAUDUIT INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

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**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)

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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 15,402,434 shares of common stock, par value \$0.10 per share, of the registrant outstanding as of October 31, 2008.

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**Table of Contents**



**TABLE OF CONTENTS**



		Page
<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>		
<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)**

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	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Net Sales	\$ 199.2	\$ 184.2	\$ 591.0	\$ 526.3
Cost of products sold	166.7	153.8	514.3	441.6
Gross Profit	32.5	30.4	76.7	84.7
Selling expense	5.5	5.3	17.7	16.3
Research expense	1.9	1.9	6.4	5.9
General expense	7.9	8.0	24.9	26.1
Total nonmanufacturing expenses	15.3	15.2	49.0	48.3
Restructuring expense (Note 4)	2.6	18.2	8.3	24.3
Operating Profit (Loss)	14.6	(3.0)	19.4	12.1
Interest expense	3.1	1.6	8.3	4.4
Other expense, net	0.6		1.6	0.1
Income (Loss) Before Income Taxes, Minority Interest and Loss from Equity Affiliates	10.9	(4.6)	9.5	7.6
Provision (benefit) for income taxes (Note 8)	2.6	(2.6)		0.5
Minority interest in earnings of subsidiaries (Note 9)		2.2	0.2	6.0
Loss from equity affiliates	1.6	0.1	1.8	0.2
Net Income (Loss)	\$ 6.7	\$ (4.3)	\$ 7.5	\$ 0.9
Net Income (Loss) Per Share:				
Basic	\$ 0.44	\$ (0.27)	\$ 0.49	\$ 0.06
Diluted	\$ 0.43	\$ (0.27)	\$ 0.48	\$ 0.06
Cash Dividends Declared Per Share	\$ 0.15	\$ 0.15	\$ 0.45	\$ 0.45
Weighted Average Shares Outstanding:				
Basic	15,401,600	15,563,400	15,401,900	15,555,500
Diluted	15,706,700	15,563,400	15,674,400	15,723,700

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)**

	September 30, 2008	December 31, 2007
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 10.3	\$ 4.0
Accounts receivable	98.1	100.6
Inventories	113.5	131.2
Other current assets	10.2	11.4
Total Current Assets	232.1	247.2
Property, Plant and Equipment, net	445.0	456.0
Intangible Assets and Goodwill (Note 9)	16.7	2.8
Investment in Equity Affiliates	17.6	15.4
Deferred Income Tax Benefits	16.0	15.2
Other Assets	38.0	38.4
Total Assets	\$ 765.4	\$ 775.0
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities		
Current debt	\$ 16.9	\$ 13.6
Accounts payable	69.9	84.3
Accrued income taxes payable	3.1	8.4
Accrued expenses	94.5	102.9
Current deferred revenue	6.0	6.0
Total Current Liabilities	190.4	215.2
Long-Term Debt	152.5	87.3
Pension and Other Postretirement Benefits	36.6	38.9
Deferred Income Tax Liabilities	21.1	25.0
Deferred Revenue	13.5	18.1
Other Liabilities	20.6	22.7
Total Liabilities	434.7	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; 15,676,566 and 15,508,397 shares outstanding at September 30, 2008 and December 31, 2007, respectively	1.6	1.6
Additional paid-in-capital	64.1	68.0
	(8.8)	(12.3)



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Common stock in treasury, at cost, 402,167 and 570,336 shares at September 30, 2008 and December 31, 2007, respectively			
Retained earnings		265.1	264.6
Accumulated other comprehensive income, net of tax		8.7	19.9
Total Stockholders Equity		330.7	341.8
Total Liabilities and Stockholders Equity	\$	765.4	\$ 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	Additional	Treasury Stock	Retained	Accumulated		
	Shares	Amount	Paid-In	Shares	Amount	Other	Comprehensive	Total
			Capital			Income (Loss)		
<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 nine months ended September 30, 2007						0.9		0.9
Adjustments to unrealized foreign currency translation, net of tax							23.5	23.5
Amortization of postretirement benefit plans costs, net of tax							1.2	1.2
Comprehensive income, net of tax								25.6
Dividends declared (\$0.45 per share)						(7.1)		(7.1)
Restricted stock issuances, net			(0.7)	(28,032)	0.6			(0.1)
Stock-based employee compensation expense			0.5					0.5
Stock issued to directors as compensation				(4,100)	0.1			0.1
Excess tax benefits of stock-based awards			0.3					0.3
Purchases of treasury stock				178,933	(4.0)			(4.0)
Issuance of shares for options exercised			0.3	(205,307)	4.2			4.5
<b>Balance, September 30, 2007</b>	<b>16,078,733</b>	<b>\$ 1.6</b>	<b>\$ 63.7</b>	<b>502,837</b>	<b>\$ (10.5)</b>	<b>\$ 264.4</b>	<b>\$ 3.6</b>	<b>\$ 322.8</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 nine months ended September 30, 2008						7.5		7.5
Adjustments to unrealized foreign currency translation, net of tax							(11.4)	(11.4)
Changes in fair value of derivative instruments, net of tax							(0.6)	(0.6)
Amortization of postretirement benefit plans costs, net of tax							0.8	0.8
Comprehensive loss, net of tax								(3.7)
Dividends declared (\$0.45 per share)						(7.0)		(7.0)
Restricted stock issuances, net			(4.4)	(200,259)	4.3			(0.1)
			0.6					0.6

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Stock-based employee compensation expense											
Stock issued to directors as compensation				(4,860)		0.1				0.1	
Purchases of treasury stock				48,900		(1.2)				(1.2)	
Issuance of shares for options exercised			(0.1)	(11,950)		0.3				0.2	
<b>Balance, September 30, 2008</b>	<b>16,078,733</b>	<b>\$</b>	<b>1.6</b>	<b>\$ 64.1</b>	<b>402,167</b>	<b>\$</b>	<b>(8.8)</b>	<b>\$</b>	<b>265.1</b>	<b>\$ 8.7</b>	<b>330.7</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)

	Nine Months Ended	
	September 30,	September 30,
	2008	2007
<b>Operations</b>		
Net income	\$ 7.5	\$ 0.9
Non-cash items included in net income:		
Depreciation and amortization	36.1	29.3
Restructuring related impairment charges and accelerated depreciation	3.6	12.8
Amortization of deferred revenue	(4.6)	(4.7)
Deferred income tax benefit	(14.8)	(11.1)
Minority interest in earnings of subsidiaries	0.2	6.0
Pension and other postretirement benefits	(0.3)	(4.0)
Loss from equity affiliates	1.8	0.2
Other items	0.3	3.0
Net changes in operating working capital	(1.8)	20.2
Cash Provided by Operations	28.0	52.6
<b>Investing</b>		
Capital spending	(30.0)	(26.8)
Capitalized software costs	(4.4)	(6.9)
LTRI minority interest acquisition (Note 9)	(51.3)	
Investment in equity affiliates	(1.9)	(10.3)
Other	3.1	(1.8)
Cash Used for Investing	(84.5)	(45.8)
<b>Financing</b>		
Cash dividends paid to SWM stockholders	(7.0)	(7.1)
Changes in short-term debt	4.1	(6.3)
Proceeds from issuances of long-term debt	100.2	25.0
Payments on long-term debt	(33.4)	(24.9)
Purchases of treasury stock	(1.2)	(4.0)
Proceeds from exercise of stock options	0.2	4.5
Excess tax benefits of stock-based awards		0.3
Cash Provided by (Used for) Financing	62.9	(12.5)
Effect of Exchange Rate Changes on Cash	(0.1)	0.6
Increase (Decrease) in Cash and Cash Equivalents	6.3	(5.1)
Cash and Cash Equivalents at beginning of period	4.0	13.7
Cash and Cash Equivalents at end of period	\$ 10.3	\$ 8.6

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 nine month periods ended September 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 paper mill in China.

**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 nine month periods ended September 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**



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The consolidated financial statements include the accounts of the Company and its 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**





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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 September 30, 2008 or its results of operations for the three and nine month periods ended September 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 does not expect the adoption of SFAS No. 157 related to nonfinancial assets and liabilities to have a material impact on the accompanying financial statements.

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 September 30, 2008 or its results of operations for the three or nine month periods ended September 30, 2008 as the Company has elected not to measure any of its financial instruments or certain commitments at fair value.

**Recent Accounting Pronouncements**



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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**



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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		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Average number of common shares outstanding	15,401.6	15,563.4	15,401.9	15,555.5
Dilutive effect of:				
- stock options	3.3	-	11.7	46.4
- restricted stock	273.1	-	233.7	104.1
- directors' deferred stock compensation	28.7	-	27.1	17.7
Average number of common and potential common shares outstanding	15,706.7	15,563.4	15,674.4	15,723.7

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. There was no dilutive effect recognized in the three month period ended September 30, 2007 because the Company had a net loss. 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 nine month periods ended September 30, 2008 were approximately 790,600 and 681,700, respectively, and for the nine month period ended September 30, 2007 was approximately 246,900.

### NOTE 3. INVENTORIES

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

	September 30, 2008	December 31, 2007
Raw materials	\$ 31.2	\$ 39.5
Work in process	25.2	25.4
Finished goods	33.0	44.8
Supplies and other	24.1	21.5
Total	\$ 113.5	\$ 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 \$1.4 million of severance and other employee related costs during the third quarter of 2008 and \$1.9 million of asset impairment charges during the second 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 \$2.6 million and \$18.2 million for the three month periods ended September 30, 2008 and 2007, respectively, and \$8.3 million and \$24.3 million for the nine month periods ended September 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 and the shutdown of the Company's entire operation in Lee, Massachusetts which began in May 2008 and has been completed. The PdMal base tipping paper machine was originally projected to be shutdown in 2008, but this has been postponed pending ongoing customer qualifications. The Company is in the process of transferring production from the Lee Mills to other facilities, primarily in Santanesia, 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, except for the postponed shutdown of the PdMal base tipping paper machine which has been delayed pending ongoing customer negotiations.

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

Table of Contents

	Three Months Ended		Nine Months Ended		Cumulative
	September 30,	September 30,	September 30,	September 30,	2006 to
	2008	2007	2008	2007	September 30,
					2008
<b>France</b>					
<b>Cash Expense</b>					
Severance and other employee related costs	\$ 0.4	\$ 5.3	\$ 2.1	\$ 9.9	\$ 24.3
Other					0.9
<b>Non-cash Expense</b>					
Accelerated depreciation	0.4	0.5	1.3	1.3	4.4
<b>Total France Restructuring Expense</b>	<b>0.8</b>	<b>5.8</b>	<b>3.4</b>	<b>11.2</b>	<b>29.6</b>
<b>United States</b>					
<b>Cash Expense</b>					
Severance and other employee related costs		1.2	0.9	1.2	2.9
Other	0.2		0.3		0.5
<b>Non-cash Expense</b>					
Asset impairment charges	0.1	10.5	0.3	10.5	11.5
Accelerated depreciation		0.3		1.0	5.2
Loss on disposal of assets	0.1		0.1		
<b>Total United States Restructuring Expense</b>	<b>0.4</b>	<b>12.0</b>	<b>1.6</b>	<b>12.7</b>	<b>20.1</b>
<b>Brazil</b>					
<b>Cash Expense</b>					
Severance and other employee related costs	1.4	0.4	1.4	0.4	1.8
<b>Non-cash Expense</b>					
Asset impairment charges			1.9		1.9
<b>Total Brazil Restructuring Expense</b>	<b>1.4</b>	<b>0.4</b>	<b>3.3</b>	<b>0.4</b>	<b>3.7</b>
<b>Summary</b>					
Total Cash Expense	2.0	6.9	4.7	11.5	30.4
Total Non-cash Expense	0.6	11.3	3.6	12.8	23.0
<b>Total Restructuring Expense</b>	<b>\$ 2.6</b>	<b>\$ 18.2</b>	<b>\$ 8.3</b>	<b>\$ 24.3</b>	<b>\$ 53.4</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 employee severance and other cash costs and \$24 to \$25 million in asset impairment charges, accelerated depreciation and other non-cash costs. Restructuring expenses of \$53.4 million, or approximately 95 percent of the total projected, have been recognized through September 30, 2008.

Table of Contents

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

	<b>Nine Months Ended September 30, 2008</b>		<b>Year Ended December 31, 2007</b>	
Balance at beginning of year	\$	16.4	\$	13.9
Accruals for announced programs		4.7		10.2
Cash payments		(14.3)		(9.5)
Exchange rate impacts		(0.4)		1.8
Balance at end of period	\$	6.4	\$	16.4

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):

	September 30, 2008	December 31, 2007
<b>Credit Agreement</b>		
U. S. Revolver	\$ 80.0	\$ 69.0
Euro Revolver	59.4	
French Employee Profit Sharing	11.5	17.0
Bank Overdrafts	7.8	6.7
Other	10.7	8.2
<b>Total Debt</b>	<b>169.4</b>	<b>100.9</b>
Less: Current debt	16.9	13.6
<b>Long-Term Debt</b>	<b>\$ 152.5</b>	<b>\$ 87.3</b>

As of September 30, 2008, the Company had availability under its Credit Agreement, of \$69.0 million plus availability under bank overdraft facilities of \$27.5 million for a total availability of \$96.5 million; however, based on its debt covenant restrictions as of September 30, 2008, the Company could have borrowed an additional \$86.4 million from its Credit Agreement and bank overdraft facilities without violating the most restrictive of those covenants.

### Credit Agreement

The Company's Credit Agreement, which expires July 31, 2012, 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 \$80.0 million as of September 30, 2008 from \$69.0 million as of December 31, 2007. Contractual availability under the U.S. Revolver decreased to \$15.0 million as of September 30, 2008 from \$26.0 million as of December 31, 2007. Borrowings under the Euro Revolver increased to 41.9 million euros, or \$59.4 million, as of September 30, 2008 from zero as of December 31, 2007. Contractual availability under the Euro Revolver decreased to 38.1 million euros as of September 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

Table of Contents

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 September 30, 2008.

**Bank Overdraft**





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The Company had bank overdraft facilities totaling \$35.3 million as of September 30, 2008. Bank overdraft obligations outstanding increased to \$7.8 million as of September 30, 2008 from \$6.7 million as of December 31, 2007, which reduced contractual availability under bank overdrafts to \$27.5 million as of September 30, 2008.

### **Interest Rate Swap Agreements**



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The Company maintains interest rate swap agreements on a portion of its long-term debt. As of September 30, 2008, the LIBOR rate component on \$30.0 million and \$8.0 million of the Company's variable-rate long-term debt was effectively fixed at 5.13 percent and 4.99 percent, respectively. The \$30.0 million interest swap agreement expires on November 30, 2008, and the \$8.0 million interest swap agreement expires on March 16, 2009. The impact of the swap agreements on the consolidated financial statements was not material for either of the three or nine month periods ended September 30, 2008.

### **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 September 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.

Table of Contents**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 nine month periods ended September 30, 2008 and 2007 were as follows (dollars in millions):

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

	Nine Months Ended September 30,							
	U.S. Pension Benefits		French Pension Benefits				U.S. OPEB Benefits	
	2008	2007	2008	2007	2008	2007	2008	2007
Service cost	\$ 0.3	\$ 0.8	\$ 1.2	\$ 1.5	\$ 0.3	\$ 0.2		
Interest cost	5.0	5.0	1.6	1.3	0.5	0.6		
Expected return on plan assets	(6.0)	(5.7)	(1.0)	(1.0)				
Amortizations and other	0.8	1.5	0.5	0.5				
Pension curtailment gain		(0.1)						
Net periodic benefit cost	\$ 0.1	\$ 1.5	\$ 2.3	\$ 2.3	\$ 0.8	\$ 0.8		

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 of accumulated other comprehensive loss for its French pension plans. The Company recognized amortization of \$0.3 million and \$0.8 million for its U.S. pension plans and \$0.2 million and \$0.5 million for its French pension plans during the three and nine month periods ended September 30, 2008, respectively.

The Company made \$2.4 million in pension contributions to its pension plans during the nine month period ended September 30, 2008, and currently expects to contribute a total of \$7 to \$8 million to its pension plans during the full-year 2008. The Company paid \$0.4 million and \$1.2 million for its U.S. OPEB benefits during the three and nine month periods ended September 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):

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	Three Months Ended				Nine Months Ended			
	September 30, 2008		September 30, 2007		September 30, 2008		September 30, 2007	
Tax provision (benefit) at U.S. statutory rate	\$ 3.8	35.8%	\$ (1.6)	35.0%	\$ 3.3	35.0%	\$ 2.7	35.0%
Tax benefits of foreign legal structure	(0.9)	(8.3)	(0.8)	17.3	(3.0)	(30.9)	(2.5)	(32.9)
Other, net	(0.3)	(2.8)	(0.2)	4.2	(0.3)	(4.1)	0.3	4.5
Provision (benefit) for income taxes	\$ 2.6	23.9%	\$ (2.6)	56.5%	\$	%\$	0.5	6.6%

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.

Table of Contents

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 September 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.

As of September 30, 2008, the Company had net deferred tax assets of \$4.6 million and \$0.9 million in Brazil and the Philippines, respectively. In France, at September 30, 2008, the Company had a net deferred tax liability; however that consisted of a net deferred tax asset of \$19.4 million in one tax group and net deferred tax liabilities of \$1.1 million and \$36.3 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 September 30, 2008 will be realized. However, operating losses, particularly in Brazil and the Company's paper operations in France, could result in the possibility of recording a valuation allowance in a future period. If at a future date the Company determines that 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 such determination is made to reduce the net deferred tax asset to an amount deemed to be more likely than not realizable.

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 September 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 nine month periods ended September 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**



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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):

Table of Contents

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 customer-related 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 \$2.0 million for the customer related intangibles during the three and nine month periods ended September 30, 2008, respectively. Additionally, the Company recorded \$0.4 million and \$1.2 million of incremental depreciation as a result of the stepped-up bases in depreciable property, plant and equipment during the three and nine month periods ended September 30, 2008, respectively.

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.

The following unaudited pro forma condensed consolidated statement of income data for the three and nine month periods ended September 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 earliest period 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 September 30, 2007			Nine Months Ended September 30, 2007		
	Historical	Pro Forma Adjustments *	Pro Forma Results	Historical	Pro Forma Adjustments *	Pro Forma Results
Net sales	\$ 184.2	\$	\$ 184.2	\$ 526.3	\$	\$ 526.3
Gross profit	30.4	(0.9)	29.5	84.7	(2.9)	81.8
Operating profit (loss)	(3.0)	(0.9)	(3.9)	12.1	(2.9)	9.2
Interest expense	1.6	0.6	2.2	4.4	1.6	6.0
Income (loss) before income taxes, minority interest and loss from equity affiliates	(4.6)	(1.5)	(6.1)	7.6	(4.5)	3.1
Provision (benefit) for income taxes	(2.6)	(0.5)	(3.1)	0.5	(1.6)	(1.1)
Minority interest in earnings of subsidiaries	2.2	(2.2)		6.0	(6.0)	
Net income (loss)	\$ (4.3)	\$ 1.2	\$ (3.1)	\$ 0.9	\$ 3.1	\$ 4.0
Basic net income (loss) per share	\$ (0.27)	\$ 0.08	\$ (0.19)	\$ 0.06	\$ 0.20	\$ 0.26

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Diluted net income (loss) per share	\$	(0.27)	\$	0.07	\$	(0.20)	\$	0.06	\$	0.19	\$	0.25
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\* 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.

Table of Contents**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.

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.

**Net Sales**

(dollars in millions)

	Three Months Ended				Nine Months Ended			
	September 30, 2008		September 30, 2007		September 30, 2008		September 30, 2007	
France	\$ 129.9	65.2%	\$ 112.5	61.1%	\$ 379.9	64.3%	\$ 315.5	60.0%
United States	60.2	30.2	58.5	31.8	173.4	29.3	171.6	32.6
Brazil	15.6	7.8	19.2	10.4	53.8	9.1	53.7	10.2
Subtotal	205.7	103.2	190.2	103.3	607.1	102.7	540.8	102.8
Intersegment sales by								
France	(1.0)	(0.5)	(1.2)	(0.7)	(2.3)	(0.4)	(3.5)	(0.7)
United States	(1.4)	(0.7)	(0.8)	(0.4)	(3.7)	(0.6)	(2.3)	(0.4)
Brazil	(4.1)	(2.0)	(4.0)	(2.2)	(10.1)	(1.7)	(8.7)	(1.7)
Subtotal	(6.5)	(3.2)	(6.0)	(3.3)	(16.1)	(2.7)	(14.5)	(2.8)
Consolidated	\$ 199.2	100.0%	\$ 184.2	100.0%	\$ 591.0	100.0%	\$ 526.3	100.0%

**Operating Profit (Loss)**

(dollars in millions)

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	Three Months Ended				Nine Months Ended			
	September 30, 2008		September 30, 2007		September 30, 2008		September 30, 2007	
France	\$ 15.1	103.4%	\$ 7.6	(253.3)%	\$ 20.7	106.7%	\$ 20.8	171.9%
United States	6.7	45.9	(7.3)	243.3	16.0	82.5	0.6	5.0
Brazil	(3.7)	(25.3)	(0.9)	30.0	(9.8)	(50.5)	(1.1)	(9.1)
Unallocated	(3.5)	(24.0)	(2.4)	80.0	(7.5)	(38.7)	(8.2)	(67.8)
Consolidated	\$ 14.6	100.0%	\$ (3.0)	100.0%	\$ 19.4	100.0%	\$ 12.1	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)



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	Three Months Ended				Nine Months Ended			
	September 30, 2008		September 30, 2007		September 30, 2008		September 30, 2007	
Net sales	\$ 199.2	100.0%	\$ 184.2	100.0%	\$ 591.0	100.0%	\$ 526.3	100.0%
Gross profit	32.5	16.3	30.4	16.5	76.7	13.0	84.7	16.1
Restructuring expense	2.6	1.3	18.2	9.9	8.3	1.4	24.3	4.6
Operating profit (loss)	14.6	7.3	(3.0)	(1.6)	19.4	3.3	12.1	2.3
Interest expense	3.1	1.6	1.6	0.9	8.3	1.4	4.4	0.8
Other expense, net	0.6	0.3			1.6	0.3	0.1	
Minority interest			2.2	1.2	0.2		6.0	1.1
Loss from equity affiliates	1.6	0.8	0.1	0.1	1.8	0.3	0.2	
Net income (loss)	\$ 6.7	3.4%	\$ (4.3)	(2.3)%	\$ 7.5	1.3%	\$ 0.9	0.2%
Diluted earnings (loss) per share	\$ 0.43		\$ (0.27)		\$ 0.48		\$ 0.06	
Cash provided by operations	\$ 15.7		\$ 30.7		\$ 28.0		\$ 52.6	
Capital spending	\$ 6.0		\$ 8.5		\$ 30.0		\$ 26.8	

Table of Contents

*Third Quarter Highlights*

Net sales were \$199.2 million for the three month period ended September 30, 2008, an 8.1 percent increase over the prior-year quarter. Net sales increased \$12.8 million as a result of favorable foreign currency exchange rate impacts, \$10.6 million due to higher average selling prices and an improved mix of products sold, partially offset by \$8.4 million from decreased sales volumes. Gross profit was \$32.5 million during the three month period ended September 30, 2008, an increase of \$2.1 million from the prior-year quarter. The gross profit margin was 16.3 percent, decreasing from 16.5 percent for the prior-year quarter. Restructuring expenses were \$2.6 million and \$18.2 million for the three month periods ended September 30, 2008 and 2007, respectively. Operating profit was \$14.6 million for the three month period ended September 30, 2008 versus an operating loss of \$3.0 million for the prior-year quarter. This change in operating profit was mainly due to a \$15.6 million decrease in restructuring expenses, as well as the benefits of cost savings programs and higher average selling prices of \$2.8 million, primarily due to an improved mix of products sold. Partially offsetting these positive impacts were inflationary cost increases of \$8.3 million, start-up costs associated with PdM's paper machine rebuild of \$2.5 million and unfavorable foreign currency impacts of \$2.0 million. Interest expense was higher by \$1.5 million as a result of increased average debt levels. Other expense, net was \$0.6 million during the third quarter of 2008 versus zero during the same period in 2007, primarily due to foreign currency transaction losses. Minority interest in earnings of subsidiaries declined from \$2.2 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 \$11.0 million and \$0.70, respectively.



*Year-To-Date Highlights*

Net sales were \$591.0 million during the nine month period ended September 30, 2008, a 12.3 percent increase over the prior-year period. Net sales increased \$39.3 million as a result of favorable foreign currency exchange rate impacts, \$28.4 million due to higher average selling prices, primarily due to an improved mix of products sold, and decreased \$3.0 million from changes in sales volumes. Gross profit was \$76.7 million for the nine month period ended September 30, 2008, a decrease of \$8.0 million from the prior-year period. The gross profit margin was 13.0 percent, decreasing from 16.1 percent during the prior-year period. The decrease in gross profit was primarily due to inflationary cost increases of \$24.6 million, start-up costs of \$11.7 million related to the rebuild of a paper machine at PdM, unfavorable foreign currency impacts of \$6.6 million and unfavorable fixed cost absorption of \$2.9 million. These unfavorable impacts were partially offset by the benefits of cost savings programs and higher average selling prices of \$15.5 million, primarily due to an improved mix of products sold. Restructuring expenses were \$8.3 million and \$24.3 million for the nine months periods ended September 30, 2008 and 2007, respectively. Operating profit was \$19.4 million for the nine month period ended September 30, 2008 versus an operating profit of \$12.1 million for the prior-year period. The increase in operating profit was primarily due to a \$16.0 million reduction in restructuring expenses, the changes in gross profit discussed above and lower nonmanufacturing expenses. Interest expense was higher by \$3.9 million as a result of significantly increased average debt levels. Minority interest in earnings of subsidiaries declined from \$6.0 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 higher than the comparable periods of the prior-year by \$6.6 million and \$0.42, respectively.



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Capital spending was \$30.0 million and \$26.8 million for the nine month periods ended September 30, 2008 and 2007, respectively. Capital spending in the 2008 period primarily consisted of \$9.5 million incurred at PdM for a paper machine rebuild and improvements to the bobbin slitting process.

Capital spending was \$30.0 million and \$26.8 million for the nine month periods ended September 30, 2008 and 2007, respectively.



**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 were 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 did not apply to customers that have long-term contracts containing specific terms regarding price revisions, as negotiations with these customers will take place primarily in the fourth quarter of 2008.

Table of Contents

*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 a substantial 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. These actions resulted in \$1.4 million of severance and other employee related costs in the third quarter of 2008 and \$1.9 million of asset impairment charges in the second quarter of 2008.

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. 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 2012. 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 and is expected to implement LIP legislation by April 2010. Australia has enacted LIP legislation with an effective date of March 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*

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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 the mill is currently operational. We are actively in the process of qualifying products with customers and soliciting orders.

### **Results 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):

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Table of Contents

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Net Sales	\$ 199.2	\$ 184.2	\$ 591.0	\$ 526.3
Cost of products sold	166.7	153.8	514.3	441.6
Gross Profit	32.5	30.4	76.7	84.7
Nonmanufacturing expenses	15.3	15.2	49.0	48.3
Restructuring expense	2.6	18.2	8.3	24.3
Operating Profit (Loss)	14.6	(3.0)	19.4	12.1
Interest expense	3.1	1.6	8.3	4.4
Other expense, net	0.6		1.6	0.1
Income (Loss) Before Income Taxes, Minority Interest and Loss from Equity Affiliates	10.9	(4.6)	9.5	7.6
Provision (benefit) for income taxes	2.6	(2.6)		0.5
Minority interest in earnings of subsidiaries		2.2	0.2	6.0
Loss from equity affiliates	1.6	0.1	1.8	0.2
Net Income (Loss)	\$ 6.7	\$ (4.3)	\$ 7.5	\$ 0.9
Diluted Net Income (Loss) Per Share	\$ 0.43	\$ (0.27)	\$ 0.48	\$ 0.06

**Three Months Ended September 30, 2008 Compared with the Three Months Ended September 30, 2007**

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**Net Sales**

(dollars in millions)

	Three Months Ended				
	September 30, 2008	September 30, 2007	Change	Percent Change	Consolidated Sales Volume Change
France	\$ 129.9	\$ 112.5	\$ 17.4	15.5%	5.6%
United States	60.2	58.5	1.7	2.9	(19.9)
Brazil	15.6	19.2	(3.6)	(18.8)	(31.2)
Subtotal	205.7	190.2	15.5		
Intersegment	(6.5)	(6.0)	(0.5)		
Total	\$ 199.2	\$ 184.2	\$ 15.0	8.1%	(6.1)%

Net sales were \$199.2 million for the three month period ended September 30, 2008 compared with \$184.2 million for the prior-year quarter. The increase of \$15.0 million, or 8.1 percent, consisted of the following (dollars in millions):

	Amount	Percent
Changes in currency exchange rates	\$ 12.8	6.9%
Changes in selling prices and product mix	10.6	5.8
Changes in sales volumes	(8.4)	(4.6)
Total	\$ 15.0	8.1%

- Changes in currency exchange rates had a favorable impact on net sales of \$12.8 million, or 6.9 percent, for the three month period ended September 30, 2008 and primarily reflected the impact of a stronger euro compared with the U.S. dollar. The euro was 7.0 percent and the Brazilian real was 11.8 percent stronger against the U.S. dollar.





- Higher average selling prices had a favorable \$10.6 million, or 5.8 percent, impact on the net sales comparison. The increase in average selling prices primarily reflected an improved mix of products sold in



Table of Contents



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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 in France, and higher average selling prices in Brazil.



- Unit sales volumes decreased by 6.1 percent for the three month period ended September 30, 2008 compared with the prior-year quarter, resulting in an unfavorable effect on net sales of \$8.4 million, or 4.6 percent.





- The Brazil segment's sales volumes decreased by 31.2 percent, primarily due to our exit of the coated papers business, partially offset by continued growth in tobacco-related paper sales volumes.



- Sales volumes in the United States decreased by 19.9 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.



- Sales volumes for the French segment increased by 5.6 percent, primarily as a result of higher sales volumes of RTL products, partially offset by decreased tobacco-related papers sales volumes.



*The French* segment net sales of \$129.9 million for the three month period ended September 30, 2008 increased by \$17.4 million, or 15.5 percent, versus \$112.5 million for the prior-year quarter. The increase in net sales was primarily the result of a stronger euro and, to a lesser extent, higher average selling prices, mainly as a result of an improved mix of products sold and higher sales volumes.

*The U.S.* segment net sales of \$60.2 million for the three month period ended September 30, 2008 increased by \$1.7 million, or 2.9 percent, compared with \$58.5 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, mostly offset by lower sales volumes.

*The Brazil* segment net sales of \$15.6 million for the three month period ended September 30, 2008 decreased by \$3.6 million, or 18.8 percent, from \$19.2 million for the prior-year quarter. The decrease was primarily due to decreased sales volumes, partially offset by higher average selling prices.

**Gross Profit**

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(dollars in millions)

	Three Months Ended		Change	Percent Change	Percent of Net Sales	
	September 30, 2008	September 30, 2007			2008	2007
Net Sales	\$ 199.2	\$ 184.2	\$ 15.0	8.1%		
Cost of products sold	166.7	153.8	12.9	8.4	83.7%	83.5%
Gross Profit	\$ 32.5	\$ 30.4	\$ 2.1	6.9%	16.3%	16.5%

Gross profit was \$32.5 million for the three month period ended September 30, 2008, an increase of \$2.1 million, or 6.9 percent, from \$30.4 million for the prior-year quarter. The gross profit margin was 16.3 percent of net sales for the three month period ended September 30, 2008, decreasing from 16.5 percent for the prior-year quarter. Gross profit was unfavorably impacted by inflationary cost increases of \$8.3 million, start-up costs related to the paper machine rebuild at PdM of \$2.5 million and unfavorable foreign currency impacts of \$2.0 million. Gross profit was favorably impacted by benefits of cost savings programs, higher average selling prices, which benefited the gross profit comparison by \$2.8 million, primarily due to an improved mix of products sold and changes in sales volumes, which benefited gross profit by \$0.9 million.

Inflationary cost increases related to higher purchased energy costs, increased per ton wood pulp prices, higher other purchased materials costs and higher labor rates combined to unfavorably impact operating results by \$8.3 million during the three month period ended September 30, 2008. Increased energy rates, primarily in France and the United States, unfavorably impacted operating results by \$3.7 million during the three month period ended September 30, 2008. Changes in per ton wood pulp prices, primarily in France, 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 September 30, 2008 compared with \$835 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 negatively impacted third quarter operating profit by \$2.5 million.



Table of Contents

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, increased operating results by \$2.8 million during the three month period ended September 30, 2008 versus the prior-year quarter. Changes in sales volumes increased operating results by \$0.9 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	
	September 30, 2008	September 30, 2007			2008	2007
Selling expense	\$ 5.5	\$ 5.3	\$ 0.2	3.8%	2.8%	2.9%
Research expense	1.9	1.9			0.9	1.0
General expense	7.9	8.0	(0.1)	(1.3)	4.0	4.4
Nonmanufacturing expenses	\$ 15.3	\$ 15.2	\$ 0.1	0.7%	7.7%	8.3%

Nonmanufacturing expenses increased by \$0.1 million, or 0.7 percent, to \$15.3 million from \$15.2 million for the prior-year quarter. Nonmanufacturing expenses were 7.7 percent and 8.3 percent of net sales for the three month periods ended September 30, 2008 and 2007, respectively.

**Restructuring Expense**

Total restructuring expense of \$2.6 million was recognized during the three month period ended September 30, 2008, comprised of \$2.0 million for employee severance and other cash costs and \$0.6 million for accelerated depreciation, asset impairment charges and loss on disposal of assets. Total restructuring expense of \$18.2 million was recognized during the prior-year third quarter, including \$10.5 million for asset impairment charges, \$6.9 million for severance and other employee related costs and \$0.8 million for accelerated depreciation.

**Operating Profit (Loss)**

(dollars in millions)

	Three Months Ended		Change	Percent Change	Return on Net Sales	
	September 30, 2008	September 30, 2007			2008	2007

Gross Profit

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France	\$	15.1	\$	7.6	\$	7.5	98.7%	11.6%	6.8%
United States		6.7		(7.3)		14.0	N.M.	11.1	(12.5)
Brazil		(3.7)		(0.9)		(2.8)	N.M.	(23.7)	(4.7)
Subtotal		18.1		(0.6)		18.7			
Unallocated expenses		(3.5)		(2.4)		(1.1)			
	\$	14.6	\$	(3.0)	\$	17.6	N.M.%	7.3%	(1.6)%

N.M. - Not meaningful

Operating profit was \$14.6 million for the three month period ended September 30, 2008 compared with an operating loss of \$3.0 million during the prior-year quarter. Operating profit was higher in our U.S. and French segments and lower in our Brazilian segment.

*The French segment's* operating profit was \$15.1 million for the three month period ended September 30, 2008, an increase of \$7.5 million, or 98.7 percent, from an operating profit of \$7.6 million for the prior-year quarter. The increase was primarily due to:

- Benefits of costs savings programs.
- Reduced restructuring expenses of \$5.0 million.
- Higher sales volumes having a \$1.8 million favorable impact on operating profit.
- Decreased nonmanufacturing expenses of \$1.1 million.

Table of Contents

The positive factors were mostly offset by:

- Inflationary cost increases of \$5.5 million, primarily due to higher energy rates and wood pulp prices.
- Start-up costs of the rebuilt paper machine at PdM of \$2.5 million.
- Lower average selling prices, primarily as the result of the mix of products sold, of \$2.2 million.

*The U.S. segment's* operating profit was \$6.7 million for the three month period ended September 30, 2008, a \$14.0 million increase from an operating loss of \$7.3 million during the prior-year quarter. The increase was primarily due to:

- Decreased restructuring expenses of \$11.6 million.
- A favorable mix of products sold and sales volume changes which combined to increase operating profit by \$4.5 million, primarily due to higher sales of cigarette paper for LIP cigarettes.

The positive factors were mostly offset by:

- Inflationary cost increases of \$1.7 million, primarily due to increased energy rates.
- Unfavorable fixed cost absorption of \$0.9 million.

*Brazil's* operating loss was \$3.7 million during the three month period ended September 30, 2008, compared with an operating loss of \$0.9 million during the prior-year quarter. The increased operating loss was primarily due to:

- The stronger Brazilian real versus the U.S. dollar, which had a \$1.7 million unfavorable impact.

- Decreased sales volumes, which had a \$1.3 million unfavorable impact.
- Increased restructuring expenses of \$1.0 million.

These negative factors were partially offset by:

- Improved mill operations.
- Higher average selling prices, which had a \$0.9 million favorable impact.
- Decreased non-manufacturing expenses of \$0.6 million.

**Non-Operating Expenses**



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Interest expense of \$3.1 million for the three month period ended September 30, 2008 increased from \$1.6 million for the prior-year quarter. Average debt levels increased significantly during the three month period ended September 30, 2008 versus the prior-year quarter mainly due to the acquisition of the LTRI minority interest during the first quarter of 2008, the effects of which were partially offset by lower weighted average effective interest rates. The weighted average effective interest rates on our revolving debt facilities were approximately 5.1 percent and 5.4 percent for the three month periods ended September 30, 2008 and 2007, respectively.

Other expense, net was \$0.6 million for the three month period ended September 30, 2008 compared with zero for the prior-year quarter, primarily due to net foreign currency transaction losses.

### **Income Taxes**



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The provision for income taxes reflected an effective income tax rate of 23.9 percent for the three months ended September 30, 2008 compared with 56.5 percent for the prior-year quarter. The difference in effective tax rates was primarily due to the loss in 2007 versus income in 2008 combined with the favorable tax impact of our foreign holding company structure and the geographic mix of taxable earnings. The proportionate effect of the benefit of the foreign holding company structure on the overall effective income tax rate decreases as earnings increase.

### **Minority Interest**





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Minority interest decreased to zero for the three month period ended September 30, 2008 from \$2.2 million for the prior-year quarter. This decrease was due to our acquisition of the LTRI minority interest in January 2008.

### **Loss from Equity Affiliates**

The loss from equity affiliates totaled \$1.6 million and \$0.1 million during the three month periods ended September 30, 2008 and 2007, respectively, and represents our 50 percent share of the net losses associated with our joint venture paper mill in China. The loss for the current year period is due to mill operations start-up costs.

### **Net Income and Net Income per Share**



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Net income for the three month period ended September 30, 2008 was \$6.7 million, or \$0.44 and \$0.43 per basic and diluted share, respectively, compared with a loss of \$4.3 million, or \$0.27 net loss per basic and diluted share, during the prior-year quarter. The increase in net income in 2008 was primarily due to increased operating profit from

Table of Contents

decreased restructuring expenses and the benefit of the LTRI minority interest acquisition, partially offset by increased interest expense and a higher loss from equity affiliates.

*Nine Months Ended September 30, 2008 Compared with the Nine Months Ended September 30, 2007*

**Net Sales**

(dollars in millions)

	Nine Months Ended		Change	Percent Change	Consolidated Sales Volume Change
	September 30, 2008	September 30, 2007			
France	\$ 379.9	\$ 315.5	\$ 64.4	20.4%	10.4%
United States	173.4	171.6	1.8	1.0	(20.9)
Brazil	53.8	53.7	0.1	0.2	(10.7)
Subtotal	607.1	540.8	66.3		
Intersegment	(16.1)	(14.5)	(1.6)		
Total	\$ 591.0	\$ 526.3	\$ 64.7	12.3%	0.3%

Net sales were \$591.0 million for the nine month period ended September 30, 2008 compared with \$526.3 million for the prior-year period. The increase of \$64.7 million, or 12.3 percent, consisted of the following (dollars in millions):

	Amount	Percent
Changes in currency exchange rates	\$ 39.3	7.5%
Changes in selling prices and product mix	28.4	5.4
Changes in sales volumes	(3.0)	(0.6)
Total	\$ 64.7	12.3%

- Changes in currency exchange rates had a favorable impact on net sales of \$39.3 million, or 7.5 percent, for the nine month period ended September 30, 2008 and primarily reflected the impact of a stronger euro compared with the U.S. dollar. The euro was 12.6 percent and the Brazilian real was 17.5 percent stronger against the U.S. dollar.



- Higher average selling prices had a favorable \$28.4 million, or 5.4 percent, impact on the net sales comparison. The increase in average selling prices reflected an improved mix of products sold, primarily due to increased sales of cigarette paper for LIP cigarettes in the United States and RTL products in France and higher average selling prices in Brazil.





- Changes in unit sales volumes for the nine month period ended September 30, 2008 versus the prior-year period, resulted in an unfavorable effect on net sales of \$3.0 million, or 0.6 percent.



- Sales volumes for the French segment increased by 10.4 percent, primarily due to higher sales volumes of RTL products, partially offset by decreased sales of tobacco-related papers sales volumes.



- Sales volumes in the United States decreased by 20.9 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 Brazil segment's sales volumes decreased by 10.7 percent, primarily due to our exit of the coated papers business, partially offset by continued growth in tobacco-related paper sales volumes.





*The French* segment net sales of \$379.9 million for the nine month period ended September 30, 2008 increased by \$64.4 million, or 20.4 percent, versus \$315.5 million for the prior-year period. The increase in net sales was primarily the result of a stronger euro, increased sales volumes and, to a lesser extent, higher average selling prices mainly as a result of an improved mix of products sold.

*The U.S.* segment net sales of \$173.4 million for the nine month period ended September 30, 2008 increased by \$1.8 million, or 1.0 percent, compared with \$171.6 million for the prior-year period. The effect of higher average selling prices, primarily due to an improved mix of products sold, was mostly offset by lower sales volumes.

*The Brazil* segment net sales of \$53.8 million for the nine month period ended September 30, 2008 increased by \$0.1 million, or 0.2 percent, from \$53.7 million for the prior-year period. The increase was due to the stronger Brazilian real and higher average selling prices, mostly offset by decreased sales volumes.

Table of Contents

**Gross Profit**

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(dollars in millions)

	Nine Months Ended		Change	Percent Change	Percent of Net Sales	
	September 30, 2008	September 30, 2007			2008	2007
Net Sales	\$ 591.0	\$ 526.3	\$ 64.7	12.3%		
Cost of products sold	514.3	441.6	72.7	16.5	87.0%	83.9%
Gross Profit	\$ 76.7	\$ 84.7	\$ (8.0)	(9.4)%	13.0%	16.1%

Gross profit was \$76.7 million for the nine month period ended September 30, 2008, a decrease of \$8.0 million, or 9.4 percent, from \$84.7 million for the prior-year period. The gross profit margin was 13.0 percent of net sales for the nine month period ended September 30, 2008, decreasing from 16.1 percent for the prior-year period. Gross profit decreased due to inflationary cost increases of \$24.6 million, start-up costs of \$11.7 million related to the rebuild of PdM's paper machine, unfavorable foreign currency impacts of \$6.6 million and unfavorable fixed cost absorption of \$2.9 million, partially offset by higher average selling prices of \$15.5 million, primarily due to an improved mix of products sold, and higher sales volumes of \$6.8 million.

Inflationary cost increases, related to higher energy rates, per ton wood pulp prices, other purchased materials costs and labor rates combined to unfavorably impact operating results by \$24.6 million during the nine month period ended September 30, 2008. Higher purchased energy costs unfavorably impacted operating results by \$12.0 million, primarily in France and the United States, during the nine month period ended September 30, 2008. Changes in per ton wood pulp prices, primarily in France and Brazil, increased operating expenses by \$7.4 million compared with the prior-year period. The average per ton list price of northern bleached softwood kraft pulp in the United States was \$880 per metric ton during the nine month period ended September 30, 2008 compared with \$810 per metric ton during the prior-year period.

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 longer than expected start-up negatively impacted operating profit by \$11.7 million for the nine month period ended September 30, 2008.

Lower production volumes for tobacco-related papers and commercial and industrial products in all 3 segments was partially offset by increased production volumes in the French RTL operation.

Higher average selling prices, resulting primarily from an improved mix of products sold primarily in the United States, increased operating results by \$15.5 million for the nine month period ended September 30, 2008 versus the prior-year period. Higher sales volumes, primarily in France, increased operating results by \$6.8 million compared with the prior-year period.

### Nonmanufacturing Expenses

(dollars in millions)

	Nine Months Ended		Change	Percent Change	Percent of Net Sales	
	September 30, 2008	September 30, 2007			2008	2007
Selling expense	\$ 17.7	\$ 16.3	\$ 1.4	8.6%	3.0%	3.1%
Research expense	6.4	5.9	0.5	8.5	1.1	1.1
General expense	24.9	26.1	(1.2)	(4.6)	4.2	5.0

Gross Profit

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Nonmanufacturing expenses	\$	49.0	\$	48.3	\$	0.7	1.4%	8.3%	9.2%
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Nonmanufacturing expenses increased by \$0.7 million, or 1.4 percent, to \$49.0 million from \$48.3 million for the prior-year period, primarily due to foreign currency translation, partially offset by lower accruals for incentive expenses. Nonmanufacturing expenses were 8.3 percent and 9.2 percent of net sales for the nine month periods ended September 30, 2008 and 2007, respectively.

Table of Contents**Restructuring Expense**

Total restructuring expense of \$8.3 million was recognized during the nine month period ended September 30, 2008, including \$4.7 million for employee severance and other cash costs, \$2.2 million for asset impairment charges and \$1.4 million for accelerated depreciation and other non-cash charges. Total restructuring expense of \$24.3 million was recognized during the prior-year period, including \$11.5 million for severance and other employee related costs, \$10.5 million for asset impairment charges and \$2.3 for accelerated depreciation.

**Operating Profit (Loss)**

(dollars in millions)

	Nine Months Ended		Change	Percent Change	Percent of Net Sales	
	September 30, 2008	September 30, 2007			2008	2007
France	\$ 20.7	\$ 20.8	\$ (0.1)	(0.5)%	5.4%	6.6%
United States	16.0	0.6	15.4	N.M.	9.2	0.3
Brazil	(9.8)	(1.1)	(8.7)	N.M.	(18.2)	(2.0)
Subtotal	26.9	20.3	6.6			
Unallocated expenses	(7.5)	(8.2)	0.7			
Total	\$ 19.4	\$ 12.1	\$ 7.3	60.3%	3.3%	2.3%

N.M. Not meaningful

Operating profit was \$19.4 million for the nine month period ended September 30, 2008 compared with an operating profit of \$12.1 million during the prior-year period. Operating profit was higher in our U.S. segment and lower in our Brazilian and French segments.

*The French segment's* operating profit was \$20.7 million for the nine month period ended September 30, 2008, a decrease of \$0.1 million, or 0.5 percent, from an operating profit of \$20.8 million for the prior-year period. The decrease was primarily due to:

- Inflationary cost increases of \$15.3 million, mainly due to increased energy rates of \$6.6 million and higher wood pulp prices of \$4.8 million.
- Start-up costs of the rebuilt paper machine at PdM of \$11.7 million.

- The unfavorable effects of foreign currency translation of \$0.9 million.

The negative factors were partially offset by:

- The benefits of cost savings programs.
- Reduced restructuring expenses of \$7.8 million.
- Increased sales volumes, primarily in RTL products, which improved operating results by \$7.7 million.
- Favorable fixed cost absorption of \$2.3 million.
- Higher average selling prices of \$1.8 million, primarily due to an improved mix of products sold.
- Decreased nonmanufacturing expenses of \$1.7 million.

*The U.S. segment's* operating profit was \$16.0 million for the nine month period ended September 30, 2008, a \$15.4 million increase from an operating profit of \$0.6 million during the prior-year period. The increase was primarily due to:

- The favorable combined effect of higher average selling prices, primarily due to increased sales of cigarette paper for LIP cigarettes and lower sales of commercial and industrial papers, and changes in sales volume of \$12.2 million.
- Decreased restructuring expenses of \$11.1 million.
- The benefits of costs savings programs.
- Reduced nonmanufacturing expenses of \$0.6 million.

These positive factors were partially offset by:

- Inflationary cost increases of \$5.6 million, mainly due to higher energy rates of \$4.3 million.
- Unfavorable fixed cost absorption of \$5.2 million as a result of reduced machine production schedules.



Table of Contents

*Brazil* s operating loss was \$9.8 million during the nine month period ended September 30, 2008, compared with an operating loss of \$1.1 million during the prior-year period. The increased operating loss was primarily due to:

- The stronger Brazilian real versus the U.S. dollar, which had a \$5.7 million unfavorable impact.
- Inflationary cost increases of \$3.7 million, mainly due to increased wood pulp prices and higher energy rates.
- Increased restructuring expenses of \$2.9 million.

These negative factors were partially offset by:

- Benefits of cost savings programs and improved mill operations.
- Higher average selling prices, which had a favorable impact on operating profit of \$1.8 million.
- Lower nonmanufacturing expenses of \$0.8 million.

**Non-Operating Expenses**



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Interest expense of \$8.3 million for the nine month period ended September 30, 2008 increased from \$4.4 million for the prior-year period. Average debt levels increased significantly during the nine month period ended September 30, 2008 versus the prior-year period mainly due to the acquisition of the LTRI minority interest in the first quarter of 2008, which was partially offset by lower weighted average effective interest rates. The weighted average effective interest rates on our revolving debt facilities were approximately 4.9 percent and 5.5 percent for the nine month periods ended September 30, 2008 and 2007, respectively.

Other expense, net was \$1.6 million and \$0.1 million for the nine month periods ended September 30, 2008 and 2007, respectively, primarily due to net foreign currency transaction losses.

### **Income Taxes**



The provision for income taxes reflected an effective income tax rate of zero percent for 2008 compared with 6.6 percent for the prior-year period. The difference in effective tax rates was primarily due to the increase in income in 2008 versus 2007 combined with the favorable tax impact of our foreign holding company structure and the geographic mix of taxable earnings. The proportionate effect of the benefit of the foreign holding company structure on the overall effective income tax rate decreases as earnings increase.

**Minority Interest**



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Minority interest decreased to \$0.2 million for the nine month period ended September 30, 2008 from \$6.0 million for the prior-year period. This \$5.8 million decrease was due to our acquisition of the LTRI minority interest in January 2008.

### **Loss from Equity Affiliates**

The loss from equity affiliates totaled \$1.8 million and \$0.2 million during the nine month periods ended September 30, 2008 and 2007, respectively, and represents our 50 percent share of the net loss associated with our joint venture paper mill in China. The loss for the current year period is due to mill operations start-up costs.

### **Net Income and Net Income per Share**





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Net income for the nine month period ended September 30, 2008 was \$7.5 million, or \$0.49 and \$0.48 per basic and diluted share, respectively, compared with \$0.9 million of net income, or \$0.06 per basic and diluted share, during the prior-year period. The increase in net income in 2008 was primarily due to increased operating profit from decreased restructuring expenses and the benefit of the LTRI minority interest acquisition, partially offset by increased interest expense.

Table of Contents**Liquidity and Capital Resources**

A major factor in our liquidity and capital resource planning is our generation of cash flow from operations, which is sensitive to changes in the sales mix, volume and pricing of our products, as well as changes in our production volumes, costs and working capital. Our liquidity is supplemented by funds contractually available under our revolving credit facility with a consortium of banks that is used as either operating conditions or strategic opportunities warrant. As previously noted, we completed the acquisition of the 28 percent minority share in LTRI in January 2008 at a cost of \$51.3 million and have been engaged in substantial restructuring activities since 2006 in the United States, Brazil and France. Each of these activities is expected to contribute to improved earnings and a more competitive production base over the longer-term. However, in order to implement these initiatives, we incurred higher levels of debt than we traditionally have carried, while at the same time we experienced less favorable earnings from operations undergoing restructuring activities.

**Cash Requirements**

As of September 30, 2008, we had net operating working capital of \$48.3 million and cash and cash equivalents of \$10.3 million, compared with net operating working capital of \$41.6 million and cash and cash equivalents of \$4.0 million as of December 31, 2007. Changes in these absolute amounts include the impacts of changes in currency exchange rates which are not included in the changes in operating working capital presented on the consolidated statements of cash flow. Our level of outstanding borrowings has decreased since the higher level in the first quarter of 2008. Based upon our existing cash and operating working capital levels, expected operating cash flows and capital spending and contractual availability of borrowings under our existing credit facilities, we believe we have the necessary financial resources to satisfy our current liquidity needs.

*Cash Flows from Operating Activities*

(dollars in millions)

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Net income	\$ 7.5	\$ 0.9
Non-cash items included in net income:		
Depreciation and amortization	36.1	29.3
Restructuring related impairment charges and accelerated depreciation	3.6	12.8
Amortization of deferred revenue	(4.6)	(4.7)
Deferred income tax benefit	(14.8)	(11.1)
Minority interest in earnings of subsidiaries	0.2	6.0
Pension and other postretirement benefits	(0.3)	(4.0)
Loss from equity affiliates	1.8	0.2
Other items	0.3	3.0
Net changes in operating working capital	(1.8)	20.2
Cash Provided by Operations	\$ 28.0	\$ 52.6

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Net cash provided by operations was \$28.0 million for the nine month period ended September 30, 2008 compared with \$52.6 million for the prior-year period. Since the first quarter of 2008, we have generated \$36.0 million in cash from operations compared with \$8.0 million cash used by operations during the first quarter of the year. Third quarter 2008 operating cash flow was positively impacted by improved operating results and stable working capital levels.

Prior to 2002, our cash provided by operations included advanced payments from customers for future product purchases. We recorded these advance payments as deferred revenue, which is being amortized into net sales as earned and credited to customers based upon a mutually agreed-upon amount per unit of product sales. We had \$19.5 million of deferred revenue on our September 30, 2008 consolidated balance sheet. At the current volume levels, we expect to fully amortize this amount by recognizing amortization of approximately \$6 million per year through 2011.

Table of Contents*Operating Working Capital*

(dollars in millions)

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Changes in operating working capital		
Accounts receivable	\$ (4.9)	\$ (5.8)
Inventories	13.3	(1.2)
Prepaid expenses	0.5	2.2
Accounts payable	(0.6)	2.3
Accrued expenses	(4.5)	14.4
Accrued income taxes	(5.6)	8.3
Net changes in operating working capital	\$ (1.8)	\$ 20.2

During the nine month period ended September 30, 2008, net changes in operating working capital contributed unfavorably to cash flow by \$1.8 million, primarily due to decreased accrued income taxes and accrued expenses, resulting from payments of prior period accruals for income taxes, restructuring and incentive compensation, and increased accounts receivable due to higher net sales. These increases in net working capital were mostly offset by lower inventories due primarily to sales of inventories built up in advance of the Lee Mills shutdown.

During the prior-year period, changes in operating working capital contributed favorably to cash flow by \$20.2 million, primarily due to increased accrued restructuring and incentive compensation costs and increased accrued income taxes due to improved LTRI earnings, partially offset by increased accounts receivable as a result of higher net sales.

*Cash Flows from Investing Activities*

(dollars in millions)

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Capital spending	\$ (30.0)	\$ (26.8)
Capitalized software costs	(4.4)	(6.9)
LTRI minority interest acquisition (Note 9)	(51.3)	
Investment in equity affiliates	(1.9)	(10.3)
Other	3.1	(1.8)
Cash Used for Investing	\$ (84.5)	\$ (45.8)

Cash used for investing activities was \$84.5 million for the nine month period ended September 30, 2008 versus \$45.8 million during the prior-year period. This \$38.7 million increase in cash used for investing was primarily due to the \$51.3 million acquisition of the LTRI minority interest and increased capital spending. We made our final contractual equity contribution in January 2008 of \$1.9 million to the China paper joint venture. Changes in the category Other, or other cash investment items, primarily consisted of changes in noncurrent assets and liabilities.

**Capital Spending and Capitalized Software Costs**



Capital spending was \$30.0 million and \$26.8 million for the nine month periods ended September 30, 2008 and 2007, respectively.

**Capital spending was \$6.0 million during the third quarter of 2008 compared with \$5.4 million during the second quarter of 2008, reflecting the absence of any significant major projects during either quarter. Major projects included in the nine months ended September 30, 2008 capital spending were \$9.5 million incurred at PdM for the paper machine rebuild and improvements to the bobbin slitting process, \$3.4 million for a new paper coating machine at the Newberry, South Carolina facility, \$1.4 million for machine improvements at LTRI, \$1.3 million for steam network improvements at Papeteries de Saint-Girons S.A.S. and \$1.2 million for a new slitting machine in the Philippines. Major projects included in the nine months ended September 30, 2007 capital spending were \$4.9 million for the PdM paper machine rebuild and improvements in the bobbin slitting process, \$4.0 million for a paper machine rebuild in Brazil, \$3.2 million for a new production facility and related equipment in Newberry and \$1.5 million for a paper machine rebuild in the Philippines.**





We incur spending necessary to meet legal requirements and otherwise relating to the protection of the environment at our facilities in the United States, France, the Philippines, Indonesia, Brazil and Canada. For these purposes, we

Table of Contents

expect to incur capital expenditures of approximately \$1 million in each of the full-years 2008 and 2009, of which no material amount is the result of environmental fines or settlements. The foregoing capital expenditures are not expected to reduce our ability to invest in other appropriate and necessary capital projects and are not expected to have a material adverse effect on our financial condition or results of operations.

Total capital spending for 2008 is expected to be approximately \$35 million.

Capitalized software costs decreased to \$4.4 million from \$6.9 million during the prior-year period, primarily due to decreased spending on an enterprise-wide information system in France. A start-up of a portion of the system occurred in January 2008 and additional portions are scheduled to be implemented in the fourth quarter of 2008 and continuing into 2009. A total of \$4.3 million was spent on this project during the nine month period ended September 30, 2008 and \$16.0 million since the inception of the project in 2005.

*Cash Flows from Financing Activities*

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(dollars in millions)

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Cash dividends paid to SWM stockholders	\$ (7.0)	\$ (7.1)
Net changes in debt	70.9	(6.2)
Purchases of treasury stock	(1.2)	(4.0)
Proceeds from exercise of stock options	0.2	4.5
Excess tax benefits of stock-based awards		0.3
Cash Provided by (Used for) Financing	\$ 62.9	\$ (12.5)

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**Financing activities during the nine month period ended September 30, 2008 included net borrowings of \$70.9 million. Other 2008 financing activities included cash dividends paid to SWM stockholders as well as purchases of treasury stock early in 2008.**

Financing activities during the nine month period ended September 30, 2008 included net borrowings of \$70.9 million.



Financing activities during the nine month period ended September 30, 2007 included cash dividends paid to SWM stockholders of \$7.1 million and net repayments of debt of \$6.2 million. Additionally, we repurchased shares of common stock during the first nine months of 2007 for a total of \$4.0 million. Partially offsetting these uses of financing, we received proceeds of \$4.5 million from the exercise of stock options.



**Dividend Payments**





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We have declared and paid quarterly dividends of \$0.15 per share since the second quarter of 1996. The Board of Directors declared a quarterly cash dividend of \$0.15 per share of common stock. The dividend will be payable on December 15, 2008 to stockholders of record on November 17, 2008. We currently expect to continue this level of dividend. However, the decision to declare a dividend is made quarter by quarter and based upon a number of factors including, but not limited to, earnings, funding of strategic opportunities and our financial condition. A decision could be made to cancel, suspend, modify or change the form of future dividend payments.

### **Share Repurchases**



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We repurchased a total of 48,900 shares of our common stock during the nine month period ended September 30, 2008 at a cost of \$1.2 million. See Part II, Item 2, Unregistered Sales of Equity Securities and Use of Proceeds.

### **Debt Instruments and Related Covenants**

(dollars in millions)

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Changes in short-term debt	\$ 4.1	\$ (6.3)
Proceeds from issuances of long-term debt	100.2	25.0
Payments on long-term debt	(33.4)	(24.9)
Net changes in debt	\$ 70.9	\$ (6.2)

Table of Contents

Primarily due to the LTRI minority interest acquisition, machine start-up costs for restructuring related activities, reduced cash generated from operations and higher capital spending, our net proceeds from long-term debt were \$66.8 million and from short-term debt were \$4.1 million during the nine month period ended September 30, 2008. We expect working capital, pension plan funding and other cash uses to increase somewhat through the fourth quarter of 2008 and therefore anticipate additional borrowings in the range of approximately \$15 to \$18 million during the remainder of 2008. With this level of borrowing, we expect to remain in compliance with our Credit Agreement financial covenants for the remainder of 2008.

Borrowing on our revolving credit facilities reduced the contractual availability under our U.S. Revolver to \$15.0 million as of September 30, 2008 from \$26.0 million as of December 31, 2007. Contractual availability under our Euro Revolver decreased to 38.1 million euros as of September 30, 2008 from 80.0 million euros as of December 31, 2007. We also had contractual availability under our bank overdraft facilities and lines of credit of \$27.5 million as of September 30, 2008. The Credit Agreement contains covenants that are customary for facilities of this type 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. As of September 30, 2008, the net debt to equity ratio was 0.48, and the net debt to adjusted EBITDA ratio was 1.94. Based on our debt covenant restrictions as of September 30, 2008, we could have borrowed an additional \$86.4 million from our Credit Agreement and bank overdraft facilities without violating the most restrictive of those covenants.

Our total debt to capital ratios at September 30, 2008 and December 31, 2007 were 33.9 percent and 21.5 percent, respectively, most recently toward the upper end of management's target range of 25 to 35 percent.

**Other Factors Affecting Liquidity and Capital Resources**

*Postretirement Benefits.* Our pension obligations are funded by our separate pension trusts, which held \$126.1 million in assets at December 31, 2007. The combined postretirement benefit obligation of our U.S. and French pension plans was underfunded by \$27.1 million as of December 31, 2007. We made \$2.4 million in pension contributions to our pension plans during the nine month period ended September 30, 2008 and expect to contribute a total of \$7 to \$8 million during the full-year of 2008 to our pension plans to improve the funded status of these plans and ensure compliance with the Pension Protection Act of 2006 in the United States, or PPA. Given the current volatile market conditions, we are studying the impacts that may have on our pension funding status, in particular in relation to compliance with PPA in the United States. Currently it appears that we could have additional pension contributions of \$5 to \$15 million by April 2009, in addition to whatever minimum required contributions we will have for 2009.

*Other Commitments.* PdM has a minimum annual commitment for calcium carbonate purchases, a raw material used in the manufacturing of some paper products, which totals approximately \$2 million per year. Our future purchases at this mill are expected to be at levels that exceed such minimum levels under the contract, which expires in 2013.

LTRI and PdM are committed to purchasing minimum annual amounts of steam provided by cogeneration facilities for the next 13 to 15 years. These minimum annual commitments together total approximately \$4 to \$5 million. LTRI's and PdM's current and expected requirements for steam are at levels that exceed the minimum levels under the respective contracts.

SWM-B and PdM separately entered into agreements for the transmission and distribution of energy. The SWM-B contract for the electrical energy supply is for the period May 1, 2006 to December 31, 2010 covering 100 percent of the mill's consumption of electrical energy. The absolute value of the electric energy to be provided under this contract is estimated at approximately \$5 million annually. The SWM-B agreements for transmission and distribution of electric energy are revolving annual contracts with the absolute value of the services being provided under these 2 contracts estimated at approximately \$3 to \$4 million annually. The PdM natural gas agreement expired on April 1, 2008, but was renewed until March 31, 2009, and provides for the supply of 100 percent of its requirements for natural gas and associated distribution to service its paper mill. The absolute value of the natural gas and distribution to be provided under this contract is estimated at approximately \$11 million.

*Employee Labor Agreements.* Hourly employees at the Lee, Massachusetts, Spotswood, New Jersey and Ancram, New York mills are represented by locals of the United Steel Workers Union. The collective bargaining agreement

Table of Contents

at our Spotswood mill is a 3-year agreement through July 28, 2010. The collective bargaining agreement at our Ancram mill expired September 30, 2008, and negotiations on a new collective bargaining agreement are in progress. The Lee Mill is operating pursuant to an extension of its May 2006 labor agreement.

Hourly employees at our Quimperlé, Malaucène, Saint-Girons and Spay, France mills are union represented. 1-year term collective bargaining agreements were signed at the Quimperlé and Malaucène mills beginning January 1, 2008 through December 31, 2008, at our Spay mill effective March 1, 2008 through February 28, 2009 and at our Saint-Girons mill beginning June 6, 2008 and expiring June 5, 2009.

**Outlook**

As expected, we improved our financial performance during the third quarter of 2008 relative to both the second quarter of 2008 and the third quarter of 2007. Earnings increased primarily due to higher sales volumes for RTL and cigarette paper used in LIP cigarettes. We also benefited from the January 2008 purchase of the 28 percent minority interest of LTRI. Operation of the rebuilt paper machines at PdM improved during the third quarter of 2008, but still contributed to an increase in production cost versus last year. As a result of increased earnings benefiting cash generation and continued reductions in capital spending, we lowered debt during the third quarter of 2008.

Our RTL business continues to realize sales volume growth and increased earnings. Full year sales growth well above 10 percent is expected for 2008. Due to the January 2008 acquisition of the minority interests in LTRI, our consolidated results will reflect 100 percent of LTRI's results for the remainder of 2008 and in future years.

Based upon the states that have passed LIP regulation, demand for this product 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 legislation and several cigarette producers have announced voluntary national distribution of this technology, supporting the likelihood that LIP cigarettes will be sold nationwide across 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 would continue to benefit our U.S. business unit's results. International LIP efforts are accelerating, especially in the EU and Australia. Continued EU rule-making activities indicate that it is increasingly likely LIP cigarette regulations outside North America will become effective by 2012 and increase demand for cigarette paper used in these LIP cigarettes. This is a positive development for us given the current level of commercial acceptance of our Alginex-banded papers and our ability to provide one or more commercially proven alternative solutions to cigarette manufacturers in addressing LIP requirements. We continue to expand our U.S. capacity for cigarette paper processing for LIP cigarettes and are undertaking capacity planning activities for this technology in Europe.

During the first nine months of 2008, benefits from cost reduction initiatives did not offset inflation, primarily due to increased energy rates and wood pulp costs. Year-to-date, inflationary cost increases totaled \$24.6 million, well above the impact seen in the preceding 12 months. In spite of the recent global economic slow down we still expect negative inflationary impacts on our earnings in the fourth quarter of 2008, but at a lower rate.

Despite the difficult machine start-ups experienced during the first half of 2008 in France and Brazil, the overall restructuring activities are progressing well. The Lee Mills in the United States has now been closed, we have finalized the exit from the coated papers business in Brazil



and are making progress in transferring profitable base tipping paper business to this location. The rebuilt PdM paper machine performance continued to improve each month during the third quarter and we now expect to reach or exceed pre-rebuild output levels by the end of the fourth quarter of 2008.

Given the cumulative impact of inflationary cost increases and unfavorable currency impacts that could not be recovered through pricing over the past 2 years, we continue to evaluate actions to curtail operation of certain of our paper machines that could not achieve an acceptable return in such a pricing environment. We are engaging our customers in price negotiations in an effort to improve the profitability of all products across our global businesses. As part of this process, we continue to evaluate the sustainability of certain operations and recoverability of the property, plant and equipment, deferred tax and other assets from these businesses. Further restructuring actions or asset impairments will likely be forthcoming during the next 9 months, with the extent dependent upon the outcome of customer price negotiations and currency hedging actions taking place during the fourth quarter of 2008.

Table of Contents

In spite of the good results during the third quarter of 2008, Schweitzer-Mauduit faces challenges for earnings in the fourth quarter, most of which are expected to be contained to that quarter. We anticipate an adverse impact to our fourth quarter results from decreases in sales volumes due to seasonal cigarette customer plant shut-downs, a slow realization of selling price increases undertaken to recover inflation and continuing unfavorable foreign currency impacts until January 1, 2009 when existing commercial supply agreements and past currency hedging contracts expire, finalization of certain restructuring activities, slower than expected growth in sales for our new joint venture paper mill in China and other expected one-time expenses.

Recent market volatility has resulted in a stronger U.S. dollar against many currencies, including the euro and the Brazilian real. The operating results of our Brazilian business have been negatively impacted in the last 2 years during which the Brazilian real had strengthened significantly versus the U.S. dollar. The recent significant weakening of the Brazilian real versus the U.S. dollar presents a more favorable situation for our Brazilian business. In October 2008, we entered into currency exchange rate hedging contracts locking in a more favorable exchange rate for approximately half of the Brazilian entity's U.S. dollar transactions exposure. While we will not participate in the further benefits for this portion of the U.S. dollar transactions exposure if the Brazilian real weakens further, this action will significantly benefit that segment's 2009 operating results in comparison to operating results during periods in which the real was stronger.

For 2009, Schweitzer-Mauduit currently expects earnings per share, excluding restructuring expenses, to be better than 2007 results due to the benefits of further increases in sales volumes for RTL and cigarette paper used in LIP cigarettes, increased operating profit in Brazil due to finalization of restructuring actions and beneficial changes in the relation of the Brazilian real to the U.S. dollar secured through recent hedging transactions, the lack of start-up expenses realized in 2008 from the rebuilt paper machine at PdM, as this machine is now expected to reach targeted output by the end of the first quarter of 2009 and, finally, 2009 customer selling price increases to recover a portion or all of the cumulative inflationary cost increases since 2005. The extent to which Schweitzer-Mauduit's earnings per share for 2009, excluding restructuring expenses, will exceed 2007 results is dependent upon the actual level of selling price increases and sales volume changes realized during our annual customer negotiations to be concluded by early 2009.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and is subject to the safe harbor created by that Act. These statements include those in the Outlook section and our expectations elsewhere in Management's Discussion and Analysis of Financial Condition and Results of Operation. They also include statements containing expect, anticipate, project, appears, should, could, may, typically and similar words. Actual results may differ materially from the results suggested by these statements a number of reasons, including the following:

- We have manufacturing facilities in 6 countries and sell products in over 90 countries. As a result, we are subject to a variety of import and export, tax, foreign currency, labor and other regulations within these countries. Changes in these regulations, or adverse interpretations or applications, as well as changes in currency exchange rates, could adversely impact our business in a variety of ways, including increasing expenses, decreasing sales, limiting our ability to repatriate funds and generally limiting our ability to conduct business.
- Our financial performance is dependent upon the cost of raw materials, particularly wood pulp, purchased energy, chemicals and labor. Recently, the cost of some of these items has increased significantly, and the nature of our

agreements with our customers may make it difficult to pass changes in these costs on to our customers in a timely and effective manner.

- Our sales are concentrated to a limited number of customers. In 2007, 41 percent of our sales were to our 2 largest customers. The loss of 1 or both such customers, or a significant reduction in 1 or both of these customers' purchases, could have a material adverse effect on our results of operations.

Table of Contents

- Our financial performance is materially impacted by sales of both RTL products and cigarette paper for LIP cigarettes. A significant change in the sales or production volumes, pricing or manufacturing costs of these products could have a material impact on future financial results.
- As a result of excess capacity in the tobacco-related papers industry and increased purchased material and operating costs experienced in the last several years, competitive levels of selling prices for certain of our products are not sufficient to cover those costs with a margin that we consider reasonable. Such competitive pressures have resulted in downtime of certain paper machines and, in some cases, accelerated depreciation or impairment charges for certain equipment and employee severance expenses associated with downsizing activities. Management continues to evaluate how to operate our production facilities more effectively with reduced production volumes and additional restructuring activities are possible for the fourth quarter of 2008. Management also continues to evaluate the recoverability of the property, plant and equipment, deferred tax assets and other assets of the businesses.
- Our Credit Agreement contains certain financial covenants including, but not limited to, a net debt to adjusted EBITDA ratio. While we currently project that we will not fail to comply with any of these covenants, changes from the expected results of operations, higher than expected capital spending, an unanticipated need for additional borrowing or other factors could cause us to violate 1 or more of the covenants in our Credit Agreement. In the event we breach the net debt to adjusted EBITDA covenant, we believe that we could obtain a temporary waiver of that covenant, obtain an amendment of our Credit Agreement or access the markets for additional capital. However, there is no assurance that the required bank consents could be obtained for a temporary waiver or an amendment, that a temporary waiver or amendment of our credit facilities would be adequate to fully resolve the condition giving rise to the default or that we could successfully access the markets for additional capital.
- In recent years, governmental and quasi-governmental entities around the world, particularly in the United States and western Europe, have taken or have proposed actions that may have the effect of reducing consumption of tobacco products. Reports with respect to the possible harmful physical effects of cigarette smoking and use of tobacco products have been publicized for many years and, together with actions to restrict or prohibit advertising and promotion of cigarettes or other tobacco products, to limit smoking in public places and to increase taxes on such products, are intended to discourage the consumption of cigarettes and other such products. Also in recent years, certain governmental entities, particularly in North America and Europe, have enacted, considered or proposed actions that would require cigarettes to meet specifications aimed at reducing their likelihood of igniting fires when the cigarettes are not actively being smoked. Furthermore, it is not possible to predict what additional legislation or regulations relating to tobacco products will be enacted, or to what extent, if any, such legislation or regulations might affect our business.

For additional factors and further discussion of these factors, please see our Annual Report on Form 10-K for the year ended December 31, 2007.

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



Our market risk exposure at September 30, 2008 is consistent with, and not materially different than, the types of market risk and amount of exposures presented under the caption "Market Risk" in Part I, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2007 filed with the SEC.

**ITEM 4. CONTROLS AND PROCEDURES**





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We currently have in place systems relating to disclosure controls and procedures with respect to the accurate and timely recording, processing, summarizing and reporting of information required to be disclosed in our periodic Exchange Act reports. We periodically review and evaluate these disclosure controls and procedures to ensure that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions about required disclosure. In completing our review and evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2008, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures were effective as of September 30, 2008. No changes in our internal control over financial reporting were identified as having occurred in the fiscal quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II**



**ITEM 1. LEGAL PROCEEDINGS**



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The Company is involved in various legal proceedings and disputes (see Note 8, Commitments and Contingencies, of the Notes to the 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 third quarter of 2008.

**ITEM 1A. RISK FACTORS**

**There were no material changes in the risk factors previously disclosed in our Form 10-K for the year ended December 31, 2007.**





**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**



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The Company repurchased shares of its common stock during the nine month period ended September 30, 2008. The following table indicates the amount of shares of the Company's common stock repurchased during 2008 and the remaining amount of share repurchases currently authorized by our Board of Directors as of September 30, 2008:

	<b>Total Number Of Shares Repurchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Repurchased As Part of Publicly Announced Programs</b>		<b>Maximum Amount Of Shares that May Yet be Repurchased Under the Program</b>
			<b>(# shares)</b>	<b>(\$ in millions)</b>	<b>(\$ in millions)</b>
Full-Year 2007	249,016	\$ 23.34	249,016	\$ 5.8	
First Quarter 2008	48,900	24.51	48,900	1.2	
Second Quarter 2008					
Third Quarter 2008					
<b>Total</b>	<b>297,916</b>	<b>\$ 23.53</b>	<b>297,916</b>	<b>\$ 7.0</b>	<b>\$ 13.0*</b>

\* On December 7, 2006, our Board of Directors authorized the repurchase of shares of our common stock during the period January 1, 2007 to December 31, 2008 in an amount not to exceed \$20.0 million.



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Corporate 10b5-1 plans have been used by the Company so that share repurchases can be made at predetermined stock price levels, without restricting such repurchases to specific windows of time. Future common stock repurchases will be dependent upon various factors, including the stock price, strategic opportunities and cash availability.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**



None

**ITEM 5. OTHER INFORMATION**

None



Table of Contents

**ITEM 6. EXHIBITS**

(a) Exhibits:

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

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\* These Section 906 certifications are not being incorporated by reference into the Form 10-Q filing or otherwise deemed to be filed with the Securities and Exchange Commission.

Table of Contents

**SIGNATURES**

Pursuant to the requirements 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.

Schweitzer-Mauduit International, Inc.  
(Registrant)

By: /s/ TORBEN WETCHE  
Torben Wetché  
Chief Financial Officer and  
Treasurer  
(duly authorized officer and  
principal financial officer)

**November 5, 2008**

By: /s/ MARK A. SPEARS  
Mark A. Spears  
Controller  
(principal accounting officer)

November 5, 2008



**Table of Contents**



**GLOSSARY OF TERMS**



**The following are definitions of certain terms used in our Form 10-Q and 10-K filings:**





- *Banded cigarette paper* is a type of paper, used to produce lower ignition propensity cigarettes, by applying bands to the paper during the papermaking process.



- *Binder* is used to hold the tobacco leaves in a cylindrical shape during the production process of cigars.



- *Cigarette paper* wraps the column of tobacco within a cigarette and has varying properties such as basis weight, porosity, opacity, tensile strength, texture and burn rate.



- *Commercial and industrial products* include lightweight printing and writing papers, coated papers for packaging and labeling applications, business forms, battery separator paper, drinking straw wrap and other specialized papers.





- *Flax* is a cellulose fiber from a flax plant used as a raw material in the production of certain cigarette papers.



- *Lower ignition propensity cigarette paper* includes banded and print banded cigarette paper, both of which contain bands, which increase the likelihood that an unattended cigarette will self-extinguish.



- *Net debt to adjusted EBITDA ratio* is a financial measurement used in bank covenants where *Net Debt* is defined as the current portion of long term debt plus other short term debt plus long term debt less cash and cash equivalents, and



- *Adjusted EBITDA* is defined as net income excluding extraordinary or 1-time items, minority interest in earnings, loss from equity of affiliates, interest expense, income taxes and depreciation and amortization less amortization of deferred revenue.





- *Net debt to capital ratio* is current and long term debt less cash and cash equivalents, divided by the sum of current debt, long term debt, minority interest and total stockholders' equity.



- *Net debt to equity ratio* is current and long term debt less cash and cash equivalents, divided by minority interest and total stockholders' equity.



- *Net operating working capital* is accounts receivable, inventory, current income tax refunds receivable and prepaid expense and other current assets excluding cash, less accounts payable, accrued liabilities, accrued income taxes payable and other current liabilities excluding debt.



- *Opacity* is a measure of the extent to which light is allowed to pass through a given material.





- *Operating profit return on assets* is operating profit divided by average total assets.



- *Plug wrap paper* wraps the outer layer of a cigarette filter and is used to hold the filter materials in a cylindrical form.



- *Print banded cigarette paper* is a type of paper, used to produce lower ignition propensity cigarettes, with bands added to the paper during a printing process, subsequent to the papermaking process.



- *Reconstituted tobacco* is produced in 2 forms: leaf, or reconstituted tobacco leaf, and wrapper and binder products. Reconstituted tobacco leaf is blended with virgin tobacco as a design aid to achieve certain attributes of finished cigarettes. Wrapper and binder are reconstituted tobacco products used by manufacturers of cigars.





- *Restructuring expense* represents expenses incurred in connection with unusual or infrequently occurring activities intended to significantly change the size or nature of the business operations, including significantly reduced utilization of operating equipment, exit of a product or market or a significant workforce reduction.



- *Start-up costs* are costs incurred prior to generation of income producing activities in the case of a new plant, or costs incurred in excess of expected ongoing normal costs in the case of a new or rebuilt machine. Start-up costs can include excess variable costs such as raw materials, utilities and labor and unabsorbed fixed costs.



- *Tipping paper* joins the filter element to the tobacco-filled column of the cigarette and is both printable and glueable at high speeds.



- *Wrapper* covers the outside of cigars providing a uniform, finished appearance.





Table of Contents

**SCHWEITZER-MAUDUIT INTERNATIONAL, INC.**

**Quarterly Report on Form 10-Q**

**for the Quarterly Period Ended September 30, 2008**

**INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
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