UST INC
Form 10-Q
August 07, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549-1004
FORM 10-Q

(Mark One)

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

For quarterly period ended June 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 __________

Commission File Number 0-17506

UST Inc.

(Exact name of Registrant as specified in its charter)

Delaware	06-1193986
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6 High Ridge Park, Building A, Stamford, Connecticut	06905
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (203) 817-3000

(Former name, former address and former fiscal year, if changed since last report.)

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

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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(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 o No þ

Number of Common Shares ($.50 par value) outstanding at July 31, 2008 147,547,580

UST Inc.
(the Registrant or the Company)
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Part I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
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CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(Dollars in thousands, except per share data)

	June 30, 2008 (Unaudited)	December 31, 2007 (Note)
Assets:		
Current assets:		
Cash and cash equivalents	$ 47,532	$ 73,697
Accounts receivable	74,777	60,318
Inventories		
Leaf tobacco	176,937	202,137
Products in process	219,485	258,814
Finished goods	177,001	163,247
Other materials and supplies	24,367	22,365
Total inventories	597,790	646,563
Deferred income taxes	21,946	26,737
Income taxes receivable	922	8,663
Prepaid expenses and other current assets	26,866	30,296
Total current assets	769,833	846,274
Property, plant and equipment, net	505,118	505,101
Deferred income taxes	39,615	35,972
Goodwill	28,211	28,304
Intangible assets, net	55,655	56,221
Other assets	18,473	15,206
Total assets	$ 1,416,905	$ 1,487,078
Liabilities and stockholders deficit:		
Current liabilities:		
Short term borrowings	$ 140,000	$
Current portion of long-term debt	240,000	
Accounts payable and accrued expenses	191,107	321,256
Income taxes payable	9,224	
Litigation liability	24,772	75,360
Total current liabilities	605,103	396,616
Long-term debt	900,000	1,090,000
Postretirement benefits other than pensions	84,486	81,668
Pensions	159,369	150,318
Income taxes payable	38,940	38,510
Other liabilities	22,562	20,162
Total liabilities	1,810,460	1,777,274

Contingencies (see Note 14)		
Minority interest and put arrangement	29,996	30,006
Stockholders deficit:		
Capital stock [(1)]	105,779	105,635
Additional paid-in capital	1,114,267	1,096,923
Retained earnings	851,583	773,829
Accumulated other comprehensive loss	(44,945)	(45,083)
	2,026,684	1,931,304
Less treasury stock [(2)]	2,450,235	2,251,506
Total stockholders deficit	(423,551)	(320,202)
Total liabilities and stockholders deficit	$ 1,416,905	$ 1,487,078

(1) Common Stock par value $.50 per share: Authorized 600 million shares; Issued 211,558,289 shares at June 30, 2008 and 211,269,622 shares at December 31, 2007. Preferred Stock par value $.10 per share: Authorized 10 million shares; Issued None.

(2) 64,016,506 shares and 60,332,966 shares of treasury stock at June 30, 2008 and December 31, 2007, respectively.

Note: The Condensed Consolidated Statement of Financial Position at December 31, 2007 has been derived from the audited financial statements at that date.

See Notes to Condensed Consolidated Financial Statements.

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UST Inc.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Net sales	$ 506,171	$ 491,254	$ 978,885	$ 938,272
Costs and expenses:				
Cost of products sold	124,951	112,787	242,344	215,914
Excise taxes	15,348	14,062	29,311	26,588
Selling, advertising and administrative	125,400	132,674	253,504	265,618
Restructuring charges	1,206	3,908	1,618	7,428
Antitrust litigation	1,525		1,525	122,100
Total costs and expenses	268,430	263,431	528,302	637,648
Gain on sale of corporate headquarters building				105,143
Operating income	237,741	227,823	450,583	405,767
Interest, net	18,854	8,555	36,531	18,130
Earnings before income taxes, minority interest and equity earnings	218,887	219,268	414,052	387,637
Income tax expense	79,039	79,072	148,334	139,812
Earnings before minority interest and equity earnings	139,848	140,196	265,718	247,825
Minority interest expense and equity earnings, net	188	225	724	341
Net earnings	$ 139,660	$ 139,971	$ 264,994	$ 247,484
Net earnings per share:				
Basic	$ 0.95	$ 0.88	$ 1.79	$ 1.55
Diluted	0.94	0.87	1.77	1.53
Dividends per share	$ 0.63	$ 0.60	$ 1.26	$ 1.20
Average number of shares:				
Basic	147,298	159,557	148,188	159,762
Diluted	148,577	161,104	149,481	161,340

See Notes to Condensed Consolidated Financial Statements

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UST Inc.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Operating Activities:		
Net earnings	$ 264,994	$ 247,484
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	26,782	22,545
Share-based compensation expense	5,559	7,001
Excess tax benefits from share-based compensation	(2,020)	(6,619)
Minority interest expense and equity earnings, net	724	341
Gain on sale of corporate headquarters		(105,143)
Gain on disposition of property, plant and equipment	(1,281)	(629)
Amortization of imputed rent on corporate headquarters		3,851
Deferred income taxes	1,075	(6,622)
Changes in operating assets and liabilities:		
Accounts receivable	(14,459)	(6,216)
Inventories	48,773	33,877
Prepaid expenses and other assets	5,378	(3,476)
Accounts payable, accrued expenses, pensions and other liabilities	(100,604)	(53,758)
Income taxes	19,192	(8,412)
Litigation liability	(50,588)	118,008
Net cash provided by operating activities	203,525	242,232
Investing Activities:		
Short-term investments, net		(20,000)
Purchases of property, plant and equipment	(27,309)	(22,582)
Proceeds from dispositions of property, plant and equipment	1,515	130,456
Investment in joint venture	(42)	(328)
Net cash (used in) provided by investing activities	(25,836)	87,546
Financing Activities:		
Revolving credit facility repayments, net	(110,000)	
Proceeds from the issuance of debt	296,307	
Change in book cash overdraft	(16,693)	
Excess tax benefits from share-based compensation	2,020	6,619
Proceeds from the issuance of stock	10,149	26,122
Dividends paid	(186,908)	(192,255)
Stock repurchased	(198,729)	(120,070)

Net cash used in financing activities	(203,854)	(279,584)
(Decrease) increase in cash and cash equivalents	(26,165)	50,194
Cash and cash equivalents at beginning of year	73,697	254,393
Cash and cash equivalents at end of the period	$ 47,532	$ 304,587
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 128,045	$ 154,866
Interest	32,386	28,575

See Notes to Condensed Consolidated Financial Statements.

UST Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)
(In thousands, except per share amounts or where otherwise noted)

1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X issued by the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (GAAP) for complete financial statements. Management believes that all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The condensed consolidated financial statements include the accounts of UST Inc. (the Company) and all of its subsidiaries after the elimination of intercompany accounts and transactions. The Company provides for minority interests in consolidated companies in which the Company s ownership is less than 100 percent. Certain prior year amounts have been reclassified to conform to the 2008 financial statement presentation. Operating results for the six month period ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ended December 31, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Form 10-K).

2 RECENT ACCOUNTING PRONOUNCEMENTS

In June 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share pursuant to the two-class method, as described in Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings per Share* (SFAS No. 128). The FSP requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividends or dividend equivalents as a separate class of securities in calculating earnings per share. FSP EITF 03-6-1 is to be applied on a retrospective basis and is effective for fiscal years beginning after December 15, 2008; as such, the Company plans to adopt the provisions of this FSP on January 1, 2009. The Company is in the process of evaluating the impact that the adoption of this FSP may have on its results of operations.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). This standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following approval by the SEC of the Public Company Accounting Oversight Board s amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company does not expect the adoption of this standard to have a material impact on the preparation of its consolidated financial statements.

UST Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3), in April 2008. FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset, as determined under provisions of SFAS No. 142, and the period of expected cash flows used to measure the fair value of the asset in accordance with SFAS No. 141(R), *Business Combinations* (SFAS No. 141(R)). FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and is to be applied prospectively to intangible assets acquired subsequent to its effective date. Accordingly, the Company plans to adopt the provisions of this FSP on January 1, 2009. The impact that the adoption of FSP FAS 142-3 may have on the Company s results of operations and financial condition will depend on the nature and extent of any intangible assets acquired subsequent to its effective date.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires entities to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133) and its related interpretations, and how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008, and, as such, the Company plans to adopt the provisions of this standard on January 1, 2009. Although SFAS No. 161 requires enhanced disclosures, its adoption will not impact the Company s results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 141(R). SFAS No. 141(R), replaces SFAS No. 141, *Business Combinations*, and establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and any goodwill acquired in a business combination. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of a business combination. SFAS No. 141(R) is to be applied on a prospective basis and, for the Company, would be effective for any business combination transactions with an acquisition date on or after January 1, 2009. The impact that the adoption of this pronouncement may have on the Company s results of operations and financial condition will depend on the nature and extent of any business combinations subsequent to its effective date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (SFAS No. 160), which establishes accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and for the deconsolidation of a subsidiary. The key provisions of SFAS No. 160 included the following: (1) noncontrolling interests in consolidated subsidiaries shall be presented in the consolidated statement of financial position within equity, but separate from the parent s equity, (2) consolidated net income shall include amounts attributable to both the parent and the noncontrolling interest, with the amount applicable to each party clearly presented in the consolidated statement of operations, (3) fair value measures shall be used when deconsolidating a subsidiary and determining any resulting gain or loss, and (4) sufficient disclosures shall be made to clearly distinguish between the interests of the parent and the interests of the noncontrolling owners. The calculation of net earnings per share will continue to be based only on income attributable to the parent. SFAS No. 160 is to be applied on a prospective basis, except for the presentation and disclosure requirements, which are to be applied retrospectively. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, and, as such, the Company plans to adopt the provisions of this standard on January 1, 2009. The Company is in the process of evaluating the impact that the adoption of this pronouncement may have on its results of operations and financial condition.

UST Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In February 2007, the FASB issued SFAS No. 159, The *Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure eligible financial instruments and certain other items at fair value at specified election dates. The Company adopted the provisions of SFAS No. 159 on January 1, 2008, as required. The adoption of SFAS No. 159 did not have an impact on the Company s results of operations or financial condition, as the Company has not elected to measure any eligible items at fair value.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 provides a common definition of fair value to be applied to existing GAAP requiring the use of fair value measures, establishes a framework for measuring fair value and enhances disclosure about fair value measures under other accounting pronouncements, but does not change existing guidance as to whether or not an asset or liability is carried at fair value. The Company adopted the provisions of SFAS No. 157 on January 1, 2008, as required. See Note 12, Derivative Instruments and Hedging Activities, for more details.

3 CAPITAL STOCK

The Company repurchased approximately 1.3 million shares of outstanding common stock at a cost of approximately $66.8 million during the quarter ended June 30, 2008. During the first six months of 2008, the Company repurchased approximately 3.7 million shares of outstanding common stock at a cost of approximately $198.7 million. Of the total shares repurchased, 1.9 million shares were repurchased at a cost of $104.8 million pursuant to the Company s authorized program, approved in December 2004, bringing the total repurchases of outstanding common stock under the program to the authorized maximum of 20 million shares. The cumulative cost of repurchases under the completed program was approximately $1 billion. The remaining 1.8 million shares repurchased during the six months ended June 30, 2008 were made pursuant to a new program to repurchase up to 20 million shares of the Company s outstanding common stock, which was authorized by the Company s Board of Directors in December 2007. As of June 30, 2008, the cumulative cost of the 1.8 million shares repurchased under the new program was approximately $93.9 million.

4 SHARE-BASED COMPENSATION

The Company accounts for share-based compensation in accordance with the provisions of SFAS No. 123(R), *Share-Based Payment*, (SFAS No. 123(R)). SFAS No. 123(R) requires all share-based payments issued to acquire goods or services, including grants of employee stock options, to be recognized in the statement of operations based on their fair values, net of estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense related to share-based awards is recognized over the requisite service period, which is generally the vesting period.

UST Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table provides a breakdown by line item of the pre-tax share-based compensation expense recognized in the Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2008 and 2007, respectively, as well as the related income tax benefit and amounts capitalized as a component of inventory for each period.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Selling, advertising and administrative expense [1]	$ 3,130	$ 4,751	$ 5,229	$ 6,702
Cost of products sold	176	144	330	288
Restructuring charges [2]		2		11
Total pre-tax share-based compensation expense	$ 3,306	$ 4,897	$ 5,559	$ 7,001
Income tax benefit	$ 1,207	$ 1,954	$ 2,028	$ 2,763
Capitalized as inventory	60	31	86	62

(1) The three and six month periods ending June 30, 2007 include accelerated vesting charges recorded in connection with an executive officer s separation from service.

(2) Represents share-based compensation expense recognized in connection with one-time termination benefits provided to employees affected by Project Momentum, the Company s

previously announced cost-reduction initiative. See Note 13 Restructuring for additional information regarding Project Momentum.

A summary of the status of restricted stock and restricted stock units for the six months ended June 30, 2008 is presented below:

	Restricted Stock		**Restricted Stock Units**	
	Number of Shares	**Weighted average grant-date fair value per share**	**Number of Units**	**Weighted average grant-date fair value per unit**
Nonvested at January 1, 2008	386,640	$ 46.56	222,448	$ 43.87
Granted	131,828	$ 52.07	53,464	$ 52.42
Forfeited	(10,400)	$ 49.52	(5,055)	$ 44.53
Vested	(3,440)	$ 50.91	(2,883)	$ 41.01
Nonvested at June 30, 2008	504,628	$ 47.91	267,974	$ 45.59

In addition to the table above, during the second quarter of 2008, the Company awarded 143,100 restricted shares for which the performance targets had not been established as of June 30, 2008. In accordance with SFAS No. 123(R), a grant date, for purposes of measuring compensation expense, cannot occur until the performance measures are established, as that is when both the Company and the award recipients would have a mutual understanding of the key terms and conditions of the award. The restricted shares granted presented in the table above include 112,325 restricted shares that were originally awarded in 2007 for which the performance targets were established in 2008.

During the three and six months ended June 30, 2008, 0.2 million and 0.3 million options were exercised with a weighted-average exercise price of $32.28 and $32.16, respectively. At June 30, 2008, there were 3.4 million options outstanding, of which 3.1 million options were exercisable, with weighted-average exercise prices of $34.34 and $33.00, respectively.

UST Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5 EMPLOYEE BENEFIT PLANS

In accordance with SFAS No. 132, *Employers Disclosures About Pensions and Other Postretirement Benefits (Revised 2003)*, as amended by SFAS No. 158, *Employers Accounting For Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, the following provides the components of net periodic benefit cost for the three and six months ended June 30, 2008 and 2007, respectively:

	Pension Plans Three Months Ended June 30,		Postretirement Benefits Other than Pensions Three Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Service cost	$ 4,172	$ 4,699	$ 848	$ 1,007
Interest cost	8,957	8,280	1,098	1,095
Expected return on plan assets	(7,323)	(7,082)		
Amortization of unrecognized transition asset		(2)		
Amortization of prior service cost (credit)	22	20	(1,042)	(1,232)
Recognized actuarial loss (gain)	775	1,139	(73)	(98)
Special termination benefits	548		339	
Net periodic benefit cost	$ 7,151	$ 7,054	$ 1,170	$ 772

	Pension Plans Six Months Ended June 30,		Postretirement Benefits Other than Pensions Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Service cost	$ 8,952	$ 9,457	$ 1,928	$ 2,309
Interest cost	17,673	16,543	2,351	2,431
Expected return on plan assets	(14,680)	(14,364)		
Amortization of unrecognized transition asset		(4)		
Amortization of prior service cost (credit)	45	38	(2,084)	(2,461)
Recognized actuarial loss	1,317	1,943	77	176
Curtailment and special termination benefits	548	1,974	339	
Net periodic benefit cost	$ 13,855	$ 15,587	$ 2,611	$ 2,455

During the second quarter of 2008, in connection with restructuring activities, the Company recorded special termination benefit charges of approximately $0.9 million related to its defined benefit pension plans and other postretirement benefit plans. These charges relate to enhanced retirement benefits to be provided to qualified individuals impacted by the restructuring activities and are reported on the restructuring charges line in the Condensed Consolidated Statement of Operations (See Note 13, Restructuring). During the first quarter of 2007, the Company recorded a charge for special termination benefits related to its defined benefit pension plans in connection with an executive officer s separation from service.

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UST Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company expects to contribute approximately $7.3 million to its non-qualified defined benefit pension plans in 2008, of which approximately $3.6 million was contributed during the first half of 2008.

In the fourth quarter of 2007, the Company amended its retiree health and welfare plans to limit the annual increase in costs subsidized by the Company to the annual percentage increase in the consumer price index. This amendment, which was effective beginning January 1, 2008, had a favorable impact on the calculation of the Company s 2008 net periodic benefit cost.

6 INCOME TAXES

The Company s income tax provision takes into consideration pre-tax income, statutory tax rates and the Company s tax profile in the various jurisdictions in which it operates. The tax bases of the Company s assets and liabilities reflect its best estimate of the future tax benefit and costs it expects to realize when such amounts are included in its tax returns. Quantitative and probability analysis, which incorporates management s judgment, is required in determining the Company s effective tax rate and in evaluating its tax positions. The Company recognizes tax benefits in accordance with the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48).

As of June 30, 2008 and December 31, 2007, the total liability for unrecognized tax benefits was $38.6 million and $39.2 million, respectively, representing the gross tax liability for all jurisdictions. Approximately $0.8 million and $0.9 million of this liability, net of federal tax benefit, is included on the income taxes receivable line of the Condensed Consolidated Statement of Financial Position as of June 30, 2008 and December 31, 2007, respectively. The remaining $37.8 million and $38.3 million of this liability, net of federal tax benefit, as of June 30, 2008 and December 31, 2007, respectively, is reported on the income taxes payable line in the non-current liabilities section of the Condensed Consolidated Statement of Financial Position.

The Company recognizes accruals of interest and penalties related to unrecognized tax benefits in income tax expense. The Company recognized approximately $0.7 million and $0.8 million in interest and penalties during the three month periods ended June 30, 2008 and 2007, respectively. For the six months ended June 30, 2008 and 2007, the Company recognized approximately $1.5 million and $1.7 million, respectively, in interest and penalties. As of June 30, 2008 and December 31, 2007, the Company had a liability of approximately $12.2 million and $10.7 million, respectively, for the payment of interest and penalties. As of June 30, 2008, approximately $0.2 million of this liability is included on the income taxes payable line in the current liabilities section of the Condensed Consolidated Statement of Financial Position while, as of December 31, 2007, approximately $0.2 million of this liability is included on the income taxes receivable line of the Condensed Consolidated Statement of Financial Position. The remaining balance for both periods is included on the income taxes payable line in the non-current liabilities section of the Condensed Consolidated Statement of Financial Position.

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UST Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company continually and regularly evaluates, assesses and adjusts its accruals for income taxes in light of changing facts and circumstances, which could cause the effective tax rate to fluctuate from period to period. Of the total $38.6 million of unrecognized tax benefits as of June 30, 2008, approximately $20.3 million would impact the annual effective tax rate if such amounts were recognized. The remaining $18.3 million of unrecognized tax benefits relate to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period. Based on information obtained to date, the Company believes it is reasonably possible that the total amount of unrecognized tax benefits could decrease by $11.5 million within the next 12 months due to negotiated resolution payments, lapses in statutes of limitations and the resolution of various examinations in multiple jurisdictions.

The Internal Revenue Service (IRS) and other tax authorities in various states and foreign jurisdictions audit the Company s income tax returns on a continuous basis. Depending on the tax jurisdiction, a number of years may elapse before a particular matter for which the Company has an unrecognized tax benefit is audited and ultimately resolved. With few exceptions, the Company is no longer subject to federal, state and local or foreign income tax examinations by tax authorities for years before 2004. While it is often difficult to predict the timing of tax audits and their final outcome, the Company believes that its estimates reflect the most likely outcome of known tax contingencies. However, the final resolution of any such tax audit could result in either a reduction in the Company s accruals or an increase in its income tax provision, both of which could have a significant impact on its results of operations in any given period.

The Company s effective tax rate, before minority interest and equity earnings, decreased to 35.8 percent for the first six months of 2008, from 36.1 percent for the first six months of 2007, as a result of $1 million of income tax accrual reversals in the current year primarily due to the expiration of certain statutes of limitations. The Company s effective tax rate, before minority interest and equity earnings, of 36.1% for the second quarter of 2008 was the same as the effective tax rate for the second quarter of 2007.

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UST Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7 SEGMENT INFORMATION

The Company s reportable segments are Smokeless Tobacco and Wine. Those business units that do not meet quantitative reportable thresholds are included in All Other Operations. Included in All Other Operations for both periods are the Company s international operations. Interim segment information is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net Sales to Unaffiliated Customers				
Smokeless Tobacco	$ 393,658	$ 399,018	$ 767,251	$ 766,451
Wine [3]	99,134	79,519	185,300	148,295
All Other	13,379	12,717	26,334	23,526
Net sales	$ 506,171	$ 491,254	$ 978,885	$ 938,272
Operating Profit [1]				
Smokeless Tobacco [2]	$ 226,198	$ 223,758	$ 429,800	$ 294,748
Wine [3]	14,842	11,460	26,706	22,720
All Other	4,107	4,945	8,804	8,941
Operating profit	245,147	240,163	465,310	326,409
Gain on Sale of Corporate Headquarters Building				105,143
Corporate expenses [1]	(7,406)	(12,340)	(14,727)	(25,785)
Interest, net	(18,854)	(8,555)	(36,531)	(18,130)
Earnings before income taxes, minority interest and equity earnings	$ 218,887	$ 219,268	$ 414,052	$ 387,637

(1) Operating profit for each reportable segment and corporate expenses for all periods presented reflect the impact of restructuring charges, as applicable. See Note 13, Restructuring, for additional information.

(2)

Smokeless Tobacco segment operating profit includes antitrust litigation charges of $1.5 million for each of the three and six months ended June 30, 2008 and $122.1 million for the six months ended June 30, 2007. See Note 14, Contingencies and Note 17, Other Matters, for additional information.

(3) Amounts reported in the Wine segment for the three and six months ended June 30, 2008 reflect the acquisition of Stag s Leap Wine Cellars, which was acquired in September 2007.

The Company s identifiable assets by reportable segment as of June 30, 2008 did not change significantly from amounts appearing in the December 31, 2007 Consolidated Segment Information (See the 2007 Form 10-K), with the exception of corporate assets which reflect a decrease in cash and cash equivalents.

8 ASSETS HELD FOR SALE

In March 2008 and January 2007, the Company sold winery properties located in the State of Washington for net proceeds of $1.8 million and $3.1 million, respectively, resulting in pre-tax gains of $1.4 million and $2 million, respectively, which were recorded as a reduction to selling, advertising and administrative (SA&A) expenses in the Condensed Consolidated Statement of Operations. The net proceeds from the March 2008 property sale included cash of approximately $0.4 million and a note receivable of approximately $1.4 million, which has a three-year term.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In March 2007, the Company finalized the sale of its corporate headquarters for cash proceeds of $130 million, as well as a below-market, short-term lease with an imputed fair market value of approximately $6.7 million. This sale resulted in a pre-tax gain of approximately $105 million, which is reported on the gain on sale of corporate headquarters building line in the Condensed Consolidated Statement of Operations.

At June 30, 2008 and December 31, 2007, the Company did not have any assets classified as held for sale.

9 NET EARNINGS PER SHARE

Basic earnings per share is computed by dividing net earnings by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing net earnings by the weighted-average number of shares of common stock outstanding during the period, increased to include the number of shares of common stock that would have been outstanding had all potentially dilutive shares of common stock been issued. The dilutive effect of outstanding options, restricted stock and restricted stock units is reflected in diluted earnings per share by applying the treasury stock method under SFAS No. 128. Under the treasury stock method, an increase in the fair value of the Company s common stock can result in a greater dilutive effect from outstanding options, restricted stock and restricted stock units. Furthermore, the exercise of options and the vesting of restricted stock and restricted stock units can result in a greater dilutive effect on earnings per share than that recognized under the treasury stock method.

The following table presents the computation of basic and diluted net earnings per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Numerator:				
Net earnings	$ 139,660	$ 139,971	$ 264,994	$ 247,484
Denominator:				
Denominator for basic earnings per share weighted-average shares	147,298	159,557	148,188	159,762
Dilutive effect of share-based awards	1,279	1,547	1,293	1,578
Denominator for diluted earnings per share	148,577	161,104	149,481	161,340
Basic earnings per share	$ 0.95	$ 0.88	$ 1.79	$ 1.55
Diluted earnings per share	$ 0.94	$ 0.87	$ 1.77	$ 1.53

Options to purchase ten thousand shares of common stock outstanding as of June 30, 2008 and 2007 were not included in the computation of diluted earnings per share because their exercise prices were greater than the average market price of the Company s common stock and, therefore, were antidilutive.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10 COMPREHENSIVE INCOME

The components of comprehensive income for the Company are net earnings, foreign currency translation adjustments, the change in the fair value of derivatives designated as effective cash flow hedges and changes in deferred components of net periodic pension and other postretirement benefit costs. For the second quarter of 2008 and 2007, total comprehensive income, net of taxes, amounted to $143.4 million and $143.5 million, respectively. For the first six months of 2008 and 2007, total comprehensive income, net of taxes, amounted to $265.1 million and $250.9 million, respectively.

11 PURCHASE COMMITMENTS

As of June 30, 2008, the Company had entered into unconditional purchase obligations in the form of contractual commitments. Unconditional purchase obligations are commitments that are either noncancelable or cancelable only under certain predefined conditions.

Through June 30, 2008, the Company completed $10.6 million in leaf tobacco purchases in fulfillment of certain contracts outstanding at December 31, 2007. As of June 30, 2008, the Company has contractual obligations of approximately $67.7 million for the purchase of leaf tobacco to be used in the production of moist smokeless tobacco products, the majority of which are expected to be fulfilled by the end of 2008.

Purchase commitments under contracts to purchase grapes for the periods beyond one year are subject to variability resulting from potential changes in applicable grape market price indices. The following table presents a summary of the net change in the Company s future payment obligations since January 1, 2008, and the balance of such commitments at June 30, 2008, for the purchases and processing of grapes for use in the production of wine, based upon estimated yields and market conditions:

	2008	2009	2010	2011	2012	Thereafter	Total
Grape commitments January 1, 2008	$ 73,623	$ 73,067	$ 72,713	$ 62,490	$ 36,742	$ 93,356	$ 411,991
Net increase	2,617	3,559	3,674	5,192	4,430	9,680	29,152
Grape commitments June 30, 2008	$ 76,240	$ 76,626	$ 76,387	$ 67,682	$ 41,172	$ 103,036	$ 441,143

12 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company has hedged against the variability of forecasted interest payments attributable to changes in interest rates through the date of an anticipated debt issuance in 2009 via a forward starting interest rate swap. The forward starting interest rate swap has a notional amount of $100 million and the terms call for the Company to receive interest quarterly at a variable rate equal to the London InterBank Offered Rate (LIBOR) and to pay interest semi-annually at a fixed rate of 5.715 percent. The fair value of the forward starting interest rate swap at June 30, 2008 was a net liability of $6.2 million, based upon analysis derived from relevant observable market inputs, and was included in other liabilities on the Condensed Consolidated Statement of Financial Position. Accumulated other comprehensive loss at June 30, 2008 included the accumulated loss on the cash flow hedge (net of taxes) of $4 million, which reflects $2.5 million of other comprehensive income and $40 thousand of other comprehensive loss recognized for the three and six months ended June 30, 2008, respectively, in connection with the change in fair value of the swap.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company has hedged the interest rate risk on its $40 million aggregate principal amount of floating rate senior notes with a ten-year interest rate swap having a notional amount of $40 million and quarterly settlement dates over the term of the contract. The Company pays a fixed rate of 7.25 percent and receives a floating rate of three-month LIBOR plus 90 basis points on the notional amount. The fair value of the swap at June 30, 2008 was a net liability of $1.3 million, based upon analysis derived from relevant observable market inputs, and was included in other liabilities on the Condensed Consolidated Statement of Financial Position. Accumulated other comprehensive loss at June 30, 2008 included the accumulated loss on the cash flow hedge (net of taxes) of $0.8 million, which reflects the $0.9 million and $0.1 million of other comprehensive income recognized for the three and six months ended June 30, 2008, respectively, in connection with the change in fair value of the swap.

During 2008, the Company entered into foreign currency forward and option contracts. Such contracts have been designated as effective cash flow hedges, in order to hedge the risk of variability in cash flows associated with foreign currency payments required in connection with anticipated oak barrel purchases for its wine operations and equipment purchases for its smokeless tobacco operations. The aggregate fair value of the foreign currency forward and options contracts is presented in the table below. The amounts reflected in net earnings and accumulated other comprehensive loss during the three and six months ended June 30, 2008 with respect to these contracts were not material.

On January 1, 2008, the Company adopted the provisions of SFAS No. 157, which establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy, which gives the highest priority to quoted prices in active markets, is comprised of the following three levels:

Level 1 Unadjusted quoted market prices in active markets for identical assets and liabilities.

Level 2 Observable inputs, other than Level 1 inputs. Level 2 inputs would typically include quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly.

Level 3 Prices or valuations that require inputs that are both significant to the measurement and unobservable.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In accordance with the provisions of SFAS No. 157, the following table presents the fair value measurements for the Company s derivative financial instruments at June 30, 2008, grouped by the level within the fair value hierarchy under which the measurement falls:

		Fair value measurements at reporting date using:		
	June 30, 2008	Quoted prices in active markets for identical assets (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)
Liabilities				
Derivatives swaps	$ 7,459	$	$ 7,459	$
Total	$ 7,459	$	$ 7,459	$
Assets				
Derivatives foreign currency hedges	$ 469	$	$ 469	$
Total	$ 469	$	$ 469	$

13 RESTRUCTURING

During the third quarter of 2006, the Company announced and commenced implementation of a cost-reduction initiative called Project Momentum. This initiative was designed to create additional resources for growth via operational productivity and efficiency enhancements. The Company believes that such an effort is prudent as it will provide additional flexibility in the increasingly competitive smokeless tobacco category.

In connection with Project Momentum, restructuring charges of $1.2 million and $1.6 million were recognized for the three and six months ended June 30, 2008, respectively, and $3.9 million and $7.4 million were recognized for the three and six months ended June 30, 2007, respectively. These amounts are reported on the restructuring charges line in the Condensed Consolidated Statement of Operations. The charges were incurred in connection with the formal plans undertaken by management and are accounted for in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The recognition of certain restructuring charges involves the use of judgments and estimates regarding the nature,

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

timing and amount of costs to be incurred under Project Momentum. While the Company believes that its estimates are appropriate and reasonable based upon the information available, actual results could differ from such estimates. The following table provides a summary of restructuring charges incurred for the three and six months ended June 30, 2008, as well as cumulative charges incurred to date and the total amount of charges expected to be incurred, in connection with Project Momentum, for each major type of cost associated with the initiative:

	Restructuring Charges Incurred for the Three Months Ended June 30, 2008	Restructuring Charges Incurred for the Six Months Ended June 30, 2008	Cumulative Charges Incurred as of June 30, 2008	Total Charges Expected to be Incurred [1]	
One-time termination benefits	$ 1,166	$ 1,550	$ 20,359	$ 21,600	$23,200
Contract termination costs			492	400	500
Other restructuring costs	40	68	13,568	13,500	13,800
Total	$ 1,206	$ 1,618	$ 34,419	$ 35,500	$37,500

[1] The total cost of one-time termination benefits expected to be incurred under Project Momentum reflects the initiative s overall anticipated elimination of approximately 10 percent of the Company s salaried, full-time positions across various functions and operations, primarily at the Company s corporate headquarters, as

well as a reduction in the number of hourly positions within the manufacturing operations. The majority of the total restructuring costs expected to be incurred were recognized in 2006 and 2007. The remaining anticipated costs are expected to be recognized in 2008. Total restructuring charges expected to be incurred currently represent the Company s best estimates of the ranges of such charges, although there may be additional charges recognized as additional actions are identified and finalized.

One-time termination benefits relate to severance-related costs and outplacement services for employees terminated in connection with Project Momentum, as well as enhanced retirement benefits for qualified individuals. Contract termination costs primarily relate to the termination of operating leases in conjunction with the consolidation and relocation of facilities. Other restructuring costs are mainly comprised of other costs directly related to the implementation of Project Momentum, primarily professional fees, as well as asset impairment charges and costs incurred in connection with the relocation of the Company s headquarters.

The following table provides a summary of restructuring charges incurred for the three and six months ended June 30, 2008, as well as cumulative charges incurred to date and the total amount of charges expected to be incurred, in connection with Project Momentum, by reportable segment:

	Restructuring Charges	**Restructuring Charges**

	Incurred for the Three Months Ended June 30, 2008	Incurred for the Six Months Ended June 30, 2008	Cumulative Charges Incurred as of June 30, 2008	Total Charges Expected to be Incurred	
Smokeless Tobacco	$ 1,173	$ 1,322	$ 29,094	$ 29,800	$31,500
Wine			322	600	700
All Other Operations		216	1,205	1,200	1,300
Total reportable segments	1,173	1,538	30,621	$ 31,600	$33,500
Corporate (unallocated)	33	80	3,798	3,900	4,000
Total	$ 1,206	$ 1,618	$ 34,419	$ 35,500	$37,500

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Accrued restructuring charges are included in the accounts payable and accrued expenses line on the Condensed Consolidated Statement of Financial Position. A reconciliation of the changes in the liability balance since December 31, 2007 is presented below.

	One-Time Termination Benefits	Contract Termination Costs	Other Costs	Total
Balance as of December 31, 2007	$ 1,643	$ 78	$	$ 1,721
Add: restructuring charges incurred	1,550		68	1,618
Less: payments	(1,639)	(34)	(64)	(1,737)
Less: reclassified liabilities [1]	(887)		(4)	(891)
Balance as of June 30, 2008	$ 667	$ 44	$	$ 711

[1] Represents liabilities associated with restructuring charges that have been recorded within other line items on the Condensed Consolidated Statement of Financial Position at June 30, 2008. The $0.9 million in the One-Time Termination Benefits column relates to enhanced retirement benefits, which is reflected in the accrued liabilities for pensions and other postretirement benefits (see Note 5 Employee

Benefit Plans), while the $4 thousand in the Other Costs column relates to asset impairment charges which were reclassified as reductions to the respective asset categories.

14 CONTINGENCIES

The Company has been named in certain health care cost reimbursement/third-party recoupment/class action litigation against the major domestic cigarette companies and others seeking damages and other relief. The complaints in these cases on their face predominantly relate to the usage of cigarettes; within that context, certain complaints contain a few allegations relating specifically to smokeless tobacco products. These actions are in varying stages of pretrial activities. The Company believes these pending litigation matters will not result in any material liability for a number of reasons, including the fact that the Company has had only limited involvement with cigarettes and the Company s current percentage of total tobacco industry sales is relatively small. Prior to 1986, the Company manufactured some cigarette products which had a de minimis market share. From May 1, 1982 to August 1, 1994, the Company distributed a small volume of imported cigarettes and is indemnified against claims relating to those products.

Smokeless Tobacco Litigation

The Company is named in certain actions in West Virginia brought on behalf of individual plaintiffs against cigarette manufacturers, smokeless tobacco manufacturers, and other organizations seeking damages and other relief in connection with injuries allegedly sustained as a result of tobacco usage, including smokeless tobacco products. Included among the plaintiffs are three individuals alleging use of the Company s smokeless tobacco products and alleging the types of injuries claimed to be associated with the use of smokeless tobacco products. These individuals also allege the use of other tobacco products.

The Company is named in an action in Florida by an individual plaintiff against various smokeless tobacco manufacturers including the Company for personal injuries, including cancer, oral lesions, leukoplakia, gum loss and other injuries allegedly resulting from the use of the Company s smokeless tobacco products. The plaintiff also claims nicotine addiction and seeks unspecified compensatory damages and certain equitable and other relief, including, but not limited to, medical monitoring.

UST Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company has been named in an action in Connecticut brought by a plaintiff individually, as executrix and fiduciary of her deceased husband s estate and on behalf of their minor children for injuries, including squamous cell carcinoma of the tongue, allegedly sustained by decedent as a result of his use of the Company s smokeless tobacco products. The Complaint also alleges addiction to smokeless tobacco. The Complaint seeks compensatory and punitive damages in excess of $15 thousand and other relief.

The Company believes, and has been so advised by counsel handling these cases, that it has a number of meritorious defenses to all such pending litigation. Except as to the Company s willingness to consider alternative solutions for resolving certain litigation issues, all such cases are, and will continue to be, vigorously defended. The Company believes that the ultimate outcome of such pending litigation will not have a material adverse effect on its consolidated financial results or its consolidated financial position, although if plaintiffs were to prevail, the effect of any judgment or settlement could have a material adverse impact on its consolidated financial results in the particular reporting period in which resolved and, depending on the size of any such judgment or settlement, a material adverse effect on its consolidated financial position. Notwithstanding the Company s assessment of the potential financial impact of these cases, the Company is not able to estimate with any certainty the amount of loss, if any, which would be associated with an adverse resolution.

Antitrust Litigation

Following a previous antitrust action brought against the Company by a competitor, Conwood Company L.P, the Company was named as a defendant in certain actions brought by indirect purchasers (consumers and retailers) in a number of jurisdictions. As indirect purchasers of the Company s smokeless tobacco products during various periods of time ranging from January 1990 to the date of certification or potential certification of the proposed class, plaintiffs in those actions allege, individually and on behalf of putative class members in a particular state or individually and on behalf of class members in the applicable states, that the Company has violated the antitrust laws, unfair and deceptive trade practices statutes and/or common law of those states. In connection with these actions, plaintiffs sought to recover compensatory and statutory damages in an amount not to exceed $75 thousand per purported class member or per class member, and certain other relief. The indirect purchaser actions, as filed, were similar in all material respects.

To date, indirect purchaser actions in almost all of the jurisdictions have been resolved, including those subject to court approval. Pursuant to the settlements in all jurisdictions except California, adult consumers received coupons redeemable on future purchases of the Company s moist smokeless tobacco products, and the Company agreed to pay all related administrative costs and plaintiffs attorneys fees.

In September 2007, the Company entered into a Settlement Agreement to resolve the California class action (for additional details regarding the resolution of the California class action, see the Company s Quarterly Report on Form 10-Q for the period ended September 30, 2007; also refer to Note 17, Other Matters, for further information). In March 2008, the court entered an order granting final approval of the California settlement, entering judgment and dismissing the settling defendants with prejudice. The court also granted plaintiffs motion for attorneys fees and costs. A Notice of Appeal from the judgment and order granting final approval of the settlement, and order granting plaintiffs attorneys fees was filed by an individual class member in April 2008.

UST Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In January 2008, the Company entered into a Settlement Agreement to resolve the New Hampshire action. In July 2008, the court entered a final judgment granting final approval of the settlement, including attorneys fees and costs, and dismissing the action with prejudice, however, a Notice of Appeal was filed by an individual class member in August 2008. Also in January 2008, the Company entered into a Settlement Agreement to resolve the Massachusetts class action. In April 2008, the court denied preliminary approval of the Massachusetts settlement but invited the parties to submit an amended settlement agreement to the court for preliminary approval. In connection with the settlements of the New Hampshire action and Massachusetts class action, during the fourth quarter of 2007 the Company recognized a liability reflecting the costs attributable to coupons expected to be distributed to consumers, which will be redeemable on future purchases of the Company s moist smokeless tobacco products, as well as plaintiffs attorneys fees and other administrative costs of the settlements. Although the court denied preliminary approval of the Massachusetts settlement, since the court has invited the parties to submit an amended settlement agreement, the Company believes the liability recognized for the Massachusetts class action currently represents its best estimate of the costs to ultimately resolve this action. Notwithstanding the Company s decision to enter into the settlement, the Company believes the facts and circumstances in the Massachusetts class action would continue to support its defenses.

Notwithstanding the fact that the Company has chosen to resolve various indirect purchaser actions via settlements, the Company believes, and has been so advised by counsel handling these cases, that it has meritorious defenses, and, in the event that any such settlements do not receive final court approval, these actions will continue to be vigorously defended.

In addition, an unresolved action remains in the State of Pennsylvania which is pending in a federal court in Pennsylvania. In this action, the Company had filed an appeal of the trial court s denial of the Company s motion to dismiss the complaint. In August 2008 the Third Circuit Court of Appeals ruled in the Company s favor, issuing an opinion vacating the trial court s denial and remanding the case to the trial court to determine whether plaintiffs should be granted permission to amend their complaint. For the plaintiffs in the foregoing action to prevail, they will now have to be granted permission to amend the complaint and then amend such complaint in a manner that satisfies the standards set forth in the August 2008 Third Circuit opinion. The plaintiffs will also have to obtain class certification and favorable determinations on issues relating to liability, causation and damages. The Company believes, and has been so advised by counsel handling this case, that it has meritorious defenses in this regard, and it is, and will continue to be, vigorously defended.

The Company believes that the ultimate outcome of these actions will not have a material adverse effect on its consolidated financial results or its consolidated financial position, although if plaintiffs were to prevail, beyond the amounts accrued, the effect of any judgment or settlement could have a material adverse impact on its consolidated financial results in the particular reporting period in which resolved and, depending on the size of any such judgment or settlement, a material adverse effect on its consolidated financial position. Notwithstanding the Company s assessment of the financial impact of these actions, management is not able to estimate the amount of loss, if any, beyond the amounts accrued, which could be associated with an adverse resolution.

The liability associated with the Company s estimated costs to resolve all indirect purchaser actions decreased to $24.8 million at June 30, 2008, from $75.4 million at December 31, 2007, primarily as a result of a payment made in connection with the California settlement, actual coupon redemption and payments of administrative costs related to previous settlements, partially offset by a charge recognized in the second quarter of 2008 reflecting a change in the estimated costs associated with the resolution of certain indirect purchaser antitrust actions.

One additional matter remains outstanding in connection with indirect purchaser actions.

UST Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company has been served with a purported class action complaint filed in federal court in West Virginia, attempting to challenge certain aspects of a prior settlement approved by the Tennessee state court and seeking additional amounts purportedly consistent with subsequent settlements of similar actions, estimated by plaintiffs to be between $8.9 million and $214.2 million, as well as punitive damages and attorneys fees. In May 2008, the court granted defendants motion to dismiss, thereby dismissing this action with prejudice. In June 2008, plaintiffs filed a Notice of Appeal. The Company believes, and has been so advised by counsel handling this case, that it has meritorious defenses in this regard, and will continue to vigorously defend against this matter throughout the appellate process. As such, the Company has not recognized a liability for the additional amounts sought in this complaint.

The Company believes that the ultimate outcome of this matter will not have a material adverse effect on its consolidated financial results or its consolidated financial position, although if plaintiffs were to prevail, the effect of an adverse resolution could have a material adverse impact on its consolidated financial results in the particular reporting period in which resolved and, depending on the size of any such resolution, a material adverse effect on its consolidated financial position. Notwithstanding the Company s assessment of the financial impact of this action, management is not able to estimate the amount of loss, if any, which could be associated with an adverse resolution.

15 BORROWING ARRANGEMENTS

Senior Notes

On February 29, 2008, the Company completed the issuance and sale of $300 million aggregate principal amount of 5.75 percent senior notes in a public offering at a price to the underwriters of 98.982 percent of the principal amount. These senior notes mature on March 1, 2018, with interest payable semiannually. Costs of $2.6 million associated with the issuance of the senior notes were capitalized and are being amortized over the term of the senior notes. Approximately $0.1 million of these costs were recognized during each of the three and six months ended June 30, 2008. Upon the completion of the issuance of the senior notes, the Company repaid $100 million of borrowings outstanding under the Company s $200 million six-month credit agreement (the Credit Agreement) and $200 million of borrowings outstanding under the Company s five-year revolving credit facility. In accordance with its terms, the Credit Agreement was terminated upon the issuance of the senior notes and the repayment of outstanding borrowings.

The Company s $240 million aggregate principal amount senior notes, of which $200 million is 7.25 percent fixed rate debt and $40 million is floating rate debt, mature on June 1, 2009. As such, these notes were reclassified to current portion of long-term debt on the June 30, 2008 Condensed Consolidated Statement of Financial Position.

Revolving Credit Facility

The Company has a $300 million, five-year revolving credit facility (the Credit Facility) which will expire on June 29, 2012. Borrowings under the Credit Facility are primarily used for general corporate purposes, including the support of commercial paper borrowings. At June 30, 2008, the Company had borrowings of $140 million outstanding under the Credit Facility.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16 GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

The following table presents the changes in the carrying amount of goodwill for the six months ended June 30, 2008:

	Total
Goodwill as of December 31, 2007	$ 28,304
Translation adjustments	(93)
Goodwill as of June 30, 2008	$ 28,211

Approximately $25.2 million of the goodwill balance at June 30, 2008 and December 31, 2007 related to the Company s Wine segment, with the remainder related to the Company s international operations.

Nonamortizable Intangible Assets Other than Goodwill

At both June 30, 2008 and December 31, 2007, the Company had $41.9 million of identifiable intangible assets that were not being amortized, as such assets were deemed to have indefinite useful lives. These nonamortizable intangible assets relate to Wine segment acquired trademarks. There were no impairment charges recorded relating to these assets during the six months ended June 30, 2008 or 2007.

Amortizable Intangible Assets

The value of the Company s amortizable intangible assets at June 30, 2008 and December 31, 2007 were approximately $13.8 million and $14.3 million (net of accumulated amortization of $1.9 million and $1.4 million), respectively. These assets consist primarily of acquired customer relationships, customer lists and intellectual property, which are being amortized on a straight-line basis over a weighted-average period of approximately 18 years.

For the second quarter of 2008 and 2007, amortization expense related to intangible assets was approximately $0.3 million and $0.1 million, respectively. For the first six months of 2008 and 2007, amortization expense related to intangible assets was approximately $0.6 million and $0.1 million, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

17 OTHER MATTERS

Minority Put Arrangement

In September 2007 the Company completed the acquisition of Stag s Leap Wine Cellars through one of the Company s consolidated subsidiaries, Michelle-Antinori, LLC (Michelle-Antinori), in which the Company holds an 85 percent ownership interest, with a 15 percent non-controlling interest held by Antinori California (Antinori). In connection with the acquisition of Stag s Leap Wine Cellars and the related formation of Michelle-Antinori, the Company provided a put right to Antinori (minority put arrangement). The minority put arrangement provides Antinori with the right to require the Company to purchase its 15 percent ownership interest in Michelle-Antinori at a price based on a fixed multiple of Stag s Leap Wine Cellars earnings before income taxes, depreciation, amortization and other non-cash items. The minority put arrangement becomes exercisable beginning on the third anniversary of the Stag s Leap Wine Cellars acquisition (September 11, 2010). The Company accounts for the minority put arrangement as mandatorily redeemable securities under Accounting Series Release No. 268, *Redeemable Preferred Stocks*, and Emerging Issues Task Force Abstract Topic No. D-98, *Classification and Measurement of Redeemable Securities*, as redemption is outside of the control of the Company. Under this accounting model, to the extent the value of the minority put arrangement is greater than the minority interest reflected on the balance sheet (traditional minority interest), the Company recognizes the difference as an increase to the value of minority interest, with an offset to retained earnings and a similar reduction to the numerator in the earnings per share available to common shareholders calculation. The Company also reflects any decreases to the amount in a similar manner, with the floor in all cases being the traditionally calculated minority interest balance as of that date. The Company values the put arrangement by estimating its redemption value as if the redemption date were the end of the current reporting period, using the most recent 12-month trailing earnings before income taxes, depreciation, amortization and other non-cash items. As of June 30, 2008, the value of the minority put arrangement did not exceed the traditional minority interest balance. Therefore, no adjustment was recognized in the Condensed Consolidated Statement of Financial Position or in the calculation of earnings per share.

Antitrust Litigation

In the first quarter of 2007 the Company recorded a $122.1 million pre-tax charge, representing the estimated costs to be incurred in connection with the resolution of the Wisconsin and California indirect purchaser class actions. Approximately $28.5 million of this charge related to settlement of the Wisconsin action resulting from court-ordered mediation in April 2007. The charge reflected costs attributable to coupons that will be distributed to consumers, which will be redeemable on future purchases of the Company s moist smokeless tobacco products. Also reflected in the Wisconsin charge are plaintiffs attorneys fees and other administrative costs of the settlement. The terms of the Wisconsin settlement were approved by the court in December 2007. The remaining $93.6 million of the first quarter 2007 charge related to settlement of the California action in May 2007, as a result of court-ordered mediation. This charge brought the total recognized liability for the California action to $96 million, which reflected the cost of cash payments to be made to the benefit of class members, as well as plaintiffs attorneys fees and other administrative costs of the settlement. Refer to Note 14, Contingencies, for additional information.

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Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the Company s consolidated results of operations and financial condition should be read in conjunction with the condensed consolidated financial statements and notes to the condensed consolidated financial statements within this Quarterly Report on Form 10-Q, as well as the consolidated financial statements and notes thereto included in the 2007 Form 10-K. Herein, the Company makes forward-looking statements that involve risks, uncertainties and assumptions. Actual results may differ materially from those anticipated in those forward-looking statements as a result of various factors, including, but not limited to, those presented under Cautionary Statement Regarding Forward-Looking Information within Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A). In addition, the Company has presented certain risk factors relevant to the Company s business included in Item 1A in Part I of the 2007 Form 10-K.

INTRODUCTION

MD&A is provided as a supplement to the accompanying consolidated financial statements and notes thereto, to assist individuals in their review of such statements. MD&A has been organized as follows:

OVERVIEW This section provides context for the remainder of MD&A, including a general description of the Company s overall business, its business segments and a high-level summary of Company-specific and industry-wide factors impacting its operations.

RESULTS OF OPERATIONS This section provides an analysis of the Company s results of operations for the three and six months ended June 30, 2008 and 2007. This section is organized using a layered approach, beginning with a discussion of consolidated results at a summary level, followed by more detailed discussions of business segment results and unallocated corporate items, including interest and income taxes.

OUTLOOK This section provides information regarding the Company s current expectations, mainly with regard to the remainder of the current fiscal year, and is organized to provide information by business segment and on a consolidated basis.

LIQUIDITY AND CAPITAL RESOURCES This section provides an analysis of the Company s financial condition, including cash flows for the six months ended June 30, 2008 and 2007 and any material updates to the Company s aggregate contractual obligations as of June 30, 2008.

OFF-BALANCE SHEET ARRANGEMENTS This section provides information regarding any off-balance sheet arrangements that are, or could be, material to the Company s results of operations or financial condition.

NEW ACCOUNTING STANDARDS This section provides information regarding any newly issued accounting standards which have not yet been adopted by the Company.

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OVERVIEW

BUSINESS

UST Inc. is a holding company for its wholly-owned subsidiaries: U.S. Smokeless Tobacco Company and International Wine & Spirits Ltd. Through its largest subsidiary, U.S. Smokeless Tobacco Company, the Company is the leading manufacturer and marketer of moist smokeless tobacco products, including the iconic premium brands *Copenhagen* and *Skoal*, and the value brands *Red Seal* and *Husky*. Through International Wine & Spirits Ltd., the Company produces and markets premium wines sold nationally, via its Ste. Michelle Wine Estates subsidiary, under 20 different labels including *Chateau Ste. Michelle*, *Columbia Crest, Conn Creek*, *Red Diamond*, *Erath* and *Stag s Leap Wine Cellars*. The Company also produces and markets sparkling wine under the *Domaine Ste. Michelle* label. In addition, the Company is the exclusive United States importer and distributor of the portfolio of wines produced by the Italian winemaker Marchesi Antinori, Srl (Antinori).

The Company conducts its business principally in the United States. The Company s operations are divided primarily into two reportable segments: Smokeless Tobacco and Wine. The Company s international smokeless tobacco operations, which are less significant, are reported as All Other Operations.

SMOKELESS TOBACCO SEGMENT

The Company s vision in the Smokeless Tobacco segment is for its smoke-free products to be recognized by adults as the preferred way to experience tobacco satisfaction. The Company s primary objective in the Smokeless Tobacco segment is to continue to grow the moist smokeless tobacco category by building awareness and social acceptability of smokeless tobacco products among adults, primarily smokers, with a secondary objective of competing effectively in every segment of the moist smokeless tobacco category.

Category Growth

Category growth is the Company s top focus, as moist smokeless tobacco is a low incidence category and offers a viable option to adult smokers who are increasingly facing restrictions and are seeking a discreet and convenient alternative. For perspective, the number of adults who smoke is significantly larger than the number of adults who use smokeless tobacco products. As a result, every one percent of adult smokers who converts to moist smokeless tobacco products represent a 7 percent to 8 percent increase in the moist smokeless tobacco category s adult consumer base. The Company views conversion as essential because consumer research indicates that the majority of new adult consumers who enter the category do so in the premium segment, of which the Company has approximately a 91 percent share.

In addition to advertising initiatives focused on category growth, the Company has utilized its direct mail and one-on-one marketing programs to promote the discreetness and convenience of smokeless tobacco relative to cigarettes. These programs, which the Company believes have been successful over the past several years, reaching over 6 million adult smokers, continue in 2008. The success of the category growth initiatives is also impacted by product innovation, as evidenced by the contribution that new products have made to the Smokeless Tobacco segment s results over the past several years. The success of the category growth initiatives is further evidenced by the fact that over the past several years, a majority of the new adult consumers who have recently entered the moist smokeless tobacco category first smoked cigarettes and that category growth has accelerated since the initiatives inception. Based on these results, the Company originally estimated category growth of 5 to 6 percent in 2008; however, given the rate of growth experienced for the first six months of 2008, the Company now expects category growth between 6 and 7 percent.

Competing Effectively

The Company is committed to competing effectively in every segment of the moist smokeless tobacco category by accelerating profitable volume growth, with the goal of growing as fast as the category. The Company is making progress towards this goal through its premium brand loyalty and brand-building initiatives, and also through price-focused efforts related to price-value products. During the first six months of 2008, net can volume for the Company s moist smokeless tobacco products grew by 2.1 percent in a category that grew approximately 7.6 percent.

Premium Brand Loyalty While category growth remains the Company s top priority, it has also significantly enhanced its efforts on adult consumer loyalty for its premium moist smokeless tobacco products. The premium brand loyalty plan is designed to minimize migration from premium to price-value products by delivering value to adult consumers through product quality and brand-building efforts, along with promotional spending and other initiatives. As a result of this effort, premium net can volume had grown on a year-over-year basis for seven of the last eight quarters; however, it declined slightly, by 0.3 percent, during the second quarter of 2008. The Company attributes this second quarter decline in premium net can volume to challenges in the overall economy, rapidly rising gasoline prices and increased competitive activity. Despite the second quarter challenges, premium net can volume increased 0.9 percent in the first half of 2008, as compared to the first half of 2007. To build upon its year-to-date success and ensure premium net can volume growth for the year in the face of a difficult economy and increased competitive activity, the Company plans to further increase its brand-building efforts and price-based loyalty initiatives during the second half of 2008.

Price-Value Initiatives The Company s commitment to accelerate profitable volume growth reflects a balanced portfolio approach, which also includes a full complement of marketing support for its price-value products. For example, the Company has implemented plans to expand the distribution and enhance the presence of its *Husky* brand at retail, and to be competitively priced with other deep discount brands. Likewise, additional promotional and brand building support was provided on its mid-priced *Red Seal* brand. The Company s successful execution of a balanced portfolio approach continued in the first half of 2008, as 8.6 percent growth in price-value net can volume occurred at the same time as 0.9 percent growth in premium net can volume. Of note, the Company repriced and repositioned its small regional brand, *Rooster,* to compete as a price-value brand during the second quarter of 2008.

WINE SEGMENT

The Company s vision in the Wine segment is for Ste. Michelle Wine Estates to be recognized as the premier fine wine company in the world. This is a vision based on continuous improvement in quality and greater recognition through third-party acclaim and superior products. In connection with that vision, the Company aims to elevate awareness of the quality of Washington state wines and increase its prestige to that of the top regions of the world through superior products, innovation and customer focus. In order to achieve these goals, attention is directed towards traditional style wines in the super premium to luxury-priced categories. The Company has made progress towards its vision, as demonstrated by its recent accomplishments, with premium case volume growth of 17.9 percent in the first six months of 2008, as compared to the corresponding period of 2007. According to ACNielsen, Ste. Michelle Wine Estates continued to be the fastest growing of the ten largest wineries in the United States during the first half of 2008. The Company continued to be the category leader for Riesling, based on ACNielsen data, with approximately 34 percent of the domestic Riesling market in the first half of 2008, reflecting a 0.9 percentage point increase over the Company s reported 2007 share in the comparable prior year period. During the first six months of 2008, the Company s *Chateau Ste. Michelle* brand was the fastest growing top ten premium brand, according to ACNielsen. In addition, as reported by ACNielsen, volume growth for Washington state wines, where the Company maintained its strong leadership position, outpaced most other major regions thus far during 2008, with a growth rate of approximately 11 percent.

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Strategic alliances and acquisitions in the Wine segment outside of Washington state have also been important in enabling the Company to achieve its long-term vision. The alliance with Antinori, to become its exclusive United States importer and distributor, and the purchase of the *Erath* label and winery, both of which occurred in 2006, have broadened the Company s position with respect to two key wine regions, Tuscany and Oregon. The addition of *Antinori* wines positions the Company as a leader in United States distribution of Tuscan wines, while the addition of Erath establishes the Company as one of the largest producers of Oregon Pinot Noir. The Company also completed the acquisition of Stag s Leap Wine Cellars and its signature Napa Valley, CA vineyards in September 2007, with a 15 percent minority interest held by Antinori California. This acquisition provides additional prestige to the Wine segment s acclaimed portfolio, further strengthens the Company s relationship with Antinori, and is expected to contribute favorably to the segment s continued operating profit growth.

Another key element of the Wine segment s strategy is expanded domestic distribution of its wines, especially in certain account categories such as restaurants, wholesale clubs, supermarkets, wine shops and mass merchandisers. To that end, the Company remains focused on the continued expansion of its sales force and category management staff.

RESULTS OF OPERATIONS

(In thousands, except per share amounts or where otherwise noted)

CONSOLIDATED RESULTS

Second Quarter of 2008 compared with the Second Quarter of 2007

	Three Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net sales	**$ 506,171**	$ 491,254	$ 14,917	3.0
Net earnings	**139,660**	139,971	(311)	(0.2)
Basic earnings per share	**0.95**	0.88	0.07	8.0
Diluted earnings per share	**0.94**	0.87	0.07	8.0
Restructuring charges	**1,206**	3,908	(2,702)	(69.1)
Antitrust litigation	**1,525**		1,525	

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Net Earnings

Consolidated net earnings was essentially flat in the second quarter of 2008, as compared to the second quarter of 2007, as increased operating income was offset by higher net interest expense. The Company reported operating income of $237.7 million in the second quarter of 2008, representing 47 percent of consolidated net sales, compared to operating income of $227.8 million, or 46.4 percent of consolidated net sales, in the second quarter of 2007. The increase in operating income was primarily due to the following:

Increased net sales and gross margin in the wine segment;

Lower selling, advertising and administrative (SA&A) expenses in the Smokeless Tobacco segment, which can be attributed to Project Momentum;

Lower unallocated corporate expenses, primarily due to the absence of costs related to changes in executive management and the amortization of imputed rent related to a below-market short-term lease the Company executed in connection with the sale of its former corporate headquarters building. The impact of such charges adversely impacted the operating margin percentage by 1 percentage point in the second quarter of 2007; and

Lower restructuring charges incurred in connection with the Project Momentum initiative (see *Restructuring Charges* section below). The impact of restructuring charges adversely impacted the operating margin percentage by approximately 0.2 percentage points and 0.8 percentage points in the second quarter of 2008 and 2007, respectively.

These factors were partially offset by:

Lower net sales and gross margin in the Smokeless Tobacco segment;

Higher SA&A expenses in the Wine segment, including the impact of the addition of Stag s Leap Wine Cellars, which was acquired in September 2007; and

The impact of $1.5 million in antitrust litigation charges recognized in the second quarter of 2008, related to the previous settlement of an indirect purchaser antitrust action, due to a change in the estimated costs associated with the resolution of such action, which adversely impacted the operating margin percentage by approximately 0.3 percentage points.

Basic and diluted earnings per share were $0.95 and $0.94, respectively, for the second quarter of 2008, representing increases of 8 percent from each of the corresponding comparative measures in 2007. Average basic shares outstanding in the second quarter of 2008 were 7.7 percent lower than in the comparable prior year period, primarily as a result of the 12.6 million shares repurchased during the 12-month period ended June 30, 2008, the majority of which were repurchased in the latter half of 2007, partially offset by the exercise of stock options. Average diluted shares outstanding in the second quarter of 2008 were lower than those in the second quarter of 2007 mainly due to the impact of share repurchases and a lower level of dilutive options outstanding.

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Net Sales

	Three Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net Sales by Segment:				
Smokeless Tobacco	**$ 393,658**	$ 399,018	$ (5,360)	(1.3)
Wine	**99,134**	79,519	19,615	24.7
All Other Operations	**13,379**	12,717	662	5.2
Consolidated Net Sales	**$ 506,171**	$ 491,254	$ 14,917	3.0

The increase in consolidated net sales for the second quarter of 2008, as compared to the second quarter of 2007, was primarily due to the following:

Improved case volume for existing premium wine brands, as well as the incremental impact from the addition of the *Stag s Leap Wine Cellars* portfolio of wines, which was acquired in September 2007;

Improved overall net can volume for moist smokeless tobacco products; and

Improved international results.

These factors were partially offset by:

Lower net revenue realization per can in the Smokeless Tobacco segment.

Segment Net Sales as a Percentage of Consolidated Net Sales

* Smokeless Tobacco

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Gross Margin

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Increase/(Decrease) Amount	Increase/(Decrease) %
Gross Margin by Segment:				
Smokeless Tobacco	**$ 322,790**	$ 329,487	$ (6,697)	(2.0)
Wine	**35,161**	26,850	8,311	31.0
All Other Operations	**7,921**	8,068	(147)	(1.8)
Consolidated Gross Margin	**$ 365,872**	$ 364,405	$ 1,467	0.4

The consolidated gross margin increase in the second quarter of 2008, as compared to the second quarter of 2007, was primarily due to higher net sales in the Wine segment, partially offset by higher cost of products sold in all segments and lower net sales in the Smokeless Tobacco segment.

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Increase/ (Decrease)
Gross Margin as a % of Net Sales by Segment:			
Smokeless Tobacco	**82.0%**	82.6%	(0.6)
Wine	**35.5%**	33.8%	1.7
All Other Operations	**59.2%**	63.4%	(4.2)
Consolidated	**72.3%**	74.2%	(1.9)

The decline in the consolidated gross margin, as a percentage of net sales, was mainly due to a change in segment mix, as case volume for wine, which sells at comparatively lower margins, grew faster than the net can volume for moist smokeless tobacco products. Also contributing to this decline was the lower net revenue realization per can in the Smokeless Tobacco segment. Gross margin percentages for each segment are discussed further below.

Restructuring Charges

The Company recognized $1.2 million and $3.9 million in restructuring charges in the second quarter of 2008 and 2007, respectively, related to actions undertaken in connection with Project Momentum. Under this initiative, the Company has targeted at least $150 million in annual savings to be realized within the three years following its initial implementation in September 2006. Refer to the *Restructuring Charges* section within the *First Six Months of 2008 compared with the First Six Months of 2007* discussion below for additional information.

First Six Months of 2008 compared with the First Six Months of 2007

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Increase/(Decrease) Amount	Increase/(Decrease) %
Net sales	**$ 978,885**	$ 938,272	$ 40,613	4.3
Net earnings	**264,994**	247,484	17,510	7.1
Basic earnings per share	**1.79**	1.55	0.24	15.5
Diluted earnings per share	**1.77**	1.53	0.24	15.7
Gain on sale of corp. HQ bldg.		105,143	(105,143)	
Restructuring charges	**1,618**	7,428	(5,810)	(78.2)
Antitrust litigation	**1,525**	122,100	(120,575)	(98.8)

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Net Earnings

Consolidated net earnings increased in the first six months of 2008, as compared to the first six months of 2007, as a result of increased operating income and the impact of a lower effective tax rate, partially offset by higher net interest expense. The Company reported operating income of $450.6 million in the first six months of 2008, representing 46 percent of consolidated net sales, compared to operating income of $405.8 million, or 43.2 percent of consolidated net sales, in the first six months of 2007. The increase in operating income was primarily due to the following:

Lower antitrust litigation charges, as the 2008 period included $1.5 million and the prior year period included $122.1 million. The charges in 2007 represented the estimated costs associated with the resolution of indirect purchaser antitrust class actions in the States of Wisconsin and California. Antitrust litigation charges adversely impacted the operating margin percentage by 0.2 percentage points and 13 percentage points in the first six months of 2008 and 2007, respectively;

Increased net sales and gross margin in the wine segment;

Lower SA&A expenses in the Smokeless Tobacco segment, which can be attributed to Project Momentum;

Lower unallocated corporate expenses, primarily due to lower costs related to changes in executive management and the absence of amortization of imputed rent related to a below-market short-term lease the Company executed in connection with the sale of its former corporate headquarters building. The impact of such charges adversely impacted the operating margin percentage by 0.1 and 0.9 percentage points in the first six months of 2008 and 2007, respectively; and

Lower restructuring charges incurred in connection with the Project Momentum initiative (see *Restructuring Charges* section below). The impact of restructuring charges adversely impacted the operating margin percentage by approximately 0.2 percentage points and 0.8 percentage points in the first six months of 2008 and 2007, respectively.

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These factors were partially offset by:

The absence of a $105 million pre-tax gain recognized in the prior year in connection with the sale of the Company s former corporate headquarters building, which favorably impacted the prior year operating margin by 11.2 percentage points;

Higher SA&A expenses in the Wine segment, including the impact of the addition of Stag s Leap Wine Cellars, which was acquired in September 2007; and

Lower gross margin in the Smokeless Tobacco segment.

Basic and diluted earnings per share were $1.79 and $1.77, respectively, for the first six months of 2008, representing increases of 15.5 percent and 15.7 percent, respectively, from each of the corresponding comparative measures in 2007. Average basic shares outstanding in the first six months of 2008 were 7.2 percent lower than in the comparable prior year period, primarily as a result of the 12.6 million shares repurchased during the 12-month period ended June 30, 2008, partially offset by the exercise of stock options. Average diluted shares outstanding in the first six months of 2008 were lower than those in the first six months of 2007 mainly due to the impact of share repurchases and a lower level of dilutive options outstanding.

Net Sales

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net Sales by Segment:				
Smokeless Tobacco	**$ 767,251**	$ 766,451	$ 800	0.1
Wine	**185,300**	148,295	37,005	25.0
All Other Operations	**26,334**	23,526	2,808	11.9
Consolidated Net Sales	**$ 978,885**	$ 938,272	$ 40,613	4.3

The increase in consolidated net sales for the first six months of 2008, as compared to the first six months of 2007, was primarily due to the following:

Improved case volume for premium wine, including the incremental impact from the addition of the *Stag s Leap Wine Cellars* portfolio of wines, which was acquired in September 2007;

Improved international results; and

Improved net can volume for moist smokeless tobacco products, with increases for both premium and price-value products.

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These factors were partially offset by:

Lower net revenue realization per unit in the Smokeless Tobacco segment.

Segment Net Sales as a Percentage of Consolidated Net Sales

* Smokeless Tobacco

Gross Margin

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	2007	Amount	%
Gross Margin by Segment:				
Smokeless Tobacco	**$ 625,936**	$ 629,939	$ (4,003)	(0.6)
Wine	**65,199**	50,949	14,250	28.0
All Other Operations	**16,095**	14,882	1,213	8.2
Consolidated Gross Margin	**$ 707,230**	$ 695,770	$ 11,460	1.6

The consolidated gross margin increase in the first half of 2008, as compared to the first half of 2007, was primarily due to higher net sales in the Wine segment, partially offset by higher cost of products sold in all segments.

	Six Months Ended June 30,		
	2008	2007	Increase/(Decrease)
Gross Margin as a % of Net Sales by Segment:			
Smokeless Tobacco	**81.6%**	82.2%	(0.6)
Wine	**35.2%**	34.4%	0.8
All Other Operations	**61.1%**	63.3%	(2.2)
Consolidated	**72.2%**	74.2%	(2.0)

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The decline in the consolidated gross margin, as a percentage of net sales, was mainly due to a change in segment mix, as case volume for wine, which sells at comparatively lower margins, grew faster than the net can volume for moist smokeless tobacco products. In addition, lower net revenue realization per can and higher costs per case in the Wine segment, contributed to the overall decline in gross margin, as a percentage of net sales. Gross margin percentages for each segment are discussed further below.

Restructuring Charges

The Company recognized $1.6 million and $7.4 million in restructuring charges in the first six months of 2008 and 2007, respectively, related to actions undertaken in connection with Project Momentum. The following table provides a summary of restructuring charges incurred during the second quarter and first six months of 2008, the cumulative charges incurred to date and the total amount of charges expected to be incurred in connection with this initiative for each major cost, by category:

	Restructuring Charges Incurred for the Three Months Ended June 30, 2008	Restructuring Charges Incurred for the Six Months Ended June 30, 2008	Cumulative Charges Incurred as of June 30, 2008	Total Charges Expected to be Incurred [1]	
One-time termination benefits	$ 1,166	$ 1,550	$ 20,359	$ 21,600	$23,200
Contract termination costs			492	400	500
Other restructuring costs	40	68	13,568	13,500	13,800
Total	$ 1,206	$ 1,618	$ 34,419	$ 35,500	$37,500

(1) The total cost of one-time termination benefits expected to be incurred under Project Momentum reflects the initiative s overall anticipated elimination of approximately 10 percent of the Company s salaried, full-time positions across various functions and operations,

primarily at the Company s corporate headquarters, as well as a reduction in the number of hourly positions within the manufacturing operations. The majority of the total one-time termination benefit costs expected to be incurred were recognized in 2006 and 2007, with the remainder expected to be recognized in 2008. The majority of total contract termination costs expected to be incurred were recognized in 2006, with the remainder recognized in 2007. Substantially all of the total other restructuring charges currently expected to be incurred were recognized through the end of 2007, with approximately half of such amounts recognized in each of 2006 and 2007. The remainder of the

total other restructuring charges to be incurred are expected to be recognized in 2008. While the Company believes that its estimates of total restructuring charges expected to be incurred related to the aforementioned $150 million in savings are appropriate and reasonable based upon the information available, actual results could differ from such estimates. Total restructuring charges expected to be incurred currently represent the Company s best estimates of the ranges of such charges; although there may be additional charges recognized as additional actions are identified and finalized. As any additional actions are approved and finalized and costs or charges

are determined, the Company will file a Current Report on Form 8-K under Item 2.05 or report such costs or charges in its periodic reports, as appropriate.

One-time termination benefits relate to severance-related costs and outplacement services for employees terminated in connection with Project Momentum, as well as enhanced retirement benefits for qualified individuals. Contract termination costs primarily relate to charges for the termination of operating leases incurred in conjunction with the consolidation and relocation of facilities. Other restructuring costs are mainly comprised of other costs directly related to the implementation of Project Momentum, primarily professional fees, as well as asset impairment charges and applicable costs incurred in connection with the relocation of the Company s headquarters. Primarily all of the restructuring charges expected to be incurred will result in cash expenditures, although approximately $5 million of such charges relate to pension enhancements offered to applicable employees, all of which will be paid directly from the respective pension plan s assets. As of June 30, 2008, the liability balance associated with restructuring charges amounted to $0.7 million. Refer to Item 1, Financial Statements Notes to Condensed Consolidated Financial Statements Note 13, Restructuring, for further information regarding accrued restructuring charges.

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SMOKELESS TOBACCO SEGMENT
Second Quarter of 2008 compared with the Second Quarter of 2007

	Three Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net sales	**$ 393,658**	$ 399,018	$ (5,360)	(1.3)
Restructuring charges	**1,173**	3,253	(2,080)	(63.9)
Antitrust litigation	**1,525**		1,525	
Operating profit	**226,198**	223,758	2,440	1.1

Net Sales

While there was a 1.3 percent increase in overall net can volume for moist smokeless tobacco products, Smokeless Tobacco segment net sales decreased in the second quarter of 2008, as compared to the second quarter of 2007, as a result of lower net revenue realization per can, which was attributable to the following:

An unfavorable shift in overall product mix, with net can volume for price-value products increasing 9.7 percent and premium products declining 0.3 percent;

An unfavorable shift in premium product mix, with net can volume for value pack and promotional products, the nature of which are described below in further detail, comprising a larger percentage of premium net can volume; and

Increased sales incentives, primarily retail buydowns, which included those related to the Company s price-value brands.

Percentage of Smokeless Tobacco Segment Net Sales by Product Category

* Moist smokeless tobacco products

** Includes dry snuff products and tobacco seeds

Net sales results for both premium and price-value products include net can sales for standard products, which consist of straight stock and value pack products, as well as pre-pack promotional products. Straight stock refers to single cans sold at wholesale list prices. Value packs, which were introduced to more effectively compete for and retain value-conscious adult consumers, are two-can packages sold year-round reflecting lower per-can wholesale list prices than wholesale list prices for straight stock single-can products. Pre-pack promotions refer to those products that are bundled and packaged in connection with a specific promotional pricing initiative for a limited period of time.

*MSTP Net Can Volume**

	Three Months Ended June 30, 2008	2007	Increase/(Decrease) Amount	%
Net Can Volume (in thousands):				
Premium	**143,216**	143,635	(419)	(0.3)
Price Value	**28,777**	26,222	2,555	9.7
Total	**171,993**	169,857	2,136	1.3

* In April 2008, the Company repositioned its regional moist smokeless tobacco brand, *Rooster*, as a price-value product. In order to ensure comparability and to conform to the current positioning, amounts related to *Rooster* for all periods presented have been reclassified from premium to price-value.

Percentage of Total Moist Smokeless Tobacco Products Net Can Volume by Category Segment

Overall net can volume for moist smokeless tobacco products increased 1.3 percent in the second quarter of 2008, as compared to the similar 2007 period, reflecting the tenth consecutive quarter of overall year-over-year net can volume growth. The increase in overall net can volume in the second quarter of 2008 was driven by net can volume growth of 9.7 percent for price-value products, which more than offset a slight decline of 0.3 percent in net can volume for premium products.

The Company believes its overall net can volume growth was favorably affected by the following factors:

- Continued spending on category growth initiatives;
- Continued execution of the Company s premium brand loyalty plan, which, to a varying extent, has narrowed the price gaps between premium and price-value products on a state-by-state basis; and
- Increased efforts on expanding distribution and focused promotional spending on price-value brands.

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The impact of these factors was partially offset by:

A more challenging external environment, including a weak economy, record-high gasoline prices and increased competitive activity.

Net can volume for premium products includes the *Copenhagen* and *Skoal* brands. In combination, net can volume for these brands was down 0.3 percent in the second quarter of 2008, versus the corresponding 2007 period, and was also below the Company s previous growth expectation of 1 to 2 percent. The Company believes the slight volume declines for both brands, as well as their shortfall to expectations, can be attributed to a number of items, including the more difficult economy and increased competitive activity, such as higher promotional support and new product launches for value or deep discount products. The majority of the adverse impact to the Company s premium net can volume results occurred late in the second quarter, tracing to one geographic region of the country that is characterized by lower per capita income and a higher price-value development. Excluding this geographic region, net can volume for premium products increased 1.2 percent in the second quarter of 2008, as compared to the similar 2007 period.

The Company remains committed to the development of new products and packaging that cover both core product launches and other possible innovations. In connection with that objective, during the first quarter of 2008, the Company launched *Skoal Edge Wintergreen Long Cut*, which contributed to second quarter 2008 premium net can volume results. *Skoal Edge Wintergreen Long Cut* is a newer, bolder wintergreen premium product, which the Company believes is unique in terms of flavor and texture, providing a softer, more comfortable mouth feel.

Despite the challenges in the second quarter of 2008, the Company s premium pouch products have demonstrated continued growth. Such products are a key component to the Company s objective to grow the moist smokeless tobacco category by building awareness and improving the social acceptability of smokeless tobacco products among adult consumers, primarily smokers. Specifically, they are designed to differentiate the Company s premium brands from competitive products, and to provide more approachable forms and flavors for adult smokers, who continue to switch to smokeless tobacco products. Net can volume for these pouch products, which include *Copenhagen Pouches* and *Skoal Pouches*, posted double-digit growth in the second quarter of 2008, as compared to second quarter of 2007. Net can volume for pouch products represented 8.2 percent of the Company s premium net can volume for the second quarter of 2008.

In addition, with regards to innovation, while the Company will be discontinuing the limited marketing of its *Skoal Dry* spit-free pouch product in its two lead markets, it plans to launch *Skoal Snus* in a limited lead market. In keeping with the objective to improve smokeless tobacco s social acceptability, this product is also aimed at converting adult smokers, and is designed to be spit-free. Over the course of the past two years, *Skoal Dry*, along with several similar competitive snus products, have been introduced in select domestic markets. All of these dry, spit-free products have substantially different attributes than traditional moist smokeless tobacco products. The limited volume associated with these launches has been largely incremental to the category and has had no measurable impact on the Company s existing products within these markets.

Net can volume for price-value products includes the *Red Seal* and *Husky* brands, along with the regional *Rooster* brand. Net can volume for the Company s mid-priced *Red Seal* brand grew mid-single digits in the second quarter of 2008, as compared to the second quarter of 2007, which the Company believes reflects the brand s inherent value proposition with 25 percent more tobacco per can than other leading brands, as well as the benefit of focused promotional spending. Net can volume for the Company s deep discount *Husky* brand grew double-digits in the second quarter of 2008, as compared to the corresponding prior year period, reflecting increased brand-building efforts, expanded distribution and strengthened retail presence. *Rooster*, which was repositioned as a regional price-value product beginning in April 2008, posted strong growth in the second quarter of 2008, as compared to the second quarter of 2007.

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Cost of Products Sold

Costs of products sold for the second quarter of 2008 increased as compared to the corresponding period of 2007, mainly due to the overall increased net unit volume for moist smokeless tobacco products and higher unit costs, including costs associated with certain trade promotional packaging.

Gross Margin

	Three Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Gross margin	**$ 322,790**	$ 329,487	$ (6,697)	(2.0)
Gross margin as % of net sales	**82.0%**	82.6%		

Gross margin decreased in the second quarter of 2008, compared to the second quarter of 2007, primarily as a result of as a result of lower net revenue realized per can, primarily due to increased sales incentives, as well as the aforementioned increase in cost of products sold. The gross margin, as a percentage of net sales, declined by 0.6 percentage points in the second quarter of 2008, as compared to the corresponding period of 2007, as a result of these factors and a shift in product mix, which included a higher percentage of price-value, value pack and promotional products.

SA&A Expenses

SA&A expenses decreased 8.4 percent in the second quarter of 2008 to $93.9 million, compared to $102.5 million in the second quarter of 2007, reflecting the following:

- Lower tobacco settlement-related costs;
- Decreased legal expenses;
- Lower tax expense related to samples;
- Decreased trade promotional costs;
- A tax refund related to the Company s seed operations;
- Lower costs associated with retail shelving systems; and
- Decreased handling fees due to a reduction in returned goods.

These decreases were partially offset by:

- Higher direct marketing costs, primarily for *Copenhagen* and *Skoal* products; and
- Higher field sales expenses, including the impact of higher fuel costs.

The Company s SA&A expenses include legal expenses, which incorporate, among other things, costs of administering and litigating product liability claims. For the quarters ended June 30, 2008 and 2007, outside legal fees and other internal and external costs incurred in connection with administering and litigating product liability claims were $4.5 million and $3.7 million, respectively. These costs reflect a number of factors, including the number of claims, and the legal and regulatory environments affecting the Company s products. The Company expects these factors to be the primary influence on its future costs of administering and litigating product liability claims. The Company does not expect these costs to increase significantly in the future; however, it is possible that adverse changes in the aforementioned factors could have a material adverse effect on such costs, as well as on results of operations and cash flows in the periods such costs are incurred.

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Antitrust Litigation

In the second quarter of 2008, the Company recorded a $1.5 million charge related to the previous settlement of an indirect purchaser antitrust action, due to a change in the estimated costs associated with the resolution of such action. See Item 1, Notes to Condensed Consolidated Financial Statements Note 14, Contingencies, for additional details regarding the Company s antitrust litigation.

Restructuring Charges

Smokeless Tobacco segment results for the three months ended June 30, 2008 and 2007 reflect $1.2 million and $3.3 million, respectively, of the restructuring charges discussed in the *Consolidated Results* section above.

First Six Months of 2008 compared with the First Six Months of 2007

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net sales	**$ 767,251**	$ 766,451	$ 800	0.1
Restructuring charges	**1,322**	6,486	(5,164)	(79.6)
Antitrust litigation	**1,525**	122,100	(120,575)	(98.8)
Operating profit	**429,800**	294,748	135,052	45.8

Net Sales

Smokeless Tobacco segment net sales were relatively flat in the first six months of 2008, as compared to the first six months of 2007, reflecting an increase in both premium and price-value net can volume for moist smokeless tobacco products. Net can volume results are discussed further below.

The impact of increased volume was substantially offset by lower net revenue realized per can, which was attributable to the following:

- An unfavorable shift in overall product mix, with price-value products contributing to a larger percentage of total net can volume;
- An unfavorable shift in premium product mix, with net can volume for value pack and promotional premium products, comprising a larger percentage of premium net can volume; and
- Increased sales incentives, primarily retail buydowns, which included those related to the Company s price-value brands.

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Percentage of Smokeless Tobacco Segment Net Sales by Product Category

* Moist smokeless tobacco products

** Includes dry snuff products and tobacco seeds

*MSTP Net Can Volume**

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net Can Volume (in thousands):				
Premium	**277,552**	275,020	2,532	0.9
Price Value	**54,330**	50,030	4,300	8.6
Total	**331,882**	325,050	6,832	2.1

* In order to ensure comparability and to conform to *Rooster s* current positioning, amounts related to this brand have been reclassified from premium to price-value for all periods presented.

Percentage of Total Moist Smokeless Tobacco Products Net Can Volume by Category Segment

Overall net can volume for moist smokeless tobacco products increased 2.1 percent in the first half of 2008, as compared to the first half of 2007. Net can volume for premium products accounted for approximately 37 percent of the overall volume increase. The premium net can volume growth of 0.9 percent in the first half of 2008, as compared to the first half of 2007, was experienced at the same time as an 8.6 percent increase in net can volume for price-value products.

The Company believes the overall net can volume growth is attributable to the following:

The Company s continued category growth efforts aimed at converting adult smokers to moist smokeless tobacco products; and

An increased focus on brand building, including promotional spending and other price-focused initiatives related to the Company s premium brand loyalty plan and price-value efforts.

The impact of these initiatives was partially offset by:

A more challenging external environment, particularly in the second quarter of 2008, including a weak economy, record-high gasoline prices and increased competitive activity.

The premium net can volume growth of 0.9 percent for the first six months of 2008 was attributable to both *Copenhagen* and *Skoal* products, reflecting the Company s continued focus on premium brand loyalty efforts, even in the face of the economic and competitive challenges.

Premium pouch products posted high single-digit net can volume growth in the first half of 2008, as compared to first half of 2007, a lower growth rate than historical trends as the prior year period included initial pipeline volume associated with the launch of *Skoal Citrus Pouches*. Net can volume for pouch products represented 8 percent of the Company s premium net can volume for the first six months of 2008.

Net can volume for *Red Seal* grew mid-single digits in the first six months of 2008, as compared to the first six months of 2007, reflecting the benefit of focused promotional spending. Net can volume for the Company s *Husky* brand grew double-digits in the first six months of 2008, as compared to the corresponding prior year period, reflecting increased brand-building efforts, expanded distribution and strengthened retail presence. For the first half of 2008, the Company continued to achieve price-value volume growth concurrent with premium volume growth, which is reflective of the Company s strategy to compete effectively within every segment of the moist smokeless tobacco category.

The following provides information from the Company s Retail Account Data Share & Volume Tracking System (RAD-SVT) for the 26-week period ending June 14, 2008, as provided by Management Science Associates, Inc., which measures shipments from wholesale to retail.

	Can-Volume % Change from Prior Year Period	% Share	Percentage Point Increase/(Decrease) from Prior Year Period
Total Category Data:			
Total Moist Smokeless Category	7.6%	N/A	N/A
Total Premium Segment	0.6%	52.7%*	(3.6)
Total Value Segments	16.5%	47.2%*	3.6
Company Data:			
Total Moist Smokeless Category	1.7%	57.9%	(3.4)
Total Premium Segment	0.3%	90.7%	(0.3)
Total Value Segments	8.6%	21.4%	(1.6)

* Amounts reported do not add to 100 percent, as this table does not reflect the

herbal segment
of the total
moist smokeless
category.

As reflected in such data, for the 26 weeks ended June 14, 2008, the total moist smokeless tobacco category grew 7.6 percent, which was consistent with trends seen in recent quarters and slightly higher than the Company s current estimate of category growth in the range of 6 to 7 percent for full-year 2008. Volume for the Company s moist smokeless tobacco products increased 1.7 percent and its share of the total category was 57.9 percent during the period. Volume for the Company s premium brands grew 0.3 percent for the 26 weeks ended June 14, 2008, while the overall premium segment grew 0.6 percent versus the comparable prior year period. Similar to the Company s net can volume shipment results, discussed earlier, RAD-SVT indicates that the premium volume challenges are largely confined to a limited geographic region. Excluding that region, the remainder of the country, which constitutes the vast majority of the Company s volume, was up 1.2 percent for the period. The Company s 90.7 percent share of the overall premium segment for the 26 weeks ended June 14, 2008 was level with the percent share reported for the 26 weeks ended February 23, 2008. Volume for the Company s value products grew 8.6 percent, a decline from the 10.4 percent level reported for the 26 weeks ended February 23, 2008. This compares to an increase in the growth rate for the overall value segment, which accelerated from 14.3 percent for the 26 weeks ending February 23, 2008 to16.5 percent in the most recent 26-week period, driven by the previously discussed competitive promotional and new product launch activity.

RAD-SVT information is provided as an indication of current domestic moist smokeless tobacco trends from wholesale to retail and is not intended as a basis for measuring the Company s financial performance. This information can vary significantly from the Company s actual results due to the fact that the Company reports net shipments to wholesale, while RAD-SVT measures shipments from wholesale to retail. In addition, differences in the time periods measured, as well as differences as a result of new product introductions and promotions, affect comparisons of the Company s actual results to those from RAD-SVT. The Company believes the difference in trend between RAD-SVT and its own net shipments is due to such factors. Furthermore, Management Science Associates, Inc. periodically reviews and adjusts RAD-SVT information, in order to improve the overall accuracy of the information for comparative and analytical purposes, by incorporating refinements to the extrapolation methodology used to project data from a statistically representative sample. Adjustments are typically made for static store counts and new reporting customers.

Cost of Products Sold

Costs of products sold for the first six months of 2008 increased as compared to the corresponding period of 2007, mainly due to the overall increased net unit volume for moist smokeless tobacco products and higher unit costs, including costs associated with certain trade promotional packaging.

Gross Margin

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Gross margin	**$ 625,936**	$ 629,939	$ (4,003)	(0.6)
Gross margin as % of net sales	**81.6%**	82.2%		

Gross margin decreased in the first half of 2008, compared to the first half of 2007, as a result of lower net revenue realized per can, primarily due to increased sales incentives, as well as the aforementioned increase in cost of products sold. The gross margin, as a percentage of net sales, declined by 0.6 percentage points in the first six months of 2008, as compared to the corresponding period of 2007, as a result of these factors and a shift in product mix, which included a higher percentage of price-value, value pack and promotional products.

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SA&A Expenses

SA&A expenses decreased 6.4 percent in the first six months of 2008 to $193.3 million, compared to $206.6 million in the first six months of 2007, reflecting the following:

- Lower tobacco settlement-related costs;
- A reduction in legal expenses;
- Decreased salaries and related costs;
- Lower print advertising costs, primarily due to lower spending on *Copenhagen, Skoal* and *Skoal Dry*;
- Lower tax expense related to samples;
- Decreased handling fees due to a reduction in returned goods; and
- A tax refund related to the Company s seed operations.

These decreases were partially offset by:

- Higher field sales expenses, including the impact of higher fuel costs;
- Increased point-of-sale, direct marketing and trade promotions costs; and
- Higher consumer promotion costs, primarily due to the *Cope Chop Shop Sweepstakes*.

For the six months ended June 30, 2008 and 2007, outside legal fees and other internal and external costs incurred in connection with administering and litigating product liability claims were $8.8 million and $7 million, respectively.

Antitrust Litigation

In the first six months of 2008, the Company recorded a $1.5 million charge reflecting a change in the estimated costs associated with the resolution of certain indirect purchaser antitrust actions. The first six months of 2007 reflect the impact of a $122.1 million pre-tax charge, representing the estimated costs to be incurred in connection with the resolution of the Company s two most significant remaining indirect purchaser class actions. The Company believes the settlement of these actions was prudent, as it removed a major distraction from the organization and reduced uncertainties regarding legal actions. The charge was comprised of the following:

- A $93.6 million pre-tax charge related to a May 2007 settlement, subject to court approval, reached in the State of California action as a result of court-ordered mediation. This charge brought the total recognized liability for the California action to $96 million, and reflected the cost of cash payments to be made to the benefit of class members, as well as plaintiffs attorneys fees and other administrative costs of the settlement. The terms of the California settlement were approved by the court in March 2008, however, an individual class member subsequently filed an appeal in April 2008.
- A $28.5 million charge related to a settlement, subject to court approval, reached in the State of Wisconsin action during a court-ordered mediation session that was held in April 2007. This charge reflects costs attributable to coupons, which will be distributed to consumers, and will be redeemable, over the next several years, on future purchases of the Company s moist smokeless tobacco products. Also reflected in this charge are plaintiffs attorneys fees and other administrative costs of the settlement. The terms of the Wisconsin settlement were approved by the court in December 2007.

See Item 1, Notes to Condensed Consolidated Financial Statements Note 14, Contingencies and Note 17, Other Matters, for additional details regarding the Company s antitrust litigation.

Restructuring Charges

Smokeless Tobacco segment results for the six months ended June 30, 2008 and 2007 reflect $1.3 million and $6.5 million, respectively, of the restructuring charges discussed in the *Consolidated Results* section above.

WINE SEGMENT

Second Quarter of 2008 compared with the Second Quarter of 2007

	Three Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net sales	**$ 99,134**	$ 79,519	19,615	24.7
Operating profit	**14,842**	11,460	3,382	29.5

Net Sales

The increase in Wine segment net sales for the second quarter of 2008, as compared to the corresponding 2007 period, was primarily due to a 20 percent increase in premium case volume. These favorable net sales results reflect the following factors:

- Strong performance by existing brands, primarily *Columbia Crest*, *Chateau Ste. Michelle, Erath, Red Diamond* and *14 Hands*;

- Incremental revenue contributed by the *Stag s Leap Wine Cellars* labels, which were added to the Company s portfolio in September 2007, with net sales of these labels accounting for approximately $5 million, or 25 percent, of the increase in net sales;

- Higher sales of the imported *Antinori* products, for which the Company is the exclusive U.S. distributor; and

- The continued benefit of favorable third-party acclaim and product ratings received in late 2007 and so far in 2008. During the second quarter of 2008 alone, the Company s wines received over 35 ratings of 90-plus from national publications, such as *Wine Spectator* and *Wine Enthusiast.*

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Case Volume

Percentage of Total Case Volume by Brand

* Includes *Stag s Leap Wine Cellars*, which was acquired in September 2007.

Chateau Ste. Michelle and *Columbia Crest*, the Company s two leading brands, accounted for 67.2 percent of total premium case volume in the second quarter of 2008, as compared to 71 percent for the corresponding 2007 period. Case volume for the second quarter of 2008 reflected the following:

A double-digit increase in *Columbia Crest* case volume in the second quarter of 2008, as compared to the second quarter of 2007, primarily due to higher case volume for *Grand Estates Chardonnay*, which received a 90 rating from two publications during the quarter,. New product introductions, including the *Horse Heaven Hills* (*H3*) ultra-premium line and the *Two Vines Vineyard 10* products, also contributed to the increase. In addition, case volume for *Two Vines* red varietals was higher in the second quarter of 2008, as compared to the same period of 2007. These increases were partially offset by lower case volume for other *Grand Estates* products;

A high single-digit increase in case volume for *Chateau Ste. Michelle*, primarily due to higher case volume for white varietals;

Case volume related to the *Stag s Leap Wine Cellars* labels, which were added to the Company s portfolio in September 2007. Case volume for *Stag s Leap Wine Cellars* labels accounted for 2.2 percentage points of the overall 20 percent case volume increase;

Strong growth for the Company s *Red Diamond, Erath, 14 Hands* and *Domaine Ste. Michelle* labels; and

Increased case volume for the *Antinori* brands.

Cost of Products Sold

Segment cost of products sold in the second quarter of 2008 increased 21.5 percent from the same prior year period, which was primarily attributable to the increased case volume, as well as higher costs per case, which includes the impact of higher freight costs driven by increased fuel prices.

Gross Margin

	Three Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Gross margin	**$ 35,161**	$ 26,850	$ 8,311	31.0
Gross margin as % of net sales	**35.5%**	33.8%		

The increase in gross margin in the second quarter of 2008, versus the second quarter of 2007, was primarily due to the increase in net sales. Gross margin, as a percentage of net sales, increased in the second quarter of 2008, as compared to the corresponding prior year period, mainly due to case sales associated with the higher margin *Stag s Leap Wine Cellars* and *Erath* labels, as well as a favorable shift in mix to higher priced varietals for the *Columbia Crest* and *Chateau Ste. Michelle* labels.

SA&A Expenses

SA&A expenses of $20.3 million in the second quarter of 2008 were 32 percent higher than the $15.4 million of such expenses recognized in the second quarter of 2007, reflecting the following:

Higher salaries and related costs, due to the continued expansion of the sales force, in alignment with the Company s broadening distribution of its wines;

Higher costs related to the addition of Stag s Leap Wine Cellars, acquired in September 2007, which accounted for approximately 27 percent (or 8.6 percentage points) of the total increase in SA&A expenses;

Increased advertising and promotional costs related to *Columbia Crest*; and

Higher legal expenses.

First Six Months of 2008 compared with the First Six Months of 2007

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net sales	**$ 185,300**	$ 148,295	37,005	25.0
Operating profit	**26,706**	22,720	3,986	17.5

Net Sales

The increase in Wine segment net sales for the first six months of 2008, as compared to the corresponding 2007 period, was primarily due to an increase in premium case volume of 17.9 percent. These favorable net sales results reflect the following factors:

Incremental revenue contributed by the *Stag s Leap Wine Cellars* labels, which were added to the Company s portfolio in September 2007, with net sales of these labels accounting for approximately 34 percent of the increase in net sales;

Strong performance by existing brands, primarily *Columbia Crest*, *Chateau Ste. Michelle, Erath, Red Diamond* and *14 Hands*;

Increased sales of *Antinori* products; and

The continued benefit of favorable third-party acclaim and product ratings.

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Case Volume

Percentage of Total Case Volume by Brand

* Includes *Stag s Leap Wine Cellars*, which was acquired in September 2007.

Chateau Ste. Michelle and *Columbia Crest* accounted for 67 percent of total premium case volume in the first six months of 2008, as compared to 70.8 percent for the corresponding 2007 period.

Case volume for the first six months of 2008 reflected the following:

A double-digit increase in *Columbia Crest* case volume, primarily due to the *Horse Heaven Hills* (*H3*) ultra-premium line and *Two Vines Vineyard 10* products, as well as higher case volume for *Grand Estates Chardonnay* in the first half of 2008, as compared to the first half of 2007. These increases were partially offset by lower case volume for other *Grand Estates* products;

Double-digit case volume growth for *Chateau Ste. Michelle*, primarily due to higher case volume for white varietals;

Incremental case volume related to the September 2007 addition of *Stag s Leap Wine Cellars* labels, which accounted for 2.6 percentage points of the overall 17.9 percent case volume increase;

Strong growth for the Company s *Red Diamond, Erath,* and *14 Hands* labels; and

Higher case volume for the *Antinori* brands.

Cost of Products Sold

Segment cost of products sold increased 23.4 percent in the first six months of 2008, as compared to the first six months of 2007, primarily due to the increased case volume and higher costs per case, which includes the impact of higher freight costs driven by increased fuel prices.

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Gross Margin

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Gross margin	**$ 65,199**	$ 50,949	$ 14,250	28.0
Gross margin as % of net sales	**35.2%**	34.4%		

The increase in gross margin in the first half of 2008, versus the first half of 2007, was primarily due to the increase in net sales. Gross margin, as a percentage of net sales, increased in the first six months of 2008, as compared to the corresponding prior year period, mainly due to case sales associated with the higher margin *Stag s Leap Wine Cellars* and *Erath* labels.

SA&A Expenses

SA&A expenses increased 36.4 percent to $38.5 million in the first six months of 2008, from $28.2 million in the first six months of 2007, reflecting the following:

- Higher costs related to the addition of Stag s Leap Wine Cellars, acquired in September 2007, which accounted for approximately 28 percent (or 10.2 percentage points) of the total increase in SA&A expenses;
- Higher salaries and related costs, due to the continued expansion of the sales force, in alignment with the Company s broadening distribution of its wines;
- A lower pre-tax gain associated with the sale of non-strategic winery property located in Washington, as the current year reflects a $1.4 million pre-tax gain related to the sale of property, as compared to a $2 million pre-tax gain reflected in the prior year;
- Increased point-of-sale advertising costs; and
- Higher advertising and promotional costs related to *Columbia Crest*.

ALL OTHER OPERATIONS

Second Quarter of 2008 compared with the Second Quarter of 2007

	Three Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net sales	**$ 13,379**	$ 12,717	$ 662	5.2
Operating profit	**4,107**	4,945	(838)	(16.9)

Net sales for All Other Operations increased 5.2 percent in the second quarter of 2008, as compared to the second quarter of 2007, reflecting the following:

- The favorable impact of foreign exchange rates related to the Company s international operations in Canada;
- Higher net unit volume in the Company s other international markets;

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These favorable items were partially offset by:

The impact of an increase in the provision for returned goods for the Company s Canadian operations, ahead of an excise tax related price increase that will become effective in the third quarter of 2008. The increase in the provision represents the estimated cost of consideration to be provided to wholesale customers during a transitional period for goods purchased prior to the effective date of the excise tax related price increase.

Foreign exchange rates had an unfavorable impact on costs of products sold in the second quarter of 2008, as compared to the comparable prior year period. Gross margin, as a percentage of net sales, was 59.2 percent in the second quarter of 2008, as compared to 63.4 percent in the second quarter of 2007. The decrease in the gross margin, as a percentage of net sales, was primarily due to the increase in the provision for returned goods. Operating profit for All Other Operations represented 30.7 percent of net sales in the second quarter of 2008, as compared to 38.9 percent in the corresponding period of 2007. The decrease in the operating margin percentage was primarily due to the aforementioned charge related to returned goods, as well as an increase in direct selling and advertising costs, primarily within the Company s Canadian operations.

First Six Months of 2008 compared with the First Six Months of 2007

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net sales	**$ 26,334**	$ 23,526	$ 2,808	11.9
Restructuring charges	**216**		216	
Operating profit	**8,804**	8,941	(137)	(1.5)

The increase in net sales for All Other Operations in the first six months of 2008, as compared to the corresponding period of 2007, was mainly due to the favorable impact of foreign exchange rates related to the Company s international operations in Canada, as well as higher net unit volume in the Company s other international markets. As noted in the discussion of quarterly results above, net sales were negatively impacted by an increase in the provision for returned goods. Foreign exchange rates had an unfavorable impact on costs of products sold in the first half of 2008, as compared to the first half of 2007. Gross margin, as a percentage of net sales decreased to 61.1 percent in the first six months of 2008, as compared to 63.3 percent in the first six months of 2007. As previously discussed, the decline was primarily due to the increase in the provision for returned goods. Operating profit for All Other Operations represented 33.4 percent of net sales in the first half of 2008, as compared to 38 percent in the first half of 2007. The decrease in the operating margin percentage was primarily due to the aforementioned increase in the provision for returned goods and an increase in direct selling and advertising costs, primarily within the Company s Canadian operations, as well as restructuring charges incurred in connection with Project Momentum in the first quarter of 2008.

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UNALLOCATED CORPORATE

Second Quarter of 2008 compared with the Second Quarter of 2007

Administrative Expenses

Unallocated corporate administrative expenses decreased 36.9 percent to $7.4 million in the second quarter of 2008, as compared to $11.7 million in the second quarter of 2007, reflecting the following:

- The absence of $2.9 million of amortization of imputed rent recognized in the second quarter of 2007 related to a below-market short-term lease the Company executed in connection with the sale of its former corporate headquarters building; and

- A decrease of $1.9 million due to the absence of a share-based compensation charge recognized in the second quarter of 2007 associated with a change in executive management.

These favorable items were partially offset by:

- Higher consulting fees.

Restructuring Charges

Unallocated restructuring charges incurred in connection with Project Momentum amounted to $0.7 million in the second quarter of 2007. The unallocated restructuring charges primarily consisted of one-time termination benefit charges, as well as professional fees directly related to the implementation of Project Momentum.

Interest Expense

Net interest expense increased to $18.9 million in the second quarter of 2008, from $8.6 million in the second quarter of 2007, due to lower income from cash equivalent investments in the current year, as well as higher levels of debt outstanding in the current year as a result of borrowings under the Company s revolving credit facility and the issuance of senior notes in February 2008.

Income Tax Expense

The Company recorded income tax expense of $79 million in the second quarter of 2008 compared to $79.1 million in the second quarter of 2007. The Company s effective tax rate, before minority interest and equity earnings, was 36.1 percent for both the second quarter of 2008 and 2007.

First Six Months of 2008 compared with the First Six Months of 2007

Administrative Expenses

Unallocated corporate administrative expenses decreased 41 percent to $14.6 million in the first six months of 2008, as compared to $24.8 million in the first six months of 2007, reflecting the following:

Lower costs related to changes in executive management, which accounted for the majority of the overall decrease in SA&A expenses in the first six months of 2008;

The absence of $3.9 million of amortization of imputed rent recognized in the first half of 2007 related to a below-market short-term lease the Company executed in connection with the sale of its former corporate headquarters building; and

Lower legal expenses.

These favorable items were partially offset by:

Higher consulting fees.

Restructuring Charges

Unallocated restructuring charges incurred in connection with Project Momentum amounted to $0.1 million in the first six months of 2008, as compared to approximately $1 million in the first six months of 2007. The unallocated restructuring charges primarily consisted of one-time termination benefit charges, as well as professional fees directly related to the implementation of Project Momentum.

Interest Expense

Net interest expense increased to $36.5 million in the first half of 2008, from $18.1 million in the corresponding period of 2007, due to lower income from cash equivalent investments in the current year, as well as higher levels of debt outstanding in the current year as a result of borrowings under the Company s revolving credit facility and the issuance of senior notes in February 2008.

Income Tax Expense

The Company recorded income tax expense of $148.3 million in the first six months of 2008 compared to $139.8 million in the first six months of 2007. Income tax expense in the first six months of 2007 reflects the impact of antitrust litigation charges, as well as the gain recognized in connection with the sale of the Company s corporate headquarters building. The Company s effective tax rate, before minority interest and equity earnings, decreased to 35.8 percent in first half of 2008, compared to 36.1 percent in the corresponding prior year period, as a result of $1 million of income tax accrual reversals in the current year primarily due to the expiration of certain statutes of limitations.

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OUTLOOK

SMOKELESS TOBACCO SEGMENT

Category Growth

The Company remains committed to its category growth initiatives, which continue to be successful as demonstrated by a continued strong growth rate in the first half of 2008 of 7.6 percent, as reported in the most recent 26-week RAD-SVT period. In light of the success of the Company s historical category growth initiatives, recent results, as well as its commitment to sustain these activities on a going forward basis, the Company now expects the category to grow between 6 and 7 percent in 2008, driven by an expanding adult consumer base. As in the past, the Company will continue to utilize its direct mail and one-on-one marketing programs to promote the discreetness and convenience of smokeless tobacco relative to cigarettes to adult smokers, as well as product innovation, all of which the Company believes have contributed to category growth in the last few years.

Competing Effectively

The Company has increased its focus on brand building in 2008, and had planned to continue to selectively increase spending behind its loyalty initiatives, with a goal of accelerating profitable moist smokeless tobacco net can volume growth for both premium and price-value products. With the net can volume trend for premium products adversely impacted in the second quarter of 2008 by the challenging economic conditions and increased competitive activity, the Company intends to further increase its promotional efforts in the latter half of the year, focusing on areas of the country that are most affected by the economic downturn. The Company expects these efforts to return premium volume to growth as the year progresses, with full-year 2008 growth of about 1 percent, excluding the impact of the extra billing day in 2007. This growth rate compares to the Company s previous estimate of approximately 2 percent. With respect to the Company s price-value products, continued solid growth is expected, as it sustains growth in line with the total category for *Red Seal* and continues to build distribution and increase the retail presence of *Husky*. Overall, the Company expects total net can volume growth in the range of 1 to 2 percent, on an equivalent billing day basis.

State Excise Taxes

The federal government imposes excise taxes on smokeless tobacco products on the basis of weight, while many states impose excise taxes on such products expressed as a percentage of the wholesale price (ad valorem). The Company believes that ad valorem excise taxes on smokeless tobacco products artificially drive consumer behavior and create market distortions by providing a tax preference for lower priced products. Weight-based excise taxes or specific taxes on smokeless tobacco products would, in the Company s opinion, allow products to compete fairly in the marketplace on the basis of price and product attributes, not the relative tax burden. The Company continues to promote tax equity in all of the states that currently impose ad valorem excise taxes on smokeless tobacco products rather than on the basis of weight. Thus far in 2008, two states, Utah and New York, representing approximately 2.5 percent of the Company s moist smokeless tobacco product net can volume, passed legislation to convert to an excise tax based on weight, bringing the total number of tax equity states to 15, representing approximately 24 percent of the Company s total net can volume. The Company believes its support of weight-based state excise taxes on smokeless tobacco products is in the best interest of the Company, its wholesaler customers, retailers, adult consumers of the Company s moist smokeless tobacco products and the state governments.

Proposed U.S. Food & Drug Administration Regulation

During the first quarter of 2008, the U.S. House Committee on Energy and Commerce (Committee) passed legislation (H.R. 1108) calling for regulation of tobacco products by the U.S. Food & Drug Administration (FDA). As communicated in the past, the Company believes that any proposals for additional regulation of tobacco products at the federal, state or local level should recognize the distinct differences between smokeless tobacco products and cigarettes. The Company believes the current version of the FDA regulation legislation as passed by the Committee, although not perfect, more appropriately recognizes the distinct differences between smokeless tobacco and cigarettes. The Company believes this version of the bill would level the playing field among smokeless tobacco manufacturers as it includes provisions relating to the sales and marketing of smokeless tobacco products that are at least as restrictive as those included in the Smokeless Tobacco Master Settlement Agreement, an agreement to which the Company is the only smokeless tobacco manufacturer signatory. The Company also believes the bill will potentially enable a comparative risk claim to be made between smokeless tobacco and cigarettes, if the science supports the claim to the satisfaction of the FDA. The Company believes that the science will ultimately support such a claim. As such, the Company will actively support passage of this version of the legislation going forward.

WINE SEGMENT

The Wine segment forecasts strong growth for both net sales and operating profit in 2008. Favorable acclaim received for products late in 2007 and early 2008 are expected to continue to benefit net sales over the remainder of the year. In addition, revenues and operating profit are expected to continue to be favorably impacted by the addition of the *Stag s Leap Wine Cellars* labels, which the Company began selling late in the third quarter of 2007.

CONSOLIDATED

The Company is currently targeting 2008 GAAP diluted earnings per share of $3.63, with a range of $3.58 to $3.68, which includes the unfavorable impact of approximately $.02 per diluted share related to antitrust litigation settlement and restructuring charges recognized to date. This guidance does not include the impact of any additional restructuring charges associated with Project Momentum, as management is not currently able to make a determination of the estimated amount, or range of amounts, of such charges to be incurred for the remainder of the year. In the event further actions under Project Momentum are finalized and committed to by the Company, and additional material restructuring charges are anticipated, the Company will provide an update to its full-year 2008 estimate of diluted earnings per share, reflecting the impact of such charges. Absent any additional restructuring charges, the Company remains confident in its full-year estimate even in light of a weak economy, high gasoline prices, and increased competitive activity, given its performance over the first half of the year. In addition, as previously noted, the Company intends to utilize some of the flexibility it had built into its plans to allow for adjustments in promotional spending, where necessary, to respond to these economic and competitive challenges and support premium unit volume, as well as to offset the impact of the Canadian excise tax increase and approximately 2 to 3 cents per share of energy-related input cost increases. The Company s long-term goal is to provide an average annual total shareholder return of 10 percent, including diluted earnings per share growth and a strong dividend. The current 2008 estimate is consistent with that goal.

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LIQUIDITY AND CAPITAL RESOURCES

(In thousands, except per share amounts or where otherwise noted)

	Six Months Ended June 30,		Increase/(Decrease)	
	2008	**2007**	**Amount**	**%**
Net cash provided by (used in) :				
Operating activities	**$ 203,525**	$ 242,232	$ (38,707)	(16.0)
Investing activities	**(25,836)**	87,546	(113,382)	
Financing activities	**(203,854)**	(279,584)	75,730	27.1

Operating Activities

The primary source of cash from operating activities in the first six months of 2008 and 2007, respectively, was net earnings generated mainly by the Smokeless Tobacco segment, adjusted for the effects of non-cash items. In the first six months of 2008, the most significant uses of cash were for the payment of accounts payable and accrued expenses incurred in the normal course of business, including payments for purchases of leaf tobacco for use in moist smokeless tobacco products and grapes for use in the production of wine. The decrease in cash provided by operating activities during the first six months of 2008, as compared to the corresponding 2007 period, was primarily related to the timing of payments related to accounts payable and accrued expenses and antitrust litigation settlements, partially offset by the timing of payments related to federal income taxes.

Investing Activities

The increase in cash used in investing activities for the first six months of 2008, as compared to the first six months of 2007, was primarily due to a decrease in proceeds from dispositions of property. The first six months of 2008 reflected cash proceeds of $1.5 million from the sale of property, plant and equipment, as compared to $130.5 million in net proceeds in the corresponding 2007 period primarily from the sale of the Company s former corporate headquarters building and the sale of winery property located in the State of Washington. In addition, expenditures related to property, plant and equipment increased to $27.3 million for the first six months of 2008, as compared to $22.6 million in the comparable prior year period, mainly related to purchases of manufacturing equipment for the Smokeless Tobacco segment and spending related to facilities expansion and equipment for the Wine segment. The impact of these items was partially offset by activity related to short-term investments, as the prior year period included $20 million of short-term investment purchases. The Company currently expects net spending under the 2008 capital program to approximate $81 million.

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Financing Activities

The lower level of net cash used in financing activities during the first six months of 2008, as compared to the first six months of 2007, was primarily due to the issuance of senior notes in February 2008, with an aggregate principal amount of $300 million. Proceeds from the senior notes issuance, net of underwriting discounts and issuance costs, amounted to $296.3 million. Upon the completion of the issuance of the senior notes, the Company repaid $100 million of borrowings that it had drawn earlier in the first quarter of 2008 under its Credit Agreement, as well as $200 million of borrowings outstanding under the Company s Credit Facility. The Company subsequently borrowed an additional $90 million under the Credit Facility during the first six month of 2008, thus resulting in $110 million of net repayment activity under the facility during the first six months of 2008. Dividends of $186.9 million paid during the first six months of 2008 were lower than the $192.3 million paid during the first six months of 2007, as the impact of a lower level of shares outstanding resulting from repurchases of common stock under the Company s share repurchase program was partially offset by a 5 percent dividend increase. The Company utilized $198.7 million to repurchase common stock under its share repurchase programs in the first six months of 2008, as compared to $120.1 million in the corresponding period of 2007. Proceeds received from the issuance of stock related to stock option activity decreased to $10.1 million in the first six months of 2008, as compared to $26.1 million in the first six months of 2007. The lower stock option exercise activity also resulted in a decrease in the tax benefit realized by the Company related to share-based compensation, in excess of the tax deduction that would have been recorded had the fair value method of accounting been applied to all share-based compensation grants, with the excess tax benefit reflected in the first six months of 2008 amounting to $2 million, as compared to $6.6 million in the corresponding period of 2007. Cash flow from financing activities for the first six months of 2008 also reflects a $16.7 million decrease in book cash overdrafts.

As a result of the aforementioned sources and uses of cash, the Company s cash and cash equivalents balance decreased to $47.5 million at June 30, 2008 from $73.7 million at December 31, 2007.

The Company will continue to have significant cash requirements for the remainder of 2008, primarily for the payment of dividends, the repurchase of common stock, purchases of leaf tobacco and grape inventories, and capital spending. The Company estimates that amounts expended in 2008 for tobacco leaf purchases for moist smokeless tobacco products will approximate the amounts expended in 2007, while grape and bulk wine purchases and grape harvest costs for wine products are expected to be higher than amounts expended in 2007. Funds generated from net earnings, supplemented by borrowings under the Company s Credit Facility, will be the primary means of meeting cash requirements over this period.

Senior Notes

On February 29, 2008, the Company completed the issuance and sale of $300 million aggregate principal amount of 5.75 percent senior notes in a public offering at a price to the underwriters of 98.982 percent of the principal amount. These senior notes mature on March 1, 2018, with interest payable semiannually. Costs of $2.6 million associated with the issuance of the senior notes were capitalized and are being amortized over the term of the senior notes. As mentioned above, upon completion of the issuance of the senior notes the Company repaid $100 million of borrowings outstanding under the Credit Agreement and $200 million of borrowings outstanding under the Company s Credit Facility. In accordance with its terms, the Credit Agreement was terminated upon the issuance of the senior notes and the repayment of outstanding borrowings.

The Company s $240 million aggregate principal amount senior notes, of which $200 million is 7.25 percent fixed rate debt and $40 million is floating rate debt, mature on June 1, 2009. The Company currently intends to fund the repayment of this debt through the issuance of long-term senior notes.

Revolving Credit Facility
The Company s Credit Facility, which is a $300 million five-year revolving facility, will expire on June 29, 2012. Borrowings under the Credit Facility will primarily be used for general corporate purposes, including the support of commercial paper borrowings. At June 30, 2008, the Company had borrowings of $140 million outstanding under the Credit Facility.

AGGREGATE CONTRACTUAL OBLIGATIONS

There have been no material changes in the Company s aggregate contractual obligations since December 31, 2007, with the exception of the execution of leaf tobacco and grape purchase activity in connection with normal purchase contracts and payments associated with antitrust litigation settlements.

Through June 30, 2008, the Company completed $10.6 million in leaf tobacco purchases related to certain contracts outstanding at December 31, 2007. As of June 30, 2008, the Company has contractual obligations of approximately $67.7 million for the purchase of leaf tobacco to be used in the production of moist smokeless tobacco products and $441 million for the purchase and processing of grapes to be used in the production of wine products. The majority of the contractual obligations to purchase leaf tobacco are expected to be fulfilled by the end of 2008.

In addition, as of June 30, 2008, the Company believes that it is reasonably possible that within the next 12 months payments of up to $10.6 million may be made to various tax authorities related to FIN 48 unrecognized tax benefits and interest. The Company cannot make a reasonably reliable estimate of the amount of liabilities for unrecognized tax benefits that may result in cash settlements for periods beyond 12 months.

OFF-BALANCE SHEET ARRANGEMENTS

The minority put arrangement provided to Antinori in connection with the acquisition of Stag s Leap Wine Cellars and the related formation of Michelle-Antinori provides Antinori with the right to require the Company to purchase its 15 percent ownership interest in Michelle-Antinori at a price based on a fixed multiple of Stag s Leap Wine Cellars earnings before income taxes, depreciation, amortization and other non-cash items. The minority put arrangement becomes exercisable beginning on the third anniversary of the Stag s Leap Wine Cellars acquisition (September 11, 2010). The Company accounts for the minority put arrangement as mandatorily redeemable securities under Accounting Series Release No. 268, *Redeemable Preferred Stocks*, and Emerging Issues Task Force Abstract Topic No. D-98, *Classification and Measurement of Redeemable Securities*, as redemption is outside of the control of the Company. Under this accounting model, to the extent the value of the minority put arrangement is greater than the minority interest reflected on the balance sheet (traditional minority interest), the Company recognizes the difference as an increase to the value of the minority interest, with an offset to retained earnings and a similar reduction to the numerator in the earnings per share available to common shareholders calculation. The Company also reflects any decreases to the amount in a similar manner, with the floor in all cases being the traditionally calculated minority interest balance as of that date. The Company values the put arrangement by estimating its redemption value as if the redemption date were the end of the current reporting period, using the most recent 12-month trailing earnings before income taxes, depreciation, amortization and other non-cash items. As of June 30, 2008, the value of the minority put arrangement did not exceed the traditional minority interest balance. Therefore, no adjustment was recognized in the Consolidated Statement of Financial Position or in the calculation of earnings per share.

The Company does not have any other off-balance sheet arrangements that are material to its results of operations or financial condition.

NEW ACCOUNTING STANDARDS

The Company reviews new accounting standards to determine the expected financial impact, if any, that the adoption of each such standard will have. As of the filing of this Quarterly Report on Form 10-Q, there were no new accounting standards issued that were projected to have a material impact on the Company s consolidated financial position, results of operations or liquidity. Refer to Part I, Item 1, Financial Statements Notes to Condensed Consolidated Financial Statements Note 2, Recent Accounting Pronouncements, for further information regarding new accounting standards.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Reference is made to the section captioned Cautionary Statement Regarding Forward-Looking Information which was filed as part of Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations of the 2007 Form 10-K, regarding important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by the Company, including forward-looking statements contained in this report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Item 7A of the 2007 Form 10-K, which is incorporated herein by reference. There has been no material change in the information provided therein, with the exception of the issuance of fixed rate senior notes (see Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Senior Notes, for additional information). However, in order to demonstrate the sensitivity of the Company s interest rate hedges to immediate changes in applicable market interest rates, updated sensitivity analyses are provided below.

The Company has hedged against the variability of forecasted interest payments attributable to changes in interest rates through the date of an anticipated debt issuance in 2009 with a forward starting interest rate swap. The forward starting interest rate swap has a notional amount of $100 million and the terms call for the Company to receive interest quarterly at a variable rate equal to LIBOR and to pay interest semi-annually at a fixed rate of 5.715 percent. The fair value of the forward starting interest rate swap at June 30, 2008 was a net liability of $6.2 million, based upon analysis derived from relevant observable market inputs. As an indication of the forward starting swap s sensitivity to changes in interest rates, based upon an immediate 100 basis point increase in the applicable interest rate at June 30, 2008, the fair value of the forward starting swap would increase by approximately $7.6 million to a net asset of $1.4 million. Conversely, a 100 basis point decrease in that rate would decrease the fair value of the forward starting swap by $8.6 million to a net liability of $14.8 million.

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The Company has hedged the interest rate risk on its $40 million aggregate principal amount of floating rate senior notes with a ten-year interest rate swap having a notional amount of $40 million and quarterly settlement dates over the term of the contract. The Company pays a fixed rate of 7.25 percent and receives a floating rate of three-month LIBOR plus 90 basis points on the notional amount. The fair value of the swap at June 30, 2008 was a net liability of $1.3 million, based upon analysis derived from relevant observable market inputs. As an indication of the interest rate swap s sensitivity to changes in interest rates, based upon an immediate 100 basis point increase in the applicable interest rate at June 30, 2008, the fair value of the interest rate swap would increase by approximately $0.3 million to a net liability of $1 million. Conversely, a 100 basis point decrease in that rate would decrease the fair value of the interest rate swap by $0.3 million to a net liability of $1.6 million.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company, under the direction of its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), has reviewed and evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, the Company s CEO and CFO believe, as of the end of such period, that the Company s disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

There have not been any changes in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In *James Joseph LaChance, et al. v. United States Tobacco Company, et al.*, Superior Court of New Hampshire, Strafford County (No. 03-C-279), on July 11, 2008, the court entered a final judgment granting final approval of the settlement, including attorneys fees and costs, and dismissing the action with prejudice (see the Company s Annual Report on Form 10-K for the year ended December 31, 2007 for additional information). On August 1, 2008, an individual class member filed a Notice of Appeal to the New Hampshire Supreme Court from the final judgment granting final approval of the settlement.

In *Robert A. Martin, et al. v. Gordon Ball, et al.,* United States District Court for the Northern District of West Virginia (No. 5:06-cv-1985), on May 20, 2008 the court entered an order and judgment dismissing this action with prejudice. On June 12, 2008, Plaintiffs filed a Notice of Appeal to the United States Court of Appeals for the Fourth Circuit.

In *Gregory Hunt, et al. v. United States Tobacco Company, et al.,* United States District Court for the Eastern District of Pennsylvania (No. 06-CV-1099), on August 5, 2008, the Third Circuit Court of Appeals ruled in the Company s favor and issued an opinion vacating the trial court s order denying the Company s motion to dismiss the complaint. The Court remanded the case to the trial court for a determination whether to grant leave to amend the complaint and to amend the complaint in a manner that satisfies the standards set forth in the Third Circuit opinion.

ITEM 1A. RISK FACTORS

There have been no material changes in the Company s risk factors from those disclosed in Part I, Item 1A of the 2007 Form 10-K.

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

The following table presents the monthly share repurchases during the quarter ended June 30, 2008:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of the Repurchase Programs [1]	Maximum Number of Shares that May Yet Be Purchased Under the Repurchase Programs [1]
April 1 30, 2008	782,800	$ 53.08	782,800	18,720,829
May 1 31, 2008	392,970	$ 52.82	392,970	18,327,859
June 1 30, 2008	81,640	$ 54.86	81,640	18,246,219
Total	1,257,410	$ 53.12	1,257,410	

(1) In December 2007, the Company s Board of Directors authorized a program to repurchase up to 20 million shares of its outstanding common stock.

Repurchases under the new program commenced in March 2008.

ITEM 6. EXHIBITS

Exhibit 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
Exhibit 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
Exhibit 32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

	UST Inc.
	(Registrant)
Date: August 7, 2008	/s/ RAYMOND P. SILCOCK
	Raymond P. Silcock
	Senior Vice President and
	Chief Financial Officer
	(Principal Financial Officer)
Date: August 7, 2008	/s/ JAMES D. PATRACUOLLA
	James D. Patracuolla
	Vice President and Controller
	(Principal Accounting Officer)

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EXHIBIT INDEX

Exhibit No.	Description
Exhibit 31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
Exhibit 31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
Exhibit 32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.