

SCHWEITZER MAUDUIT INTERNATIONAL INC

Form 10-Q

August 06, 2008

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FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2008

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from _____ to _____

1-13948

(Commission file number)

SCHWEITZER-MAUDUIT INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

30022
(Zip code)

1-800-514-0186

(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

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PART I

ITEM 1. FINANCIAL STATEMENTS

SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions, except per share amounts)

(Unaudited)

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

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

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

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

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

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

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SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS

EQUITY AND COMPREHENSIVE INCOME

(dollars in millions, except per share amounts)

(Unaudited)

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

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

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

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

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

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

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NOTE 1. GENERAL

Nature of Business

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

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

Basis of Presentation

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

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

Principles of Consolidation

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

Use of Estimates

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

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Fair Value

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

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

Recent Accounting Pronouncements

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

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

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

NOTE 2. NET INCOME PER SHARE

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

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

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

NOTE 3. INVENTORIES

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

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

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NOTE 4. RESTRUCTURING ACTIVITIES

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

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

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

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

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

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

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

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

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

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

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

NOTE 5. DEBT

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

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

Credit Agreement

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

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

Bank Overdraft

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

Interest Rate Swap Agreements

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

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NOTE 6. COMMITMENTS AND CONTINGENCIES

Litigation

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

Environmental Matters

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

NOTE 7. POSTRETIREMENT AND OTHER BENEFITS

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

Pension and OPEB Benefits

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

| | Three Months Ended June 30, | | | | | | | |
|--------------------------------|------------------------------------|-------------|-----------------------|-------------|-----------------|-------------|---------------------------|-------------|
| | U.S. Pension | | French Pension | | | | U.S. OPEB Benefits | |
| | Benefits | | Benefits | | Benefits | | Benefits | |
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost | \$ 0.1 | \$ 0.2 | \$ 0.4 | \$ 0.5 | \$ 0.1 | | \$ 0.1 | |
| Interest cost | 1.7 | 1.7 | 0.6 | 0.5 | 0.1 | | 0.1 | 0.2 |
| Expected return on plan assets | (2.0) | (1.9) | (0.3) | (0.4) | | | | |
| Amortizations and other | 0.2 | 0.6 | 0.1 | 0.1 | | | | |
| Net periodic benefit cost | \$ 0.0 | \$ 0.6 | \$ 0.8 | \$ 0.7 | \$ 0.2 | | \$ 0.2 | |

Six Months Ended June 30,

French Pension

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

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

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

NOTE 8. INCOME TAXES

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

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

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

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

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

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

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

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

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

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

NOTE 9. ACQUISITION

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

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

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

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

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

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

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

NOTE 10. SEGMENT INFORMATION

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

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

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

Table of Contents**Net Sales**

(dollars in millions)

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

Operating Profit (Loss)

(dollars in millions)

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

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

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

Introduction

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

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

Executive Summary

(dollars in millions, except per share amounts)

| | Three Months Ended | | | | Six Months Ended | | | | | | | |
|-----------|---------------------------|-------|----------------------|----|-------------------------|--------|----------------------|-------|--------|----|-------|--------|
| | June 30, 2008 | | June 30, 2007 | | June 30, 2008 | | June 30, 2007 | | | | | |
| Net sales | \$ | 202.0 | 100.0% | \$ | 171.8 | 100.0% | \$ | 391.8 | 100.0% | \$ | 342.1 | 100.0% |

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

Second Quarter Highlights

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

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

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

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

Year-To-Date Highlights

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

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

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

Recent Developments

Price Increases

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

Operational Changes Brazil

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

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

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

Lower Ignition Propensity Cigarette Papers

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

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

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

China Joint Venture

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

Table of ContentsResults of Operations

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

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

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

(dollars in millions)

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

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

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

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

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

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

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

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

Gross Profit

(dollars in millions)

Three Months Ended

Gross Profit

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

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

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

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

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

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

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

Nonmanufacturing Expenses

(dollars in millions)

| | Three Months Ended | | Change | Percent Change | Percent of Net Sales | |
|---------------------------|--------------------|---------------|----------|----------------|----------------------|------|
| | June 30, 2008 | June 30, 2007 | | | 2008 | 2007 |
| Selling expense | \$ 5.8 | \$ 5.4 | \$ 0.4 | 7.4% | 2.9% | 3.1% |
| Research expense | 2.5 | 2.0 | 0.5 | 25.0 | 1.2 | 1.2 |
| General expense | 7.4 | 9.2 | (1.8) | (19.6) | 3.7 | 5.4 |
| Nonmanufacturing expenses | \$ 15.7 | \$ 16.6 | \$ (0.9) | (5.4)% | 7.8% | 9.7% |

Nonmanufacturing expenses decreased by \$0.9 million, or 5.4 percent, to \$15.7 million from \$16.6 million for the prior-year quarter, primarily due to lower accruals for incentive expenses during 2008. Nonmanufacturing expenses were 7.8 percent and 9.7 percent of net sales for the three month periods ended June 30, 2008 and 2007, respectively.

Restructuring Expense

Total restructuring expense of \$3.7 million was recognized during the three month period ended June 30, 2008, comprised of \$2.1 million for asset impairment charges, \$1.2 million for severance and other cash costs and \$0.4 million for accelerated depreciation. Total restructuring expense of \$3.4 million was recognized during the prior-year quarter, comprised of \$2.6 million for severance related costs and \$0.8 million for accelerated depreciation.

Operating Profit (Loss)

(dollars in millions)

| | Three Months Ended | | | Change | Percent Change | Return on Net Sales | |
|----------------------|--------------------|---------------|----------|---------|----------------|---------------------|------|
| | June 30, 2008 | June 30, 2007 | | | | 2008 | 2007 |
| France | \$ 6.5 | \$ 6.0 | \$ 0.5 | 8.3% | 5.0% | 5.8% | |
| United States | 3.9 | 3.4 | 0.5 | 14.7 | 6.8 | 6.0 | |
| Brazil | (4.4) | (0.4) | (4.0) | N.M. | (21.7) | (2.3) | |
| Subtotal | 6.0 | 9.0 | (3.0) | | | | |
| Unallocated expenses | (1.2) | (3.0) | 1.8 | | | | |
| Total | \$ 4.8 | \$ 6.0 | \$ (1.2) | (20.0)% | 2.4% | 3.5% | |

N.M. Not meaningful

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Operating profit was \$4.8 million for the three month period ended June 30, 2008 compared with an operating profit of \$6.0 million during the prior-year quarter. Operating profit was higher in our French and U.S. segments, and lower in our Brazilian segment.

The French segment's operating profit was \$6.5 million for the three month period ended June 30, 2008, an increase of \$0.5 million from an operating profit of \$6.0 million for the prior-year quarter. The increase was primarily due to:

- Higher average selling prices, primarily due to an improved mix of products sold, of \$3.7 million.
- Increased sales volumes which improved operating profit by \$3.1 million.
- Reduced restructuring expenses of \$2.0 million.
- Decreased nonmanufacturing expenses of \$0.9 million.

The positive factors were mostly offset by:

- Inflationary cost increases of \$4.7 million, equally due to higher wood pulp prices and energy rates.
- Start-up costs of the rebuilt paper machine at PdM of \$3.9 million.

The U.S. segment's operating profit was \$3.9 million for the three month period ended June 30, 2008, a \$0.5 million increase from operating profit of \$3.4 million during the prior-year quarter. The increase was primarily due to:

- A favorable mix of products sold and sales volume changes combined to increase operating profit by \$4.0 million, primarily due to higher sales of cigarette paper for LIP cigarettes.
- Improved mill operations and benefits of cost savings programs.

The positive factors were mostly offset by:

- Unfavorable fixed costs absorption and inflationary cost increases of \$2.9 million and \$2.8 million, respectively.

Brazil's operating loss was \$4.4 million during the three month period ended June 30, 2008, compared with an operating loss of \$0.4 million during the prior-year quarter. The increased operating loss was primarily due to:

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- Impairment charges of \$1.9 million as a result of the decision to exit the coated papers business.
- The stronger Brazilian real versus the U.S. dollar, which had a \$1.9 million unfavorable impact.
- Inflationary cost increases of \$1.5 million

These negative factors were partially offset by benefits of cost savings programs.

Non-Operating Expenses

Interest expense of \$2.8 million for the three month period ended June 30, 2008 increased from \$1.5 million for the prior-year quarter. Average debt levels increased significantly during the three month period ended June 30, 2008 versus the prior-year quarter, the effects of which were partially offset by lower weighted average effective interest rates. The weighted average effective interest rates on our revolving debt facilities were approximately 3.9 percent and 5.6 percent for the three month periods ended June 30, 2008 and 2007, respectively.

Other income (expense), net was income of \$0.6 million for the three month period ended June 30, 2008 compared with expense of \$0.2 million for the prior-year quarter, primarily due to foreign currency transaction gains and losses.

Income Taxes

The provision for income taxes was zero for the three month period ended June 30, 2008 compared with an effective income tax rate of 27.9 percent for the prior-year quarter. The difference in effective tax rates was primarily due to the favorable tax impact of our foreign holding company structure and the geographic mix of taxable earnings.

Minority Interest

Minority interest decreased to zero for the three month period ended June 30, 2008 from \$2.1 million for the prior-year quarter. This decrease was due to our acquisition of the LTRI minority interest in January 2008.

Loss from Equity Affiliates

The loss from equity affiliates totaled \$0.6 million and zero during the three month periods ended June 30, 2008 and 2007, respectively, and represents our 50 percent share of the net loss associated with our joint venture in China. The cigarette paper machine began the start-up phase during the second quarter of 2008.

Table of Contents**Net Income and Net Income per Share**

Net income for the three month period ended June 30, 2008 was \$2.0 million, or \$0.13 per share, compared with \$1.0 million, or \$0.06 per share, during the prior-year quarter. Net income in 2008 was higher due to the benefit of the LTRI minority interest acquisition, partially offset by decreased operating profit and increased interest expense.

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

(dollars in millions)

| | | Six Months Ended | | | | Percent | Consolidated | |
|---------------|----------|------------------|----------|--------|--------|---------|--------------|--------|
| | June 30, | June 30, | June 30, | Change | Change | Change | | |
| | 2008 | 2007 | 2007 | | | | | |
| France | \$ | 250.0 | \$ | 203.0 | \$ | 47.0 | 23.2% | 12.5% |
| United States | | 113.2 | | 113.1 | | 0.1 | 0.1 | (20.0) |
| Brazil | | 38.2 | | 34.5 | | 3.7 | 10.7 | (0.2) |
| Subtotal | | 401.4 | | 350.6 | | 50.8 | | |
| Intersegment | | (9.6) | | (8.5) | | (1.1) | | |
| Total | \$ | 391.8 | \$ | 342.1 | \$ | 49.7 | 14.5% | 3.6% |

Net sales were \$391.8 million for the six month period ended June 30, 2008 compared with \$342.1 million for the prior-year period. The increase of \$49.7 million, or 14.5 percent, consisted of the following (dollars in millions):

| | Amount | Percent |
|---|---------|---------|
| Changes in currency exchange rates | \$ 26.5 | 7.7% |
| Changes in selling prices and product mix | 17.8 | 5.2 |
| Changes in sales volumes | 5.4 | 1.6 |
| Total | \$ 49.7 | 14.5% |

- Changes in currency exchange rates had a favorable impact on net sales of \$26.5 million, or 7.7 percent, for the six month period ended June 30, 2008 and primarily reflected the impact of a stronger euro and Brazilian real compared with the U.S. dollar. The euro was 15.5 percent and the Brazilian real was 20.6 percent stronger against the U.S. dollar.

- Higher average selling prices had a favorable \$17.8 million, or 5.2 percent, impact on the net sales comparison. The increase in average selling prices reflected an improved mix of products, primarily due to increased

sales of cigarette paper for LIP cigarettes in the United States and RTL products in France.

- Unit sales volumes increased by 3.6 percent for the six month period ended June 30, 2008 versus the prior-year period, resulting in a favorable effect on net sales of \$5.4 million, or 1.6 percent.
- Sales volumes for the French segment increased by 12.5 percent, primarily due to higher sales volumes of RTL products, partially offset by decreased sales of tobacco-related papers sales volumes.
- Brazil sales volumes were essentially unchanged compared with the prior year period.
- Sales volumes in the United States decreased by 20.0 percent, reflecting reduced sales of commercial and industrial products associated with the shutdown of the Lee Mills and reduced sales volumes of certain tobacco-related products.

The French segment net sales of \$250.0 million for the six month period ended June 30, 2008 increased by \$47.0 million, or 23.2 percent, versus \$203.0 million for the prior-year period. The increase in net sales was primarily the result of a stronger euro and higher sales volumes of RTL products.

The U.S. segment net sales of \$113.2 million for the six month period ended June 30, 2008 increased by \$0.1 million, compared with \$113.1 million for the prior-year period. The effect of higher average selling prices, primarily due to an improved mix of products sold, was essentially offset by lower sales volumes.

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The Brazil segment net sales of \$38.2 million for the six month period ended June 30, 2008 increased by \$3.7 million, or 10.7 percent, from \$34.5 million for the prior-year period. The increase was due to the stronger Brazilian real, higher sales volumes and higher average selling prices, that primarily resulted from an improved mix of products sold.

Gross Profit

(dollars in millions)

| | Six Months Ended | | Change | Percent Change | Percent of Net Sales | |
|-----------------------|------------------|---------------|-----------|----------------|----------------------|-------|
| | June 30, 2008 | June 30, 2007 | | | 2008 | 2007 |
| Net Sales | \$ 391.8 | \$ 342.1 | \$ 49.7 | 14.5% | | |
| Cost of products sold | 347.6 | 287.8 | 59.8 | 20.8 | 88.7% | 84.1% |
| Gross Profit | \$ 44.2 | \$ 54.3 | \$ (10.1) | (18.6)% | 11.3% | 15.9% |

Gross profit was \$44.2 million for the six month period ended June 30, 2008, a decrease of \$10.1 million, or 18.6 percent, from \$54.3 million for the prior-year period. The gross profit margin was 11.3 percent of net sales for the six month period ended June 30, 2008, decreasing from 15.9 percent for the prior-year period. Gross profit decreased due to inflationary cost increases of \$16.3 million, start-up costs of \$9.2 million related to the rebuild of PdM's paper machine, unfavorable foreign currency impacts of \$4.6 million and unfavorable fixed cost absorption of \$2.8 million, partially offset by higher average selling prices, primarily due to an improved mix of products sold, of \$12.7 million and increased sales volumes of \$5.9 million.

Inflationary cost increases, related to higher energy rates, per ton wood pulp prices, other purchased materials costs and labor rates combined to unfavorably impact operating results by \$16.3 million during the six month period ended June 30, 2008. Higher purchased energy costs unfavorably impacted operating results by \$8.3 million, primarily in France and the United States, during the six month period ended June 30, 2008. Changes in per ton wood pulp prices, primarily in France and Brazil, increased operating expenses by \$4.7 million compared with the prior-year period. The average per ton list price of northern bleached softwood kraft pulp in the United States was \$880 per metric ton during the six month period ended June 30, 2008 compared with \$800 per metric ton during the prior-year period.

During the first six months of 2008, the rebuilt paper machine at PdM initiated operations as part of the plan to restructure the PdM operation. The start-up is taking longer than originally expected due to operational issues and has negatively impacted 2008 operating profit by \$9.2 million.

Lower production volumes for tobacco-related papers and commercial and industrial products, primarily in the United States and France, was partially offset by increased production volumes in the French RTL operation.

Higher average selling prices, resulting primarily from an improved mix of products sold primarily in the United States and France, increased operating results by \$12.7 million for the six month period ended June 30, 2008 versus the prior-year period. Higher sales volumes, primarily in the French segment, increased operating results by \$5.9 million compared with the prior-year period.

Nonmanufacturing Expenses

(dollars in millions)

| | Six Months Ended | | Change | Percent Change | Percent of Net Sales | |
|---------------------------|------------------|---------------|--------|----------------|----------------------|------|
| | June 30, 2008 | June 30, 2007 | | | 2008 | 2007 |
| Selling expense | \$ 12.2 | \$ 11.0 | \$ 1.2 | 10.9% | 3.1% | 3.2% |
| Research expense | 4.5 | 4.0 | 0.5 | 12.5 | 1.2 | 1.2 |
| General expense | 17.0 | 18.1 | (1.1) | (6.1) | 4.3 | 5.3 |
| Nonmanufacturing expenses | \$ 33.7 | \$ 33.1 | \$ 0.6 | 1.8% | 8.6% | 9.7% |

Nonmanufacturing expenses increased by \$0.6 million, or 1.8 percent, to \$33.7 million from \$33.1 million for the prior-year period, primarily due to foreign currency translation, partially offset by lower accruals for incentive expenses during the second quarter of 2008.

Nonmanufacturing expenses were 8.6 percent and 9.7 percent of net sales for the six month periods ended June 30, 2008 and 2007, respectively.

Table of Contents**Restructuring Expense**

Total restructuring expense of \$5.7 million was recognized during the six month period ended June 30, 2008, including \$2.7 million for severance and other cash costs, \$2.1 million for asset impairment charges and \$0.9 million for accelerated depreciation. Total restructuring expense of \$6.1 million was recognized during the prior-year period, comprised of \$4.6 million for severance related costs and \$1.5 million for accelerated depreciation.

Operating Profit (Loss)

(dollars in millions)

| | Six Months Ended | | Change | Percent Change | Return on Net Sales | |
|----------------------|------------------|---------------|-----------|----------------|---------------------|-------|
| | June 30, 2008 | June 30, 2007 | | | 2008 | 2007 |
| France | \$ 5.6 | \$ 13.2 | \$ (7.6) | (57.6)% | 2.2% | 6.5% |
| United States | 9.3 | 7.9 | 1.4 | 17.7 | 8.2 | 7.0 |
| Brazil | (6.1) | (0.2) | (5.9) | N.M. | (16.0) | (0.6) |
| Subtotal | 8.8 | 20.9 | (12.1) | | | |
| Unallocated expenses | (4.0) | (5.8) | 1.8 | | | |
| Total | \$ 4.8 | \$ 15.1 | \$ (10.3) | (68.2)% | 1.2% | 4.4% |

N.M. Not meaningful

Operating profit was \$4.8 million for the six month period ended June 30, 2008 compared with an operating profit of \$15.1 million during the prior-year period. Operating profit was lower in our French and Brazilian segments and higher in our U.S. segment.

The French segment's operating profit was \$5.6 million for the six month period ended June 30, 2008, a decrease of \$7.6 million from an operating profit of \$13.2 million for the prior-year period. The decrease was primarily due to:

- Inflationary cost increases of \$9.8 million, mainly due to increased energy rates of \$4.5 million and higher wood pulp prices of \$2.9 million.
- Start-up costs of the paper machine rebuild at PdM of \$9.2 million.

The negative factors were partially offset by:

- Increased sales volumes, primarily in RTL products, which improved operating results by \$5.9 million.

Gross Profit

- Higher average selling prices, primarily due to an improved mix of products sold, of \$4.0 million.
- Reduced restructuring expenses of \$2.8 million.

The U.S. segment's operating profit was \$9.3 million for the six month period ended June 30, 2008, a \$1.4 million increase from an operating profit of \$7.9 million during the prior-year period. The increase was primarily due to:

- Higher average selling prices, primarily due to increased sales of cigarette paper for LIP cigarettes and lower sales of commercial and industrial papers, of \$7.8 million
- The benefits of costs savings programs.

These positive factors were partially offset by:

- Unfavorable fixed cost absorption of \$4.3 million as a result of reduced machine production schedules.
- Inflationary cost increases of \$3.9 million, mainly due to higher energy rates of \$3.0 million.

Brazil's operating loss was \$6.1 million during the six month period ended June 30, 2008, compared with an operating loss of \$0.2 million during the prior-year period. The increased operating loss was primarily due to:

- The stronger Brazilian real versus the U.S. dollar, which had a \$4.0 million unfavorable impact.
- Inflationary cost increases of \$2.6 million, mainly due to increased wood pulp prices and higher energy rates.
- Asset impairment charges of \$1.9 million recorded in the second quarter of 2008 due to our exit of the coated papers business.

These negative factors were partially offset by the benefits of cost savings programs.

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Non-Operating Expenses

Interest expense of \$5.2 million for the six month period ended June 30, 2008 increased from \$2.8 million for the prior-year period. Average debt levels increased significantly during the six month period ended June 30, 2008 versus the prior-year period, which was partially offset by lower weighted average effective interest rates. The weighted average effective interest rates on our revolving debt facilities were approximately 4.0 percent and 5.6 percent for the six month periods ended June 30, 2008 and 2007, respectively.

Other expense, net was \$1.0 million versus \$0.1 million for the six month periods ended June 30, 2008 and 2007, respectively, primarily due to foreign currency transaction losses.

Income Taxes

The provision for income taxes for the six month period ended June 30, 2008 reflected a negative effective income tax rate compared with 25.4 percent for the prior-year period. The difference in effective tax rates was primarily due to the loss in 2008 versus income in 2007 combined with the favorable tax impact of our foreign holding company structure and the geographic mix of taxable earnings.

Minority Interest

Minority interest decreased to \$0.2 million for the six month period ended June 30, 2008 from \$3.8 million for the prior-year period. This \$3.6 million decrease was due to our acquisition of the LTRI minority interest in January 2008.

Loss from Equity Affiliates

The loss from equity affiliates totaled \$0.2 million compared with \$0.1 million during the six month periods ended June 30, 2008 and 2007, respectively, and represents our 50 percent share of the net loss associated with our joint venture in China.

Net Income and Net Income per Share

Net income for the six month period ended June 30, 2008 was \$0.8 million, or \$0.05 per share, compared with \$5.2 million, or \$0.33 per share, during the prior-year period. The decrease in net income in 2008 was primarily due to decreased operating profit and increased interest expense, partially offset by the benefit of the LTRI minority interest acquisition.

Liquidity and Capital Resources

A major factor in our liquidity and capital resource planning is our generation of cash flow from operations, which is sensitive to changes in the sales mix, volume and pricing of our products, as well as changes in our production volumes, costs and working capital. Our liquidity is supplemented by funds available under our revolving credit facility with a consortium of banks that is used as either operating conditions or strategic opportunities warrant. As previously noted, we completed the acquisition of the 28 percent minority share in LTRI in January 2008 at a cost of \$51.3 million and have been engaged in substantial restructuring activities over the past 2.5 years in the United States, Brazil and France. Each of these activities is expected to contribute to improved earnings and a more competitive production base over the longer-term. However, in order to implement these initiatives, we incurred higher levels of debt than we traditionally have carried, while at the same time we experienced less favorable earnings from operations undergoing restructuring activities.

Cash Requirements

As of June 30, 2008, we had net operating working capital of \$51.2 million and cash and cash equivalents of \$9.4 million, compared with net operating working capital of \$41.6 million and cash and cash equivalents of \$4.0 million as of December 31, 2007. Changes in these absolute amounts include the impacts of changes in currency exchange rates which are not included in the changes in operating working capital presented on the consolidated statements of cash flow. Given the increase in our level of debt combined with increased operating cash needs during the first half of 2008, we are conserving cash and prioritizing any further borrowing.

Table of Contents*Cash Flows from Operating Activities*

(dollars in millions)

| | Six Months Ended | |
|---|------------------|------------------|
| | June 30, 2008 | June 30, 2007 |
| Net income | \$ 0.8 | \$ 5.2 |
| Non-cash items included in net income: | | |
| Depreciation and amortization | 23.8 | 19.4 |
| Restructuring related impairment charges and accelerated depreciation | 3.0 | 1.5 |
| Amortization of deferred revenue | (3.1) | (3.2) |
| Deferred income tax benefit | (11.8) | (4.0) |
| Minority interest in earnings of subsidiaries | 0.2 | 3.8 |
| Pension and other postretirement benefits | 0.7 | (2.1) |
| Other items | 0.8 | 2.4 |
| Net changes in operating working capital | (2.1) | (1.1) |
| Cash Provided by Operations | \$ 12.3 | \$ 21.9 |

Net cash provided by operations was \$12.3 million for the six month period ended June 30, 2008 compared with \$21.9 million for the prior-year period. Our net cash provided by operations changed unfavorably by \$9.6 million in 2008, primarily due to lower net income of \$4.4 million and higher deferred income tax benefits of \$7.8 million, partially offset by decreased minority interest of \$3.6 million.

Prior to 2002, our cash provided by operations included advanced payments from customers for future product purchases. We recorded these advance payments as deferred revenue, which is now being amortized into net sales as earned and credited to customers based upon a mutually agreed-upon amount per unit of product sales. We had \$21.0 million of deferred revenue on our June 30, 2008 consolidated balance sheet. At the current volume levels, we expect to fully amortize this amount by recognizing amortization of approximately \$6 million per year through 2011.

Operating Working Capital

(dollars in millions)

| | Six Months Ended | |
|--|------------------|------------------|
| | June 30, 2008 | June 30, 2007 |
| Changes in operating working capital | | |
| Accounts receivable | \$ (0.6) | \$ (3.9) |
| Inventories | 9.2 | (5.8) |
| Prepaid expenses | (1.1) | 0.6 |
| Accounts payable | 6.6 | 1.6 |
| Accrued expenses | (8.8) | 1.2 |
| Accrued income taxes | (7.4) | 5.2 |
| Net changes in operating working capital | \$ (2.1) | \$ (1.1) |

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During the six month period ended June 30, 2008, net changes in operating working capital contributed unfavorably to cash flow by \$2.1 million, primarily due to decreased accrued expenses and accrued income taxes, mostly offset by increased accounts payable and lower inventories due to sales of inventories built up in advance of the Lee Mills shutdown.

During the prior-year period, changes in operating working capital contributed unfavorably to cash flow by \$1.1 million, primarily due to an increase in inventories and accounts receivable, partially offset by an increase in accrued income taxes. Inventories increased from a planned inventory build-up in preparation for machine shut downs associated with capital improvements at PdM. Increased accounts receivable was mainly due to higher net sales in 2007 versus the prior-year period. The increase in accrued income taxes was mainly a result of increased LTRI earnings.

Table of Contents*Cash Flows from Investing Activities*

(dollars in millions)

| | Six Months Ended | |
|------------------------------------|------------------|------------------|
| | June 30, 2008 | June 30, 2007 |
| Capital spending | \$ (24.0) | \$ (18.3) |
| Capitalized software costs | (2.2) | (4.5) |
| LTRI minority interest acquisition | (51.3) | |
| Investment in equity affiliates | (1.9) | (6.5) |
| Other | (3.7) | (1.0) |
| Cash Used for Investing | \$ (83.1) | \$ (30.3) |

Cash used for investing activities was \$83.1 million for the six month period ended June 30, 2008 versus \$30.3 million during the prior-year period. This \$52.8 million increase in cash used for investing was primarily due to the \$51.3 million acquisition of the LTRI minority interest and increased capital spending. We made our final contractual equity contribution in January 2008 of \$1.9 million to the China paper joint venture. Changes in the category Other, or other cash investment items, primarily consisted of changes in noncurrent assets and liabilities.

Capital Spending and Capitalized Software Costs

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

2008 capital spending included \$11.0 million incurred at PdM for the paper machine rebuild and improvements to the bobbin slitting process, \$1.3 million for steam network improvements at Papeteries de Saint-Girons S.A.S. and \$1.2 million for a new slitting machine in the Philippines. 2007 capital spending included \$3.4 million toward a paper machine rebuild in Brazil, \$2.8 million for the purchase of our production facility in Newberry, South Carolina and \$2.5 million toward the paper machine rebuild and

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

improvements to the bobbin slitting process at PdM.

We incur spending necessary to meet legal requirements and otherwise relating to the protection of the environment at our facilities in the United States, France, the Philippines, Indonesia, Brazil and Canada. For these purposes, we expect to incur capital expenditures of approximately \$1 million in each of the full-years 2008 and 2009, of which no material amount is the result of environmental fines or settlements. The foregoing capital expenditures are not expected to reduce our ability to invest in other appropriate and necessary capital projects and are not expected to have a material adverse effect on our financial condition or results of operations.

Total capital spending for 2008 is expected to be in the range of \$30 million to \$35 million.

Capitalized software costs decreased to \$2.2 million from \$4.5 million during the prior-year period, primarily due to decreased spending on an enterprise-wide information system in France following a January 2008 partial start-up. A total of \$2.2 million was spent on this project during the six month period ended June 30, 2008 and \$13.9 million since the inception of the project in 2005.

Cash Flows from Financing Activities

(dollars in millions)

| | Six Months Ended | |
|---|------------------|------------------|
| | June 30, 2008 | June 30, 2007 |
| Cash dividends paid to SWM stockholders | \$ (4.7) | \$ (4.7) |
| Net changes in debt | 82.1 | 2.8 |
| Purchases of treasury stock | (1.2) | (0.1) |
| Proceeds from exercise of stock options | 0.1 | 4.4 |
| Excess tax benefits of stock-based awards | | 0.3 |
| Cash Provided by Financing | \$ 76.3 | \$ 2.7 |

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Financing activities during the six month period ended June 30, 2008 included borrowings of \$103.0 million and repayments of debt totaling \$20.9 million for a net borrowing increase of \$82.1 million. Other 2008 financing activities included cash dividends paid to SWM stockholders as well as purchases of treasury stock early in 2008.

Financing activities during the six month period ended June 30, 2007 included borrowings of \$15.4 million and repayments of debt totaling \$12.6 million for a net increase in debt of \$2.8 million. Other 2007 financing activities included proceeds from stock option exercises for which we issued 204,807 common shares from treasury stock.

Dividend Payments

We have declared and paid quarterly dividends of \$0.15 per share since the second quarter of 1996. The Board of Directors declared a quarterly cash dividend of \$0.15 per share of common stock. The dividend will be payable on September 15, 2008 to stockholders of record on August 18, 2008. We currently expect to continue this level of dividend. However, the decision to declare a dividend is made quarter by quarter and based upon a number of factors including, but not limited to, earnings, funding of strategic opportunities and our financial condition. A decision could be made to cancel, suspend, modify or change the form of future dividend payments.

Share Repurchases

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

Debt Instruments and Related Covenants

(dollars in millions)

| | Six Months Ended | |
|---|------------------|------------------|
| | June 30, 2008 | June 30, 2007 |
| Changes in short-term debt | \$ 2.9 | \$ 2.4 |
| Proceeds from issuances of long-term debt | 100.1 | 13.0 |
| Payments on long-term debt | (20.9) | (12.6) |
| Net proceeds from borrowings | \$ 82.1 | \$ 2.8 |

Primarily due to the LTRI minority interest acquisition, initial start-up costs for restructuring related activities, reduced cash generated from operations and higher capital spending, our net proceeds from long-term debt were \$79.2 million and from short-term debt were \$2.9 million during the six month period ended June 30, 2008. We anticipate borrowing approximately \$10 million during the remainder of 2008. With this level of borrowing, we expect to remain in compliance with our Credit Agreement financial covenants for the remainder of 2008.

Borrowing on our revolving credit facilities reduced the availability under our U.S. Revolver to \$3.0 million as of June 30, 2008 from \$26.0 million as of December 31, 2007. Availability under our Euro Revolver decreased to 39.0 million euros as of June 30, 2008 from 80.0 million euros as of December 31, 2007. We also had availability under our bank overdraft facilities and lines of credit of \$33.3 million as of June 30, 2008. The Credit Agreement contains covenants that are customary for facilities of this type that, among other things, require the Company to maintain (a) a net debt to equity ratio not to exceed 1.0 and (b) a net debt to adjusted EBITDA ratio not to exceed 3.0. As of June 30, 2008, the net debt to equity ratio was 0.50, and the net debt to adjusted EBITDA ratio was 2.32.

Our total debt to capital ratios at June 30, 2008 and December 31, 2007 were 34.4 percent and 21.5 percent, respectively, most recently at the upper end of our target range of 25 to 35 percent.

Other Factors Affecting Liquidity and Capital Resources

Postretirement Benefits. The pension obligations are funded by our separate pension trusts, which held \$126.1 million in assets at December 31, 2007. The combined postretirement benefit obligation of our U.S. and French pension plans was underfunded by \$27.1 million as of December 31, 2007. We made \$0.7 million in pension contributions to our pension plans during the six month period ended June 30, 2008 and expect to contribute a total of \$3 to \$6 million during the full-year of 2008 to our pension plans to improve the funded status of these plans and ensure compliance with the Pension Protection Act of 2006 in the United States.

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

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

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

Employee Labor Agreements. Hourly employees at the Lee, Massachusetts, Spotswood, New Jersey and Ancram, New York mills are represented by locals of the United Steel Workers Union. The collective bargaining agreement at our Spotswood mill is a 3-year agreement through July 2010. The collective bargaining agreement at our Ancram mill is a 4-year agreement effective through September 2008. The Lee Mills collective bargaining agreement will continue through completion of the plant shutdown during 2008. With 3 of its 4 mills closed, the Lee Mills is operating pursuant to an extension of the May 2006 agreement.

Hourly employees at our Quimperlé, Malaucène, Saint-Girons and Spay, France mills are union represented. Collective bargaining agreements at both our Quimperlé and Malaucène mills expired December 31, 2007. A new agreement was signed at the Quimperlé mill beginning January 1, 2008 with a 1-year term. A new agreement was signed at our Spay mill effective March 1, 2008 with a 1-year term. The collective bargaining agreement at Saint-Girons expired June 30, 2008. Negotiations with the unions began in February 2008 and are continuing for Malaucène and began in May 2008 for Saint-Girons.

Outlook

As expected, we improved our financial performance during the second quarter of 2008 relative to the first quarter of 2008 in terms of net income, cash generation and debt levels. Continuing growth in sales of RTL products in France, especially given full ownership of this business as of earlier this year, and cigarette paper for LIP cigarettes in the United States are expected to continue to benefit earnings in 2008 and beyond. However, significant improvement in our traditional tobacco papers business is less certain. We face continuing challenges for earnings growth in the second half of 2008, primarily as a result of inflationary cost increases, unfavorable foreign currency impacts, ongoing implementation of customer pricing actions, restructuring activities underway across the company and the start-up of our new joint venture paper mill in China.

During the first half of 2008, benefits from cost reduction initiatives did not offset inflation, primarily due to increased purchased energy costs. During the last 6 months, inflationary cost increases totaled \$16.3 million, well above the impact seen in the preceding 12 months. The continuing rise in crude oil prices, and the resulting eventual impact on our electricity, natural gas, fuel oil and specialty chemical costs, will continue to negatively impact our results for the balance of 2008.

Despite the difficult machine start-up experienced during the first half of 2008 in France, the overall restructuring activities are progressing and have been expanded with the recent announcement to exit the coated papers business in Brazil. Although the restart of the paper machine at PdM negatively impacted our 2008 results, the impact lessened during the second quarter. The PdM paper machine performance continues to improve, but will further negatively impact results throughout 2008. Progress continues to be made in both France and the United States in the transfer of base tipping paper production to Brazil. We substantially completed the shutdown of the Lee Mills in May 2008. Despite progress in implementing all of the significant restructuring actions undertaken to-date, full realization of the range of earnings improvement from the restructuring actions is now less certain given other factors impacting our business, including prospects for continuing inflationary cost increases and a weak U.S. dollar.

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Given the accelerated rate of inflationary cost increases and unfavorable currency impacts, we are further evaluating actions to curtail operation of certain of our paper machines and are engaging our customers in price negotiations. Decisions regarding any further restructuring actions will likely be forthcoming during the second half of 2008. Despite further restructuring actions, the continued operating losses in our paper operations in France and Brazil increase the possibility of additional asset impairment charges. The restructuring and other actions we have taken are expected to return those operations to profitability. In the coming quarters, we will assess the improvements in profitability as a result of those actions, and we will continue to evaluate the recoverability of the property, plant and equipment, deferred tax assets and other assets of those businesses.

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

Based upon the states that have passed LIP regulation, demand for this product is expected to grow from the current level of approximately 32 percent of North American cigarette consumption to approximately 80 percent by early 2010. Additionally, jurisdictions representing essentially all of North American consumption have either passed or proposed LIP legislation and several cigarette producers have announced voluntary national distribution of this technology, supporting the likelihood that LIP cigarettes will be sold nationwide across the United States by late 2009 or early 2010. As a result, we expect to realize continued growth in demand for cigarette paper used in LIP cigarettes, which would continue to benefit our U.S. business unit's results. International LIP efforts are accelerating, especially in the EU. Continued EU rule-making activities indicate that it is increasingly likely LIP cigarette regulations outside North America will become effective by 2011 and increase demand for cigarette paper used in these LIP cigarettes. This is a positive development for us given the current level of commercial acceptance of our Alginex banded papers and our ability to provide 1 or more commercially proven alternative solutions to cigarette manufacturers in addressing LIP requirements. We continue to expand our U.S. capacity for cigarette paper processing for LIP cigarettes and are undertaking capacity planning activities for this technology in Europe.

Growth in earnings in 2008 is still expected to come from the acquisition of the LTRI minority interest, increased sales volumes for RTL products and cigarette paper for LIP cigarettes and from the benefits of the announced restructuring activities. The challenges to earnings growth in 2008 will continue to be inflationary cost increases, particularly energy, initial losses associated with the start-up of our rebuilt paper machine in France, as well as start-up expenses to be incurred by our 50 percent tobacco-related joint venture in China, likely further unfavorable foreign currency impacts and the ongoing decline in demand for our traditional paper products. We now anticipate that quarterly earnings during the second half of 2008, excluding restructuring expenses, will be approximately at the same level as during the second quarter of 2008. Further, we expect cash generation, working capital, capital spending and other cash uses to remain relatively stable throughout the balance of 2008 and therefore anticipate additional borrowings of approximately \$10 million.

Forward-Looking Statements

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

- We have manufacturing facilities in 6 countries and sell products in over 90 countries. As a result, we are subject to a variety of import and export, tax, foreign currency, labor and other regulations within these countries. Changes in these regulations, or adverse interpretations or applications, as well as changes in currency exchange rates, could adversely impact our business in a variety of ways, including increasing expenses, decreasing sales, limiting our ability to repatriate funds and generally limiting our ability to conduct business.

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- Our financial performance is dependent upon the cost of raw materials, particularly wood pulp, purchased energy, chemicals and labor. Recently, the cost of some of these items has increased significantly, and the nature of our agreements with our customers may make it difficult to pass changes in these costs on to our customers in a timely and effective manner.
- Our sales are concentrated to a limited number of customers. In 2007, 41 percent of our sales were to our 2 largest customers. The loss of 1 or both such customers, or a significant reduction in 1 or both of these customers purchases, could have a material adverse effect on our results of operations.
- Our financial performance is materially impacted by sales of both RTL products and cigarette paper for LIP cigarettes. A significant change in the sales or production volumes, pricing or manufacturing costs of these products could have a material impact on future financial results.
- As a result of excess capacity in the tobacco-related papers industry and increased purchased material and operating costs experienced in the last several years, competitive levels of selling prices for certain of our products are not sufficient to cover those costs with a margin that we consider reasonable. Such competitive pressures have resulted in downtime of certain paper machines and, in some cases, accelerated depreciation or impairment charges for certain equipment and employee severance expenses associated with downsizing activities. Management continues to evaluate how to operate our production facilities more effectively with reduced production volumes and additional restructuring activities are possible for the second half of 2008. Management also continues to evaluate the recoverability of the property, plant and equipment, deferred tax assets and other assets of the businesses.
- Our Credit Agreement contains certain financial covenants including, but not limited to, a net debt to adjusted EBITDA ratio. While we currently project that we will not fail to comply with any of these covenants, changes from the expected results of operations, higher than expected capital spending, an unanticipated need for additional borrowing or other factors could cause us to violate 1 or more of the covenants in our Credit Agreement. In the event we breach the net debt to adjusted EBITDA covenant, we believe that we could obtain a temporary waiver of that covenant, obtain an amendment of our Credit Agreement or access the markets for additional capital. However, there is no assurance that the required bank consents could be obtained for a temporary waiver or an amendment, that a temporary waiver or amendment of our credit facilities would be adequate to fully resolve the condition giving rise to the default or that we could successfully access the markets for additional capital.
- In recent years, governmental and quasi-governmental entities around the world, particularly in the United States and western Europe, have taken or have proposed actions that may have the effect of reducing consumption of tobacco products. Reports with respect to the possible harmful physical effects of cigarette smoking and use of tobacco products have been publicized for many years and, together with actions to restrict or prohibit advertising and promotion of cigarettes or other tobacco products, to limit smoking in public places and to increase taxes on such

products, are intended to discourage the consumption of cigarettes and other such products. Also in recent years, certain governmental entities, particularly in North America and Europe, have enacted, considered or proposed actions that would require cigarettes to meet specifications aimed at reducing their likelihood of igniting fires when the cigarettes are not actively being smoked. Furthermore, it is not possible to predict what additional legislation or regulations relating to tobacco products will be enacted, or to what extent, if any, such legislation or regulations might affect our business.

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

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

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

Table of Contents**PART II****ITEM 1. LEGAL PROCEEDINGS**

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

ITEM 1A. RISK FACTORS

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

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

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

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

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

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

None

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

(a) Exhibits:

| | |
|-------|--|
| 10.24 | Schweitzer-Mauduit International, Inc. Annual Incentive Plan, Amended and Restated, effective January 1, 2009. |
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| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.* |

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

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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.

Schweitzer-Mauduit International, Inc.
(Registrant)

By: /s/ PETER J. THOMPSON
Peter J. Thompson
Chief Financial Officer and
Treasurer
(duly authorized officer and
principal financial officer)

August 6, 2008

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

August 6, 2008

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GLOSSARY OF TERMS

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

- *Banded cigarette paper* is a type of paper, used to produce lower ignition propensity cigarettes, by applying bands to the paper during the papermaking process.
- *Binder* is used to hold the tobacco leaves in a cylindrical shape during the production process of cigars.
- *Cigarette paper* wraps the column of tobacco within a cigarette and has varying properties such as basis weight, porosity, opacity, tensile strength, texture and burn rate.
- *Commercial and industrial products* include lightweight printing and writing papers, coated papers for packaging and labeling applications, business forms, battery separator paper, drinking straw wrap and other specialized papers.
- *Flax* is a cellulose fiber from a flax plant used as a raw material in the production of certain cigarette papers.
- *Lower ignition propensity cigarette paper* includes banded and print banded cigarette paper, both of which contain bands, which increase the likelihood that an unattended cigarette will self-extinguish.
- *Net debt to adjusted EBITDA ratio* is a financial measurement used in bank covenants where *Net Debt* is defined as the current portion of long term debt plus other short term debt plus long term debt less cash and cash equivalents, and
- *Adjusted EBITDA* is defined as net income excluding extraordinary or 1-time items, minority interest in earnings, loss from equity of affiliates, interest expense, income taxes and depreciation and amortization less amortization of deferred revenue.

- *Net debt to capital ratio* is current and long term debt less cash and cash equivalents, divided by the sum of current debt, long term debt, minority interest and total stockholders' equity.
- *Net debt to equity ratio* is current and long term debt less cash and cash equivalents, divided by minority interest and total stockholders' equity.
- *Net operating working capital* is accounts receivable, inventory, current income tax refunds receivable and prepaid expense and other current assets excluding cash, less accounts payable, accrued liabilities, accrued income taxes payable and other current liabilities excluding debt.
- *Opacity* is a measure of the extent to which light is allowed to pass through a given material.
- *Operating profit return on assets* is operating profit divided by average total assets.
- *Plug wrap paper* wraps the outer layer of a cigarette filter and is used to hold the filter materials in a cylindrical form.
- *Print banded cigarette paper* is a type of paper, used to produce lower ignition propensity cigarettes, with bands added to the paper during a printing process, subsequent to the papermaking process.
- *Reconstituted tobacco* is produced in 2 forms: leaf, or reconstituted tobacco leaf, and wrapper and binder products. Reconstituted tobacco leaf is blended with virgin tobacco as a design aid to achieve certain attributes of finished cigarettes. Wrapper and binder are reconstituted tobacco products used by manufacturers of cigars.
- *Restructuring expense* represents expenses incurred in connection with unusual or infrequently occurring activities intended to significantly change the size or nature of the business operations, including significantly reduced utilization of operating equipment, exit of a product or market or a significant workforce reduction.
- *Start-up costs* are costs incurred prior to generation of income producing activities in the case of a new plant, or costs incurred in excess of expected ongoing normal costs in the case of a new or rebuilt machine. Start-up costs can include excess variable costs such as raw materials, utilities and labor and unabsorbed fixed costs.

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

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

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SCHWEITZER-MAUDUIT INTERNATIONAL, INC.

Quarterly Report on Form 10-Q

for the Quarterly Period Ended June 30, 2008

INDEX TO EXHIBITS

| Exhibit Number | Description |
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