SCHWEITZER MAUDUIT INTERNATIONAL INC
Form 10-Q
August 06, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
	For the quarterly period ended June 30, 2014
OR	
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
	For the transition period from __________________to __________________

1-13948
(Commission file number)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

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

The Company had 30,461,362 shares of common stock issued and outstanding as of August 1, 2014.

SCHWEITZER-MAUDUIT INTERNATIONAL, INC.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(dollars in millions, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net Sales	$203.6	$196.5	$408.3	$391.0
Cost of products sold	144.4	131.6	291.5	263.4
Gross Profit	59.2	64.9	116.8	127.6
Selling expense	5.5	5.5	11.0	10.5
Research expense	4.2	3.7	8.3	7.5
General expense	15.8	12.9	30.6	23.5
Total nonmanufacturing expenses	25.5	22.1	49.9	41.5
Restructuring and impairment expense	3.2	0.7	3.3	2.3
Operating Profit	30.5	42.1	63.6	83.8
Interest expense	2.1	0.7	3.6	1.4
Other income, net	2.8	1.2	3.6	2.5
Income from Continuing Operations before Income Taxes and Income from Equity Affiliates	31.2	42.6	63.6	84.9
Provision for income taxes	6.5	13.8	16.3	26.2
Income from equity affiliates, net of income taxes	0.3	0.6	0.9	1.4
Income from Continuing Operations	25.0	29.4	48.2	60.1
Loss from Discontinued Operations	—	(2.8)	—	(3.4)
Net Income	$25.0	$26.6	$48.2	$56.7
Net Income (Loss) per Share - Basic:				
Income per share from continuing operations	$0.82	$0.94	$1.57	$1.92
Loss per share from discontinued operations	—	(0.09)	—	(0.11)
Net income per share – basic	$0.82	$0.85	$1.57	$1.81
Net Income (Loss) per Share – Diluted:				
Income per share from continuing operations	$0.81	$0.93	$1.56	$1.91
Loss per share from discontinued operations	—	(0.09)	—	(0.11)
Net income per share – diluted	$0.81	$0.84	$1.56	$1.80
Weighted Average Shares Outstanding:				
Basic	30,096,500	31,097,300	30,379,700	31,021,900
Diluted	30,210,700	31,259,500	30,492,900	31,184,600

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

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SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(dollars in millions)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net Income	$25.0	$26.6	$48.2	$56.7
Other Comprehensive Income (Loss), net of tax:				
Foreign currency translation adjustments	(0.7)	(4.8)	(2.4)	(16.0)
Less: Reclassification adjustment for realized translation adjustments	—	(1.1)	—	(1.1)
Unrealized gains (losses) on derivative instruments	2.2	(6.1)	5.1	(4.7)
Less: Reclassification adjustment for (gains) losses on derivative instruments included in net income	0.8	(0.2)	2.2	(0.5)
Less: Amortization of postretirement benefit plans' costs included in net periodic benefit cost	0.8	1.0	1.6	2.1
Other Comprehensive Income (Loss)	3.1	(11.2)	6.5	(20.2)
Comprehensive Income	$28.1	$15.4	$54.7	$36.5

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

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

	June 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	$291.4	$272.0
Accounts receivable, net	124.2	107.6
Inventories	130.4	132.8
Income taxes receivable	14.6	9.9
Current deferred income tax benefits	8.9	10.1
Other current assets	5.7	4.7
Total Current Assets	575.2	537.1
Property, Plant and Equipment, net	389.7	393.2
Deferred Income Tax Benefits	—	—
Investment in Equity Affiliates	66.8	63.1
Goodwill	121.0	121.1
Intangible Assets	79.2	80.7
Other Assets	32.0	31.6
Total Assets	$1,263.9	$1,226.8
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Current debt	$4.2	$4.2
Accounts payable	50.0	49.4
Accrued expenses	81.4	92.7
Total Current Liabilities	135.6	146.3
Long-Term Debt	444.9	381.2
Pension and Other Postretirement Benefits	28.9	28.7
Deferred Income Tax Liabilities	83.1	80.9
Other Liabilities	26.3	28.3
Total Liabilities	718.8	665.4
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; 30,460,933 and 31,423,427 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	3.0	3.1
Additional paid-in-capital	46.9	43.3
Retained earnings	493.7	520.0
Accumulated other comprehensive loss, net of tax	1.5	(5.0)
Total Stockholders' Equity	545.1	561.4
Total Liabilities and Stockholders' Equity	$1,263.9	$1,226.8

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

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SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(dollars in millions, except per share amounts)
(Unaudited)

	Common Stock Issued			Treasury Stock				
	Shares	Amount	Additional Paid-In Capital	Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2012	31,209,866	$3.1	$ 41.0	8,760	$ (0.3)	$ 483.4	$ (15.4)	$ 511.8
Net income						56.7		56.7
Other comprehensive loss, net of tax							(20.2)	(20.2)
Dividends declared ($0.60 per share)						(18.8)		(18.8)
Restricted stock issuances, net	208,061		(0.2)	(5,000)	0.2			—
Stock-based employee compensation expense			0.8					0.8
Excess tax benefits of stock-based employee compensation			0.5					0.5
Stock issued to directors as compensation	771		0.1					0.1
Issuance of shares for options exercised	21,000		0.3					0.3
Share cancellation	(47,218)		(1.8)	(47,218)	1.8			—
Purchases of common stock				43,458	(1.7)			(1.7)
Balance, June 30, 2013	31,392,480	$3.1	$ 40.7	—	$ —	$ 521.3	$ (35.6)	$ 529.5
Balance, December 31, 2013	31,423,427	$3.1	$ 43.3	—	$ —	$ 520.0	$ (5.0)	$ 561.4
Net income						48.2		48.2
Other comprehensive income, net of tax							6.5	6.5
Dividends declared ($0.72 per share)						(22.0)		(22.0)
Restricted stock issuances, net	198,180	—	—	—	—			—
Stock-based employee compensation expense			3.0					3.0
Excess tax benefits of stock-based employee compensation			0.6					0.6
Stock issued to directors as compensation	1,138	—	—					—

Purchases and retirement of common stock	(1,161,812)	(0.1)	—	—	—	(52.5)		(52.6)
Balance, June 30, 2014	30,460,933	$3.0	$ 46.9	—	$ —	$ 493.7	$ 1.5	$545.1

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

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

	Six Months Ended June 30, 2014	June 30, 2013
Operations		
Net income	$48.2	$56.7
Less: Loss from discontinued operations	—	(3.4)
Income from continuing operations	48.2	60.1
Non-cash items included in net income:		
Depreciation and amortization	23.6	18.1
Deferred income tax provision	2.9	7.7
Pension and other postretirement benefits	2.1	2.4
Stock-based compensation	3.0	0.8
Income from equity affiliates	(0.9)	(1.4)
Excess tax benefits of stock-based awards	(0.6)	(0.5)
Cash dividends received from equity affiliates	4.4	3.6
Other items	(2.1)	1.1
Changes in operating working capital:		
Accounts receivable	(16.5)	(5.1)
Inventories	(0.9)	(4.3)
Prepaid expenses	(0.9)	(0.5)
Accounts payable	3.8	0.7
Accrued expenses	(5.6)	2.1
Accrued income taxes	(4.0)	(4.1)
Net changes in operating working capital	(24.1)	(11.2)
Net cash provided by operating activities of:		
- Continuing operations	56.5	80.7
- Discontinued operations	0.9	1.1
Cash Provided by Operations	57.4	81.8
Investing		
Capital spending	(15.1)	(9.2)
Capitalized software costs	(0.2)	(0.1)
Acquisitions, net of cash acquired	(2.4)	—
Investment in equity affiliates	(8.8)	—
Other investing	(1.5)	(0.6)
Cash Used for Investing	(28.0)	(9.9)
Financing		
Cash dividends paid to SWM stockholders	(22.0)	(18.8)
Changes in short-term debt	0.2	(0.7)
Proceeds from issuances of long-term debt	210.0	31.4
Payments on long-term debt	(146.2)	(21.3)
Purchases of common stock	(52.6)	(1.7)
Proceeds from exercise of stock options	—	0.3
Excess tax benefits of stock-based awards	0.6	0.5
Cash Used in Financing	(10.0)	(10.3)
Effect of exchange rate changes on cash and cash equivalents	—	(0.1)
Increase in cash and cash equivalents	19.4	61.5

Cash and cash equivalents at beginning of period	272.0	151.2
Cash and cash equivalents at end of period	$291.4	$212.7

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

Note 1. General

Nature of Business

Schweitzer-Mauduit International, Inc., or SWM or the Company, is a multinational diversified producer of premium specialty papers and filtration media headquartered in the United States of America. The Company manufactures and sells paper and reconstituted tobacco products to the tobacco industry as well as specialized paper and filtration products for use in other industry applications. We manufacture lightweight specialty papers used in manufacturing ventilated cigarettes, banded papers used in the production of lower ignition propensity, or LIP, cigarettes and resin-based plastic netting through an extrusion process, as well as certain meltblown products and machined plastic core tubes. We are also the leading independent producer of reconstituted tobacco used in producing blended cigarettes.

The primary products we sell to the tobacco industry include cigarette, plug wrap and base tipping papers, or Cigarette Papers, which are used to wrap various parts of a cigarette and reconstituted tobacco leaf, or RTL, which is used as a blend with virgin tobacco in cigarettes, reconstituted tobacco wrappers and binders for cigars. We sell these products directly to tobacco companies or their designated converters in the Americas, Europe, Asia and elsewhere. We also sell a diverse mix of products to non-tobacco industries, including low volume, high-value engineered papers and commodity paper grades produced, among other reasons, to maximize our machine utilization. In December 2013, we acquired DelStar, Inc., or DelStar, a manufacturer of plastic netting and other resin-based products mainly focused on the filtration and medical market segments. The acquisition of DelStar diversifies SWM's global presence in advanced materials, particularly in filtration.

We conduct business in over 90 countries and operate 14 production locations worldwide, with facilities in the United States, Canada, France, Brazil, China and Poland. We also have a 50% equity interest in two joint ventures in China: China Tobacco Mauduit (Jiangmen) Paper Industry Ltd., or CTM, which produces cigarette and porous plug wrap papers, and China Tobacco Schweitzer (Yunnan) Reconstituted Tobacco Co. Ltd., or CTS, which produces RTL.

Basis of Presentation

The accompanying unaudited condensed 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 U.S. 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 including the results of a business reclassified as a discontinued operation which is more fully described in Note 4. Discontinued Operations.

The results of operations are not necessarily indicative of the results to be expected for the full year. The unaudited condensed consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and the related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on February 28, 2014.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and wholly-owned, majority-owned and controlled subsidiaries. The Company’s share of the net income of its 50% owned joint ventures in China are included in the condensed consolidated statements of income as income from equity affiliates. Intercompany balances and transactions have been eliminated.

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Use of Estimates

The preparation of financial statements in conformity with U.S. 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 condensed consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, inventory valuation, useful lives of tangible and intangible assets, fair values, sales returns, receivables valuation, pension, postretirement and other benefits, restructuring and impairment, taxes and contingencies. Actual results could differ materially from those estimates.

Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-08 (ASU 2014-08) "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." ASU 2014-08 raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. It is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals that have not been reported in financial statements previously issued. The Company is currently in the process of evaluating the impact of the adoption on the consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606). The new guidance specifies how and when an entity will recognize revenue arising from contracts with customers and requires entities to disclose information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance is effective for annual periods beginning on or after December 15, 2016 and may be implemented using a full retrospective or a modified retrospective application. The Company is currently in the process of evaluating the impact of the adoption on the consolidated financial statements.

Note 2. Other Comprehensive Income

Comprehensive income includes net income, as well as items charged and credited directly to stockholders' equity, which are excluded from net income. The Company has presented comprehensive income in the condensed consolidated statements of comprehensive income (loss). Reclassification adjustments of derivative instruments are presented in Net Sales in the condensed consolidated statements of income. See Note 11. Derivatives for additional information. Amortization of accumulated pension and other post-employment benefit, or OPEB, liabilities are included in the computation of net periodic pension and OPEB costs, which are more fully discussed in Note 13. Postretirement and Other Benefits.

Components of accumulated other comprehensive loss were as follows ($ in millions):

	June 30, 2014	December 31, 2013
Accumulated pension and OPEB liability adjustments, net of income tax of $15.7 million and $16.6 million at June 30, 2014 and December 31, 2013, respectively	$(28.5)	$(30.1)
Accumulated unrealized loss on derivative instruments, net of income tax (benefit) provision of $(0.2) million and $0.3 million at June 30, 2014 and December 31, 2013, respectively	(0.8)	(8.1)
Accumulated unrealized foreign currency translation adjustments	30.8	33.2
Accumulated other comprehensive income (loss)	$1.5	$(5.0)

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Changes in the components of accumulated other comprehensive loss were as follows ($ in millions):

	Three Months Ended					
	June 30, 2014			June 30, 2013		
	Pre-tax	Tax	Net of Tax	Pre-tax	Tax	Net of Tax
Pension and OPEB liability adjustments	$1.3	$(0.5)	$0.8	$1.4	$(0.4)	$1.0
Unrealized gain (loss) on derivative instruments	3.0	—	3.0	(6.1)	(0.2)	(6.3)
Unrealized foreign currency translation adjustments	(0.7)	—	(0.7)	(5.9)	—	(5.9)
Total	$3.6	$(0.5)	$3.1	$(10.6)	$(0.6)	$(11.2)

	Six Months Ended					
	June 30, 2014			June 30, 2013		
	Pre-tax	Tax	Net of Tax	Pre-tax	Tax	Net of Tax
Pension and OPEB liability adjustments	$2.5	$(0.9)	$1.6	$3.3	$(1.2)	$2.1
Unrealized gain (loss) on derivative instruments	6.8	0.5	7.3	(4.4)	(0.8)	(5.2)
Unrealized foreign currency translation adjustments	(2.4)	—	(2.4)	(17.1)	—	(17.1)
Total	$6.9	$(0.4)	$6.5	$(18.2)	$(2.0)	$(20.2)

Note 3. DelStar Acquisition

On December 12, 2013, the Company completed the acquisition of DelStar through a merger of SWM Acquisition Corp. II, an indirect wholly-owned subsidiary of the Company with and into DelStar. As a result of the merger, DelStar became a wholly-owned, indirect subsidiary of the Company. The DelStar acquisition diversifies SWM’s global presence in advanced materials, focused in large part on filtration.

As consideration, the Company paid $233.7 million in cash, including $2.4 million paid in March 2014, primarily for the adjusted value of working capital at the acquisition date. The acquisition was financed using borrowings under the Company's Credit Agreement (as defined in Note 10. Debt).

The consideration paid for DelStar and the final fair values of the assets acquired and liabilities assumed as of the December 12, 2013 acquisition date are as follows ($ in millions):

	Fair value as of December 12, 2013
Cash and cash equivalents	$1.6
Accounts receivable	17.3
Inventory	21.2
Income taxes receivable	5.7
Deferred income tax benefits	1.5
Other current assets	0.8
Property, plant and equipment	41.5
Other noncurrent assets	0.7
Identifiable intangible assets	80.9
Total Assets	171.2
Accounts payable	4.8
Accrued expenses	6.7
Deferred income tax liabilities	40.4
Other liabilities	0.7
Net assets acquired	118.6
Goodwill	115.1
Consideration paid	$233.7

The Company used the income, market, or cost approach (or a combination thereof) for the valuation as appropriate, and used valuation inputs in these models and analyses that were based on market participant assumptions. Market participants are considered to be buyers and sellers in the principal or most advantageous market for the asset or liability. For certain items, the carrying amount was determined to be a reasonable approximation of fair value based on information available to SWM management. The fair value of receivables acquired from DelStar on December 12, 2013 was $17.3 million, with gross contractual amounts receivable of $17.6 million. Acquired inventories and property, plant and equipment were recorded at their fair values. Acquired intangible assets are primarily trade names, customer relationships and developed technology.

Properties acquired included a number of manufacturing and related facilities, land and leased sites that include leasehold improvements, and machinery and equipment for use in manufacturing operations. Management valued properties using the cost approach, supported where available by observable market data which included consideration of obsolescence.

Intangible assets acquired included a number of trade names that are both business-to-business and business-to-consumer. Also acquired was technology related to products subject to a number of existing patents and trade know-how. In addition to these intangible assets, the Company acquired a number of customer relationships in the water filtration, industrial filtration and healthcare industries. Management valued intangible assets using the relief from royalty and multi-period excess earnings methods, both forms of the income approach supported by observable market data for peer companies. The following table shows the fair values assigned to intangible assets ($ in millions):

	Fair Value as of December 12, 2013	Weighted-Average Amortization Period (Years)
Amortizable intangible assets:		
Customer relationships	$45.3	23
Developed technology	13.8	12.8
Indefinite-lived intangible assets:		
Trade names	21.8	Indefinite
Total	$80.9	21

In connection with the DelStar acquisition, the Company recorded goodwill, which represents the excess of the consideration transferred over the estimated fair value of tangible and intangible assets acquired, net of liabilities assumed. The goodwill is attributed primarily to DelStar's revenue growth from combining the SWM and DelStar businesses and workforce as well as the benefits of access to different market segments and customers. Goodwill from the DelStar acquisition was assigned to the Filtration segment. None of the goodwill is expected to be deductible for tax purposes. The goodwill was determined on the basis of the fair values of the assets and liabilities identified as of the acquisition date.

In December 2013, the Company incurred $2.0 million in financing costs related to the DelStar acquisition. In the six months ended June 30, 2014 and in December 2013, the Company recognized $0.4 million and $1.1 million, respectively, in direct and indirect acquisition-related costs. Direct and indirect acquisition-related costs were expensed as incurred and are included in the General Expense line item in the condensed consolidated statements of income. Financing costs related to expanding the Credit Agreement have been capitalized and will be amortized in Interest Expense over the life of the Credit Agreement.

Note 4. Discontinued Operations

The Company's former paper mills in Medan, Indonesia and in San Pedro, Philippines have been reported as discontinued operations. The sale of the Indonesia mill was completed in the second quarter of 2013. The physical assets at the Philippines paper mill were sold during the fourth quarter of 2013. For all periods presented, results of these mills have been removed from each individual line within the statements of income and the operating activities section of the statements of cash flow. In each case, a separate line has been added for the net results of discontinued operations.

Included in Other Current Assets, Other Assets and Accrued Expenses within the condensed consolidated balance sheet are the following major classes of assets and liabilities, respectively, associated with the discontinued operations ($ in millions):

	June 30, 2014	December 31, 2013
Assets of discontinued operations:		
Current assets	$1.1	$2.0
Other assets	3.9	3.1
Liabilities of discontinued operations:		
Current liabilities	0.5	0.6

Summary financial results of discontinued operations were as follows ($ in millions):

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net sales	$—	$2.0	$—	$6.4
Restructuring and impairment expense	—	1.5	—	1.4
Loss on disposal	—	(1.6)	—	(1.6)
Loss from discontinued operations before income taxes	—	(3.6)	—	(4.0)
Income tax benefit	—	0.8	—	0.6
Loss from discontinued operations	—	(2.8)	—	(3.4)

Note 5. Net Income Per Share

The Company uses the two-class method to calculate earnings per share. The Company has granted restricted stock that contains nonforfeitable rights to dividends on unvested shares. Since these unvested shares are considered participating securities under the two-class method, the Company allocates earnings per share to common stock and participating securities according to dividends declared and participation rights in undistributed earnings.

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 dilutive stock-based compensation, including long-term share-based incentive compensation, stock options outstanding, and directors' accumulated deferred stock compensation which may be received by the directors in the form of stock or cash. 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 millions, shares in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Numerator (basic and diluted):				
Net income	$25.0	$26.6	$48.2	$56.7
Less: Dividends paid to participating securities	(0.1)	—	(0.2)	(0.1)
Less: Undistributed earnings available to participating securities	(0.2)	(0.2)	(0.3)	(0.4)
Undistributed and distributed earnings available to common stockholders	$24.7	$26.4	$47.7	$56.2
Denominator:				
Average number of common shares outstanding	30,096.5	31,097.3	30,379.7	31,021.9
Effect of dilutive stock-based compensation	114.2	162.2	113.2	162.7
Average number of common and potential common shares outstanding	30,210.7	31,259.5	30,492.9	31,184.6

There were no anti-dilutive stock options during the three or six month periods ended June 30, 2014 or 2013.

Note 6. Inventories

Inventories are valued at the lower of cost using the First-In, First-Out, or FIFO, and weighted average methods, or market. The Company's costs included in inventory primarily include pulp, resins, chemicals, direct labor, utilities, maintenance, depreciation, finishing supplies and an allocation of overhead costs. Machine start-up costs or abnormal machine shut downs are expensed in the period incurred and are not reflected in inventory. The definition of market value, with respect to all inventories, is replacement cost or net realizable value. The Company reviews inventories at least quarterly to determine the necessity of write-offs for excess, obsolete or unsalable inventory. The Company estimates write-offs for inventory obsolescence and shrinkage based on its judgment of future realization. These reviews require the Company to assess customer and market demand. The following schedule details inventories by major class ($ in millions):

	June 30, 2014	December 31, 2013
Raw materials	$34.1	$39.2
Work in process	31.2	24.4
Finished goods	50.5	50.9
Supplies and other	14.6	18.3
Total	$130.4	$132.8

Note 7. Goodwill

The changes in the carrying amount of goodwill by segment for the six months ended June 30, 2014 were as follows($ in millions):

	Reconstituted Tobacco	Filtration	Total
Goodwill as of December 31, 2013	$6.0	$115.1	$121.1
Foreign currency translation adjustments	(0.1)	—	(0.1)
Goodwill as of June 30, 2014	$5.9	$115.1	$121.0

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Note 8. Intangible Assets

The gross carrying amount and accumulated amortization for intangible assets consisted of the following ($ in millions):

	June 30, 2014			December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets						
Customer Relationships (Filtration)	45.3	1.1	44.2	45.3	0.1	45.2
Developed Technology (Filtration)	13.8	0.6	13.2	13.8	0.1	13.7
Total	$59.1	$1.7	$57.4	$59.1	$0.2	$58.9
Unamortized intangible assets (Filtration)						
Trade names	$21.8			$21.8		

Amortization expense of intangible assets was $0.7 million and $0.1 million for the three months ended June 30, 2014 and 2013, respectively, and $1.5 million and $0.2 million for the six months ended June 30, 2014 and 2013, respectively. Finite-lived intangibles in the Filtration segment are expensed using the straight-line amortization method. The estimated aggregate amortization expense is $3.1 million in each of the next five years.

Note 9. Restructuring Activities

The Company incurred restructuring expenses of $3.2 million and $0.7 million in the three months ended June 30, 2014 and 2013, respectively, and $3.3 million and $2.3 million in the six months ended June 30, 2014 and 2013, respectively.

In the Paper segment, restructuring expenses were $0.4 million for the three months ended June 30 2013 and $1.5 million for the six months ended June 30, 2013, primarily related to severance and early retirement expenses in the French operations for ongoing accruals over the remaining service lives of affected employees related to previously announced actions.

The Reconstituted Tobacco segment restructuring and impairment expenses were $3.2 million and $0.3 million for the three months ended June 30, 2014 and 2013, respectively, and $3.3 million and $0.8 million for the six months ended June 30, 2014 and 2013, respectively. During the three months ended June 30, 2014, restructuring expenses primarily related to a voluntary early retirement program at our Spay, France facility. The 2013 expenses were for severance and early retirement expenses in the French operations for ongoing accruals over the remaining service lives of affected employees related to previously announced actions.

Restructuring liabilities were classified within Accrued Expenses in each of the consolidated balance sheets as of June 30, 2014 and December 31, 2013. Changes in the restructuring liabilities, substantially all of which are employee-related, during the periods ended June 30, 2014 and December 31, 2013 are summarized as follows ($ in millions):

	Six Months Ended June 30, 2014	Year Ended December 31, 2013
Balance at beginning of year	$4.7	$3.4
Accruals for announced programs	3.3	3.9
Cash payments	(2.4)	(2.7)
Exchange rate impacts	—	0.1
Balance at end of period	$5.6	$4.7

Note 10. Debt

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

	June 30, 2014	December 31, 2013
Credit Agreement - U.S. dollar borrowings	$351.0	$367.7
Credit Agreement - euro borrowings	80.0	—
French Employee Profit Sharing	16.8	15.8
Bank Overdrafts	1.2	1.7
Other	0.1	0.2
Total Debt	449.1	385.4
Less: Current debt	(4.2)	(4.2)
Long-Term Debt	$444.9	$381.2

Credit Agreement

In December 2013, the Company amended and restated its five-year unsecured revolving credit facility, or Credit Agreement. The Credit Agreement provides for borrowing capacity of $500 million in either U.S. dollars or a $300 million equivalent sublimit in euros, with an option to increase borrowing capacity by $200 million. The Credit Agreement contains representations and warranties customary for facilities of this type and covenants and provisions that, among other things, require the Company to maintain (a) a maximum net debt to EBITDA ratio of 3.00 and (b) minimum interest coverage ratio of 3.50. The Company was in compliance with all of its covenants under the Credit Agreement at June 30, 2014.

Under the Credit Agreement, interest rates are based on the London Interbank Offered Rate plus an applicable margin that varies from 1.25% to 2.00% depending on the Net Debt to EBITDA Ratio, as defined in the Credit Agreement. The Company will incur commitment fees at an annual rate of 0.20% to 0.30% of the applicable margin on the committed amounts not drawn, depending on the Net Debt to EBITDA Ratio. As of June 30, 2014, the applicable interest rate on Credit Agreement borrowings was 1.44% on U.S. dollar borrowings and 1.41% on euro borrowings.

Fair Value of Debt

At June 30, 2014 and December 31, 2013, the estimated fair values of the Company’s current and long-term debt approximated the respective carrying amounts since the interest rates were variable and based on current market indices.

Note 11. Derivatives

In the normal course of business, the Company is exposed to foreign currency exchange rate risk and interest rate risk on its variable-rate debt. To manage these risks, the Company utilizes a variety of practices including, where considered appropriate, derivative instruments. The Company has no derivative instruments for trading or speculative purposes or derivatives with credit risk-related contingent features. All derivative instruments used by the Company are either exchange traded or are entered into with major financial institutions in order to reduce credit risk and risk of nonperformance by third parties. The fair values of the Company's derivative instruments are determined using observable inputs and are considered Level 2 assets or liabilities.

The Company utilizes currency forward, swap and, to a lesser extent, option contracts to selectively hedge its exposure to foreign currency risk when it is practical and economical to do so. The use of these contracts minimizes transactional exposure to exchange rate changes. We designate certain of our foreign currency hedges as cash flow hedges. Changes in the fair value of cash flow hedges are reported as a component of other comprehensive income (loss) and reclassified into earnings when the forecasted transaction affects earnings. For foreign exchange contracts not designated as cash flow hedges, changes in the contracts' fair value are recorded to net income each period.

The Company selectively hedges its exposure to interest rate increases on variable-rate, long-term debt when it is practical and economical to do so. Changes in the fair value of interest rate contracts considered cash flow hedges are reported as a component of other comprehensive income (loss) and reclassified into earnings when the forecasted transaction affects earnings.

The following table presents the fair value of asset and liability derivatives and the respective balance sheet locations at June 30, 2014 ($ in millions):

	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedges:				
Foreign exchange contracts	Accounts Receivable	$1.5	Accrued Expenses	$2.2
Foreign exchange contracts	Other Assets	—	Other Liabilities	0.4
Interest rate contracts	Other Assets	—	Other Liabilities	0.3
Total derivatives designated as hedges		$1.5		$2.9

The following table presents the fair value of asset and liability derivatives and the respective balance sheet locations at December 31, 2013 ($ in millions):

	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedges:				
Foreign exchange contracts	Accounts Receivable	$—	Accrued Expenses	$6.5
Foreign exchange contracts	Other Assets	—	Other Liabilities	2.1
Interest rate contracts	Other Assets	0.5	Other Liabilities	—
Total derivatives designated as hedges		$0.5		$8.6

The following table provides the effect that derivative instruments in cash flow hedging relationships had on accumulated other comprehensive income (loss), or AOCI, and results of operations ($ in millions):

Derivatives Designated as Cash Flow Hedging Relationships	Gain (Loss) Recognized in AOCI on Derivatives, Net of Tax				(Loss) Gain Reclassified from AOCI			
	Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013	2014	2013	2014	2013
Foreign exchange contracts	$3.3	$(6.3)	$7.8	$(5.2)	$(0.8)	$0.2	$(2.2)	$0.5
Interest rate contracts	(0.3)	—	(0.5)	—	—	—	—	—
Total	$3.0	$(6.3)	$7.3	$(5.2)	$(0.8)	$0.2	$(2.2)	$0.5

The Company's designated derivative instruments are perfectly effective. As such, related to the hedge ineffectiveness or amounts excluded from hedge effectiveness testing, there were no gains or losses recognized immediately in income for the three or six months ended June 30, 2014 and 2013.

The following table provides the effect that derivative instruments not designated as hedging instruments had on net income ($ in millions):

Derivatives Not Designated as Cash Flow Hedging Instruments	Amount of Gain / (Loss) Recognized in Other Income / Expense			
	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Foreign exchange contracts	$—	$(0.4)	$0.1	$(0.8)

Note 12. Commitments and Contingencies

Litigation

Imposto sobre Circulação de Mercadorias e Serviços, or ICMS, is a form of value-added tax in Brazil. In December 2000, Schweitzer-Mauduit do Brasil Indústria e Comércio de Papel Ltda., or SWM-B, our Brazilian subsidiary, received two assessments from the tax authorities of the State of Rio de Janeiro for unpaid ICMS taxes on certain raw materials from January 1995 through November 2000 (collectively, the Raw Materials Assessments).

The Raw Materials Assessments concerned the accrual and use by SWM-B of ICMS tax credits generated from the production and sale of certain non-tobacco related grades of paper sold domestically that are immune from the tax to offset ICMS taxes otherwise owed on the sale of products that are not immune. One of the two assessments, or Assessment 1 (case number 2001.001.115144-5), related in part to tax periods that predated our acquisition of the Pirahy mill in Pirai, Brazil and is covered in part by an indemnification from the sellers of the Pirahy mill. The second assessment, or Assessment 2 (case number 2001.001.064544-6), pertains exclusively to periods that SWM-B owned the Pirahy mill. While SWM-B would be primarily responsible for the full payment of the Raw Materials Assessments in the event of an ultimate unfavorable outcome, SWM-B is not aware of any difficulties that would be encountered in obtaining reimbursement of that portion of any payment resulting from Assessment 1 from the previous owners of the Pirahy mill under the indemnification.

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SWM-B has contested the Raw Materials Assessments based on Article 150, VI of the Brazilian Federal Constitution of 1988, which grants immunity from ICMS taxes to papers used in the production of books, newspapers and periodicals, or immune papers, and the raw material inputs used to produce immune papers.

Both of the Raw Materials Assessments are presently on appeal in separate chambers of the Federal Supreme Court of Brazil. SWM-B won a favorable ruling in each at the first level, then received a favorable ruling on Assessment 1 on appeal and an unfavorable ruling on Assessment 2 on appeal. Assessment 1 is before the court on the State's appeal of a procedural question which, if decided favorably to us, would invalidate Assessment 1. If decided against SWM-B, the lower court would be notified to send the case records to the Federal Supreme Court for a decision on the merits. Assessment 2 is before the Federal Supreme Court of Brazil on SWM-B's appeal on the merits and will be decided by the action of the chamber of the court hearing the matter, unless there is a prior decision by a chamber of the Federal Supreme Court on Assessment 1 that contradicts such decision, in which case the conflict between the rulings of the different chambers would be decided by the Federal Supreme Court sitting as a whole. No docket entry has been made yet regarding argument on either Assessment 1 or Assessment 2. Based on the foreign currency exchange rate at June 30, 2014, the Raw Materials Assessments totaled approximately $42 million, of which approximately $19 million is covered by the above-discussed indemnification.

Beginning February 2008, SWM-B received assessments from the tax authorities of the State of Rio de Janeiro for unpaid ICMS and Fundo Estadual de Combate à Pobreza (FECP) taxes on interstate purchases of electricity. The state issued three assessments against SWM-B, one for each of the following time periods: May 2006 - November 2007 (the first electricity assessment), January 2008 - December 2010 (the second electricity assessment), and September 2011 - September 2013 (the third electricity assessment, and collectively with the first electricity assessment and the second electricity assessment, the Electricity Assessments). SWM-B has challenged all three Electricity Assessments in administrative proceedings before the state tax council (Junta de Revisão Fiscal and Conselho de Contribuintes) based on Resolution 1.610/89, which defers these taxes on electricity purchased by an "electricity-intensive consumer."

SWM-B's challenges to the first two Electricity Assessments were unsuccessful at the first administrative level (Junta de Revisão), but different appeals chambers of the Conselho de Contribuintes have reached different conclusions about the assessments. On the first electricity assessment, one chamber of the Conselho de Contribuintes recognized that SWM-B is an electricity-intensive consumer but denied applicability of the tax deferral resolution. On the second electricity assessment, a different chamber of the Junta de Revisão Fiscal recognized that SWM-B is an electricity-intensive consumer and agreed that the tax deferral resolution applies. Both assessments are now on appeal before the full council of the Conselho de Contribuintes, which is scheduled to hear the cases on August 27, 2014. Court proceedings are possible if the full administrative council issues an adverse decision. SWM-B's challenge to the third electricity assessment is pending at the first administrative level (Junta de Revisão Fiscal). Based on the foreign currency exchange rate at June 30, 2014, the Electricity Assessments totaled approximately $21 million.

The state of Rio de Janeiro has a tax amnesty program open in August and September 2014 that could permit SWM-B to resolve one or more of the ICMS assessments by paying a portion of the total taxes claimed. However, as SWM-B evaluates this program, it continues to vigorously contest the Raw Materials Assessments and the Electricity Assessments and believes that they will ultimately be resolved in its favor. No liability has been recorded in our condensed consolidated financial statements for these assessments based on our evaluation of these matters under the facts and law as presently understood. The Company can give no assurance as to the ultimate outcome of such proceedings.

Environmental Matters

The Company's operations are subject to various nations' federal, state and local laws, regulations and ordinances relating to environmental matters. The nature of the Company's operations exposes it to the risk of claims with respect to various 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 effect on its financial condition or results of operations. However, future events, such as changes in existing laws and regulations, or unknown contamination of sites 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 effect on its financial condition or results of operations.

General Matters

In the ordinary course of conducting business activities, the Company and its subsidiaries are involved in certain other judicial, administrative and regulatory proceedings involving both private parties and governmental authorities. These proceedings include insured and uninsured regulatory, employment, general and commercial liability, environmental and other matters. At this time, the Company does not expect any of these proceedings to have a material effect on its reputation, business, financial condition, results of operations or cash flows. However, the Company can give no assurance that the results of any such proceedings will not materially affect its reputation, business, financial condition, results of operations or cash flows.

Note 13. Postretirement and Other Benefits

The Company sponsors pension benefits in the United States, France and Canada and postretirement healthcare and life insurance, or OPEB, benefits in the United States and Canada. The Company's Canadian 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 months ended June 30, 2014 and 2013 were as follows ($ in millions):