

SCHWEITZER MAUDUIT INTERNATIONAL INC  
Form 10-Q  
November 02, 2016  
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 September 30, 2016

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 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  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  
o No x

The Company had 30,535,550 shares of common stock issued and outstanding as of November 2, 2016.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2016	2015	2016	2015
Net Sales	\$209.3	\$ 184.4	\$641.2	\$ 554.3
Cost of products sold	146.2	132.0	447.7	395.7
Gross Profit	63.1	52.4	193.5	158.6
Selling expense	6.0	5.5	18.8	16.0
Research expense	4.2	3.5	12.9	10.5
General expense	20.8	10.3	57.9	43.3
Total nonmanufacturing expenses	31.0	19.3	89.6	69.8
Restructuring and impairment expense	1.3	1.3	4.0	10.5
Operating Profit	30.8	31.8	99.9	78.3
Interest expense	3.9	1.7	12.6	5.3
Other income, net	0.7	1.3	4.0	9.5
Income from Continuing Operations before Income Taxes and Income from Equity Affiliates	27.6	31.4	91.3	82.5
Provision for income taxes	10.7	5.9	27.9	17.9
Income from equity affiliates, net of income taxes	1.8	0.1	2.4	4.3
Income from Continuing Operations	18.7	25.6	65.8	68.9
Income (Loss) from Discontinued Operations	—	0.2	—	(0.9)
Net Income	\$18.7	\$ 25.8	\$65.8	\$ 68.0
Net Income per Share - Basic:				
Income per share from continuing operations	\$0.62	\$ 0.84	\$2.16	\$ 2.26
Income (loss) per share from discontinued operations	—	0.01	—	(0.03)
Net income per share – basic	\$0.62	\$ 0.85	\$2.16	\$ 2.23
Net Income per Share – Diluted:				
Income per share from continuing operations	\$0.61	\$ 0.84	\$2.15	\$ 2.25
Income (loss) per share from discontinued operations	—	0.01	—	(0.03)
Net income per share – diluted	\$0.61	\$ 0.85	\$2.15	\$ 2.22
Weighted Average Shares Outstanding:				
Basic	30,316,400	30,275,400	30,308,200	30,243,000
Diluted	30,458,800	30,408,600	30,443,100	30,366,600

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



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

(dollars in millions)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2016	2015	2016	2015
Net Income	\$18.7	\$ 25.8	\$65.8	\$ 68.0
Other Comprehensive Income (Loss), net of tax:				
Foreign currency translation adjustments	0.2	(6.3 )	5.3	(42.1 )
Unrealized gains (losses) on derivative instruments	(0.3 )	(15.4 )	11.7	(25.1 )
Less: Reclassification adjustment for losses on derivative instruments included in net income	0.6	3.7	6.2	7.3
Reclassification adjustment for amortization of postretirement benefit plans' costs (gains) included in net periodic benefit cost	1.0	(0.5 )	2.1	(1.8 )
Other Comprehensive Income (Loss)	1.5	(18.5 )	25.3	(61.7 )
Comprehensive Income	\$20.2	\$ 7.3	\$91.1	\$ 6.3

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

SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in millions, except per share amounts)

(Unaudited)

	September 30, 2016	December 31, 2015
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 89.5	\$ 186.5
Accounts receivable, net	137.0	119.4
Inventories	110.9	112.4
Assets held for sale	20.1	21.9
Other current assets	5.6	4.6
Total Current Assets	363.1	444.8
Property, Plant and Equipment, net	308.9	308.1
Deferred Income Tax Benefits	2.4	0.1
Investment in Equity Affiliates	67.6	67.5
Goodwill	232.4	233.3
Intangible Assets	203.5	213.9
Other Assets	27.0	22.3
Total Assets	\$ 1,204.9	\$ 1,290.0
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Current debt	\$ 3.2	\$ 3.3
Accounts payable	47.1	49.0
Income taxes payable	9.4	5.3
Accrued expenses	70.7	85.5
Total Current Liabilities	130.4	143.1
Long-Term Debt	441.1	568.2
Pension and Other Postretirement Benefits	33.1	33.5
Deferred Income Tax Liabilities	48.3	45.3
Other Liabilities	26.6	32.0
Total Liabilities	679.5	822.1
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; 30,554,217 and 30,474,149 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	3.1	3.0
Additional paid-in-capital	57.2	53.7
Retained earnings	581.2	552.6
Accumulated other comprehensive loss, net of tax	(116.1	) (141.4
Total Stockholders' Equity	525.4	467.9
Total Liabilities and Stockholders' Equity	\$ 1,204.9	\$ 1,290.0
The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.		





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		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
Balance, December 31, 2014	30,465,522	\$ 3.0	\$ 49.8	\$ 512.7	\$ (76.5 )	\$ 489.0
Net income				68.0		68.0
Other comprehensive loss, net of tax					(61.7 )	(61.7 )
Dividends declared (\$1.14 per share)				(34.7 )		(34.7 )
Restricted stock issuances, net	70,949	—	—			—
Stock-based employee compensation expense			1.7			1.7
Excess tax benefits of stock-based employee compensation			0.5			0.5
Stock issued to directors as compensation	2,638	—	0.1			0.1
Purchases and retirement of common stock	(63,365 )	—		(2.9 )		(2.9 )
Balance, September 30, 2015	30,475,744	\$ 3.0	\$ 52.1	\$ 543.1	\$ (138.2 )	\$ 460.0
Balance, December 31, 2015	30,474,149	\$ 3.0	\$ 53.7	\$ 552.6	\$ (141.4 )	\$ 467.9
Net income				65.8		65.8
Other comprehensive income, net of tax					25.3	25.3
Dividends declared (\$1.20 per share)				(36.6 )		(36.6 )
Restricted stock issuances, net	94,576	0.1	—			0.1
Stock-based employee compensation expense			3.5			3.5
Excess tax expense of stock-based employee compensation			(0.2 )			(0.2 )
Stock issued to directors as compensation	5,031	—	0.2			0.2
Purchases and retirement of common stock	(19,539 )	—		(0.6 )		(0.6 )
Balance, September 30, 2016	30,554,217	\$ 3.1	\$ 57.2	\$ 581.2	\$ (116.1 )	\$ 525.4

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

SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

(dollars in millions)

(Unaudited)

	Nine Months Ended	
	September 30,	September 30,
	2016	2015
<b>Operating</b>		
Net income	\$65.8	\$ 68.0
Less: Loss from discontinued operations	—	(0.9 )
Income from continuing operations	65.8	68.9
Non-cash items included in net income:		
Depreciation and amortization	33.3	29.0
Restructuring-related impairment	0.5	3.5
Deferred income tax provision	(3.3 )	0.5
Pension and other postretirement benefits	2.7	3.4
Stock-based compensation	3.7	1.8
Income from equity affiliates	(2.4 )	(4.3 )
Gain on sale of intangible assets	(1.8 )	(4.3 )
Excess tax expense (benefits) of stock-based awards	0.2	(0.5 )
Cash dividends received from equity affiliates	—	3.9
Other items	(1.2 )	0.3
Changes in operating working capital:		
Accounts receivable	(14.7 )	(32.6 )
Inventories	4.9	(3.0 )
Prepaid expenses	(1.0 )	—
Accounts payable	(2.5 )	2.0
Accrued expenses	(7.2 )	(1.5 )
Accrued income taxes	6.1	12.6
Net changes in operating working capital - (use) source	(14.4 )	(22.5 )
Net cash provided by (used in) operating activities of:		
- Continuing operations	83.1	79.7
- Discontinued operations	(0.1 )	0.5
Net Cash Provided by Operations	83.0	80.2
<b>Investing</b>		
Capital spending	(17.5 )	(14.0 )
Capitalized software costs	(1.7 )	(0.7 )
Acquisitions, net of cash acquired	—	(0.4 )
Other investing	4.2	2.9
Net Cash Used in Investing	(15.0 )	(12.2 )

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

	Nine Months Ended	
	September 30,	September 30,
	2016	2015
<b>Financing</b>		
Cash dividends paid to SWM stockholders	(36.6 )	(34.7 )
Changes in short-term debt	—	0.2
Proceeds from issuances of long-term debt	35.6	35.5
Payments on long-term debt	(167.2)	(68.1 )
Purchases of common stock	(0.6 )	(2.9 )
Excess tax benefits of stock-based awards	(0.2 )	0.5
Net Cash Used in Financing	(169.0)	(69.5 )
Effect of exchange rate changes on cash and cash equivalents	4.0	(20.3 )
Decrease in cash and cash equivalents	(97.0 )	(21.8 )
Cash and cash equivalents at beginning of period	186.5	290.3
Cash and cash equivalents at end of period	\$89.5	\$ 268.5
<b>Supplemental Cash Flow Disclosures</b>		
Cash paid for interest	\$10.5	\$ 5.2
Cash paid (recovered) for taxes, net	\$24.4	\$ (3.7 )
Change in capital spending in accounts payable and accrued liabilities	\$1.3	\$ 1.0

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

SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. General

Nature of Business

Schweitzer-Mauduit International, Inc., or SWM or the Company, headquartered in Alpharetta, Georgia in the United States of America, is a multinational diversified producer of highly engineered solutions and advanced materials for a variety of industries. The Company maintains two operating product line segments: Engineered Papers and Advanced Materials and Structures.

Historically, through its Engineered Papers, or EP, segment, the Company has primarily served the tobacco industry via the manufacture and sale of paper and reconstituted tobacco products, which remains a key focus. The primary products sold 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, reconstituted tobacco leaf, or RTL, which is used as a blend with virgin tobacco in cigarettes, and reconstituted tobacco wrappers and binders for cigars. These products are sold directly to tobacco companies or their designated converters in the Americas, Europe, Asia, Africa, the Middle East and elsewhere. The EP segment is a manufacturer of lightweight specialty papers used in manufacturing banded papers used in the production of lower ignition propensity, or LIP, cigarettes and also produces premium specialized papers for other applications, including low volume specialized commercial and industrial commodity paper grades produced, among other reasons, to maximize machine utilization.

Through its Advanced Materials & Structures, or AMS, segment, the Company is a specialty producer of resin-based plastic netting through an extrusion process, as well as certain meltblown products, machined plastic core tubes, urethane films, and resin-based rolled products for use in other end segments, such as filtration, surface protection, medical and other industrials. As discussed more fully in Note 3. Business Acquisitions, in October 2015, the Company completed the acquisition of Argotec Intermediate Holdings LLC, or Argotec, a manufacturer of urethane films for use in high-performance niche applications such as surface and automotive paint protection, glass lamination, medical woundcare and other industrial uses. This acquisition has been incorporated into the AMS segment.

The Company has operations in the United States, United Kingdom, Canada, France, Luxembourg, Russia, Brazil, China and Poland, conducts business in over 90 countries, and operates 18 production locations worldwide. The Company also has 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 and these notes thereto included herein should be read in conjunction with the audited consolidated financial statements and the related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC on February 26, 2016.

#### Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned, majority-owned and controlled subsidiaries. The Company's share of the net income of its 50%-owned joint ventures in China

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SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

is included in the condensed consolidated statements of income as income (loss) from equity affiliates. Intercompany balances and transactions have been eliminated.

#### 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 and rebates, 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 May 2014, the Financial Accounting Standards Board, or FASB, issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606). This 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. In August 2015, the FASB deferred the effective date for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods). Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). The Company is currently in the process of evaluating the impact of the pronouncement on the consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory." This update requires entities to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using the Last-in, First-out or the retail inventory method. This guidance is effective for annual reporting periods beginning after December 15, 2016, and interim periods thereafter. The Company is currently in the process of evaluating the impact of the pronouncement on the consolidated financial statements and does not expect that its adoption will have a material impact on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842): Amendments to the FASB Accounting Standards Codification." The new standard establishes a right-of-use model that requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than twelve months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. This guidance is effective for annual reporting periods beginning after December 15, 2018, and interim periods thereafter. Early adoption is permitted. Companies must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently in the process of evaluating the impact of the pronouncement on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." This standard makes several modifications to existing guidance related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement

presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. This guidance is effective for annual reporting periods beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The Company is currently in the process of evaluating the impact of the pronouncement on the consolidated financial statements.

In March, April and May 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," ASU 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing," ASU 2016-11, "Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates

SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting," and ASU 2016-12, "Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients," which provide supplemental adoption guidance and clarification to ASC 2014-09. ASU 2016-08, ASU 2016-10, ASU 2016-11 and ASU 2016-12 must be adopted concurrently with the adoption of ASU 2014-09. The Company is currently in the process of evaluating the impact of the pronouncements 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, Other income, net, or Interest Expense 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, net of tax, were as follows (\$ in millions):

	September 30, 2016	December 31, 2015
Accumulated pension and OPEB liability adjustments, net of income tax of \$20.1 million and \$21.9 million at September 30, 2016 and December 31, 2015, respectively	\$(33.5 )	\$(35.6 )
Accumulated unrealized loss on derivative instruments, net of income tax of \$2.5 million and \$0.3 million at September 30, 2016 and December 31, 2015, respectively	(3.7 )	(21.6 )
Accumulated unrealized foreign currency translation adjustments	(78.9 )	(84.2 )
Accumulated other comprehensive loss	\$(116.1 )	\$(141.4 )

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

	Three Months Ended					
	September 30, 2016		September 30, 2015			
	Pre-tax	Net of Tax	Pre-tax	Tax	Net of Tax	
Unrealized gain (loss) on Pension and OPEB liability adjustments	\$1.2	\$(0.2)	\$1.0	\$(0.8 )	\$0.3	\$(0.5 )
Unrealized gain (loss) on derivative instruments	2.0	(1.7 )	0.3	(11.9 )	0.2	(11.7 )
Unrealized gain (loss) on foreign currency translation	0.2	—	0.2	(6.3 )	—	(6.3 )
Total	\$3.4	\$(1.9)	\$1.5	\$(19.0)	\$0.5	\$(18.5)

  

	Nine Months Ended					
	September 30, 2016		September 30, 2015			
	Pre-tax	Net of Tax	Pre-tax	Tax	Net of Tax	
Unrealized gain (loss) on Pension and OPEB liability adjustments	\$3.9	\$(1.8)	\$2.1	\$(2.8 )	\$1.0	\$(1.8 )
Unrealized gain (loss) on derivative instruments	15.7	2.2	17.9	(18.3 )	0.5	(17.8 )
Unrealized gain (loss) on foreign currency translation	5.3	—	5.3	(42.1 )	—	(42.1 )
Total	\$24.9	\$0.4	\$25.3	\$(63.2)	\$1.5	\$(61.7)





SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3. Business Acquisitions

On October 28, 2015, the Company completed the acquisition of Argotec Intermediate Holdings, LLC, or Argotec, through an Equity Interest Purchase Agreement entered into on September 17, 2015, by and among Argotec, the Company, SWM-Argotec, LLC, an indirect wholly-owned subsidiary of the Company, Argotec Intermediate Holdings Two LLC, Argotec LLC, Argotec Holdings LLC, and certain equity holders of Argotec Holdings LLC. The acquisition of Argotec expanded and diversified SWM's global presence in advanced materials and has been incorporated into the Company's AMS segment.

As of September 30, 2016, the fair values of the assets acquired and liabilities assumed are provisional because final appraisals have not yet been completed. As consideration, the Company paid \$282.7 million in cash, subject to certain customary post-closing adjustments, primarily for the adjusted value of working capital at the acquisition date. The acquisition was financed using borrowings under the Company's Amended Credit Agreement (defined below). See Note 10. Debt, for additional information.

The consideration paid for Argotec and the preliminary fair values of the assets acquired and liabilities assumed as of the October 28, 2015 acquisition date were as follows (\$ in millions):

	Preliminary Fair Value as of October 28, 2015
Cash and cash equivalents	\$ 2.7
Accounts receivable	16.1
Inventory	16.3
Other current assets	0.1
Property, plant and equipment	15.9
Other noncurrent assets	0.1
Identifiable intangible assets	131.0
Total Assets	182.2
Accounts payable	4.6
Accrued expenses	4.5
Net assets acquired	173.1
Goodwill	109.6
Cash paid	\$ 282.7

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 Argotec on October 28, 2015 was \$16.1 million, with gross contractual amounts receivable of \$16.8 million. Acquired inventories and

property, plant and equipment were recorded at their fair values. Acquired intangible assets are primarily trade names, customer relationships and non-competition agreements.

Properties acquired included a manufacturing and related facility, land and leased sites that include leasehold improvements, and machinery and equipment for use in manufacturing operations. Management valued properties

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SCHWEITZER-MAUDUIT INTERNATIONAL, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

using the cost approach supported where available by observable market data which included consideration of obsolescence. One of the properties acquired, the Argotec-Stevens facility in Easthampton, Massachusetts with an estimated fair value of \$1.0 million, was held for sale as of the acquisition date and during the fourth quarter of 2015 came under contract for sale to a third party. The sale of this property was completed in April 2016 and no gain or loss was recognized on the disposition.

Intangible assets acquired included trade names that are both business-to-business and business-to-consumer. In addition to these intangible assets, the Company acquired a number of customer relationships in the aeronautical, transportation, graphics, medical and industrial markets. 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):

	Preliminary Fair Value as of October 28, 2015	Weighted-Average Amortization Period (Years)
Amortizable intangible assets:		
Customer relationships	\$ 115.3	15
Non-competition agreements	1.7	4
Total amortizable intangible assets	117.0	15
Indefinite-lived intangible assets:		
Trade names	14.0	Indefinite
Total	\$ 131.0	

In connection with the acquisition, the Company recorded goodwill, which represents the excess of the consideration transferred over the preliminary fair value of tangible and intangible assets acquired, net of liabilities assumed. The goodwill is attributed primarily to Argotec's revenue growth from combining the SWM and Argotec businesses and workforces as well as the benefits of access to different markets and customers. Goodwill from the Argotec acquisition was assigned to the AMS reportable segment. The goodwill from this acquisition is expected to be deductible for tax purposes. The goodwill was determined on the basis of the preliminary fair values of the assets and liabilities identified as part of the transaction.

In the three and nine months ended September 30, 2016, the Company recognized \$0.1 million and \$0.4 million, respectively, of direct and indirect acquisition-related costs. In 2015, the Company recognized \$1.8 million of direct and indirect acquisition-related costs and incurred \$7.4 million in acquisition-related financing costs. Direct and indirect acquisition-related costs were expensed as incurred and are included in the General expense line item in the consolidated statements of income. Financing costs related to expanding the Amended Credit Agreement have been capitalized and will be amortized in Interest expense over the life of the Amended Credit Agreement.

The amounts of the unaudited pro forma Net Sales and Income from Continuing Operations of the combined entity had the acquisition date been January 1, 2015 are as follows (\$ in millions):

	Net Sales	Income from Continuing Operations
2015 Supplemental Pro Forma from July 1, 2015 - September 30, 2015	\$210.8	\$ 25.4
2015 Supplemental Pro Forma from January 1, 2015 - September 30, 2015	641.6	70.7

Note 4. Discontinued Operations

Beginning in 2013, the Company's former paper mill in San Pedro, Philippines has been reported as a discontinued operation. This mill was previously presented as a component of the EP segment. The physical assets at the Philippines paper mill were sold during the fourth quarter of 2013. For all periods presented, results of this mill 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.

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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):

	September 30, December 31,	
	2016	2015
Assets of discontinued operations:		
Current assets	\$ 1.1	\$ 1.1
Other assets	2.5	2.6
Liabilities of discontinued operations:		
Current liabilities	0.1	0.2

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

	Three Months		Nine Months	
	Ended		Ended	
	September 30,	September 30,	September 30,	September 30,
	2016	2015	2016	2015
Net sales	\$ —	\$ —	\$ —	\$ —
Other expense	—	0.2	—	(0.7 )
Loss from discontinued operations before income taxes	—	0.2	—	(0.7 )
Income tax provision	—	—	—	(0.2 )
Loss from discontinued operations	\$ —	\$ 0.2	\$ —	\$ (0.9 )

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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 non-forfeitable 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 stock-based incentive compensation 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		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Numerator (basic and diluted):				
Net income	\$ 18.7	\$ 25.8	\$ 65.8	\$ 68.0
Less: Dividends paid to participating securities	(0.1 )	—	(0.2 )	(0.2 )
Less: Undistributed earnings available to participating securities	—	—	(0.2 )	(0.2 )
Undistributed and distributed earnings available to common stockholders	\$ 18.6	\$ 25.8	\$ 65.4	\$ 67.6
Denominator:				
Average number of common shares outstanding	30,316.4	30,275.4	30,308.2	30,243.0
Effect of dilutive stock-based compensation	142.4	133.2	134.9	123.6
Average number of common and potential common shares outstanding	30,458.8	30,408.6	30,443.1	30,366.6

Note 6. Inventories

Inventories are valued at the lower of cost (using the First-In, First-Out 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 certain 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):

	September 30, December 31,	
	2016	2015
Raw materials	\$ 39.5	\$ 45.2
Work in process	21.0	17.3
Finished goods	40.4	36.1
Supplies and other	10.0	13.8
Total	\$ 110.9	\$ 112.4





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Note 7. Goodwill

The changes in the carrying amount of goodwill by segment for the nine months ended September 30, 2016 were as follows (\$ in millions):

	Engineered Papers	Advanced Materials & Structures	Total
Goodwill as of December 31, 2015	\$ 4.8	\$ 228.5	\$ 233.3
Goodwill adjusted during the period	—	0.1	0.1
Foreign currency translation adjustments	0.1	(1.1 )	(1.0 )
Goodwill as of September 30, 2016	\$ 4.9	\$ 227.5	\$ 232.4

Note 8. Intangible Assets

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

	September 30, 2016		Net Carrying Amount	December 31, 2015		Net Carrying Amount
	Gross Carrying Amount	Accumulated Amortization*		Gross Carrying Amount	Accumulated Amortization*	
Amortized intangible assets						
Engineered Papers						
Customer-related intangibles	\$ 10.0	\$ 10.0	\$ —	\$ 10.0	\$ 10.0	\$ —
Advanced Materials & Structures						
Customer Relationships	167.7	14.8	152.9	167.7	6.4	161.3
Developed Technology	16.0	3.7	12.3	16.0	2.4	13.6
Customer Contracts	0.9	0.8	0.1	0.9	0.5	0.4
Non-Compete Agreements	1.7	0.4	1.3	1.7	0.1	1.6
Patents	1.5	0.2	1.3	1.5	0.1	1.4
Total	\$ 197.8	\$ 29.9	\$ 167.9	\$ 197.8	\$ 19.5	\$ 178.3

Unamortized intangible assets (Advanced Materials & Structures)

Trade names	\$ 35.6	\$ 35.6
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\* Accumulated amortization also includes adjustments for foreign currency translation.

Amortization expense of intangible assets was \$3.0 million and \$1.1 million for the three months ended September 30, 2016 and 2015, respectively, and \$9.2 million and \$3.2 million for the nine months ended September 30, 2016 and 2015, respectively. Finite-lived intangibles in the AMS segment are expensed using the straight-line amortization method. The estimated average aggregate amortization expense is \$11.6 million in each of the next five years.

Note 9. Restructuring and Impairment Activities

The Company incurred restructuring and impairment expenses of \$1.3 million in both the three months ended September 30, 2016 and 2015 and \$4.0 million and \$10.5 million in the nine months ended September 30, 2016 and 2015, respectively.

In the EP segment, restructuring and impairment expenses were \$1.3 million and \$1.4 million for the three months ended September 30, 2016 and 2015, respectively, and \$3.1 million and \$10.5 million for the nine months ended September 30, 2016 and 2015. Restructuring and impairment expenses for the nine months ended September 30, 2016 consisted of \$2.6 million in severance accruals for employees at our manufacturing facilities in the U.S., France and Brazil and \$0.5 million of impairment expense recognized on equipment at our Poland manufacturing facility. During the nine months ended September 30, 2015, restructuring and impairment expenses were composed of \$7.0 million in

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severance accruals for employees at our Quimperlé and Spay, France facilities as well as \$3.5 million in loss recognized to adjust the recorded value of equipment at our Philippines RTL location to its estimated fair value as discussed in more detail below.

The AMS segment incurred no restructuring and impairment expenses for the three months ended September 30, 2016 and 2015, and incurred \$0.6 million and reversed \$0.2 million for the nine months ended September 30, 2016 and 2015, respectively. Restructuring and impairment expenses for the nine months ended September 30, 2016 consisted of severance accruals for employees at our U.S. manufacturing operations. In the nine months ended September 30, 2015, restructuring and impairment expenses were reversed related to previously accrued severance costs in our AMS segment resulting from one of our business acquisitions in December 2014.

Additionally, the Company incurred \$0.0 million and reversed \$0.1 million in restructuring expenses during the three months ended September 30, 2016 and 2015, respectively, and incurred \$0.3 million and \$0.2 million in restructuring expenses during the nine months ended September 30, 2016 and 2015, respectively, in each case related to accruals for severance expenses within supporting overhead departments which were not allocated to a specific segment.

Restructuring liabilities were classified within Accrued Expenses in each of the consolidated balance sheets as of September 30, 2016 and December 31, 2015. Changes in the restructuring liabilities, substantially all of which are employee-related, during the periods ended September 30, 2016 and December 31, 2015 are summarized as follows (\$ in millions):

	Nine Months Ended September 30, 2016	Year Ended December 31, 2015
Balance at beginning of year	\$ 7.7	\$ 8.7
Accruals for announced programs	3.5	8.0
Cash payments	(6.7 )	(8.3 )
Exchange rate impacts	0.5	(0.7 )
Balance at end of period	\$ 5.0	\$ 7.7

Long-lived assets to be sold are classified as held for sale in the period in which all of the following criteria are met: management, having the authority to approve the action, commits to a plan to sell the assets; the assets are available for immediate sale in present condition subject only to terms that are usual and customary for sales of such assets; an active program to locate a buyer and other actions required to complete the plan to sell the assets have been initiated; the sale of the assets is probable, and transfer of the assets is expected to qualify for recognition as a completed sale within one year, except if events or circumstances beyond our control extend the period of time required to sell the assets beyond one year; the assets are being actively marketed for sale at a price that is reasonable in relation to current fair value; and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

A long-lived asset that is classified as held for sale is initially measured at the lower of its carrying value or fair value less any costs to sell. Any loss resulting from this measurement is recognized in the period in which the held for sale criteria are met. Conversely, gains are not recognized on the sale of a long-lived asset until the date of sale. The fair value of a long-lived asset less any costs to sell is assessed each reporting period it remains classified as held for sale and any reduction in fair value is reported as an adjustment to the carrying value of the asset. Upon being classified as held for sale, depreciation is ceased. Long-lived assets to be disposed of other than by sale are continued to be depreciated. Upon determining that a long-lived asset meets the criteria to be classified as held for sale, the assets and

liabilities of the disposal group, if material, are reported in the line item Assets Held for Sale in our condensed consolidated balance sheets.

In early 2015, the Company made the decision to dispose of the Company's mothballed RTL facility and related equipment in the Philippines. These assets are included in the EP segment. During 2015, the Company reclassified the balance of the equipment, along with the land and building associated with the property, at this location from Property, Plant and Equipment, net, to Assets Held for Sale on the consolidated balance sheets. The reclassifications were made for all assets that are expected to be sold within one year of the balance sheet date and, as of September 30,

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2016, all of the physical assets of this entity are classified as Assets Held for Sale. There were no impairment charges recognized on these assets during the three or nine months ended September 30, 2016.

Note 10. Debt

The components of total debt are summarized in the following table (\$ in millions):

	September 30, 2016	December 31, 2015
Term Loan A-1	\$ 60.0	\$ 60.0
Term Loan A-2	247.5	249.4
Revolving Credit Agreement - U.S. dollar borrowings	134.0	197.0
Revolving Credit Agreement - euro borrowings	—	62.4
French Employee Profit Sharing	10.2	11.4
Total Debt	451.7	580.2
Less: Debt issuance costs	(7.4	) (8.7
Less: Current debt	(3.2	) (3.3
Long-Term Debt	\$ 441.1	\$ 568.2

Credit Agreement

On October 28, 2015, the Company, together with two of its Luxembourg-based wholly-owned holding subsidiaries, entered into a Second Amended and Restated Credit Agreement, or the Amended Credit Agreement, with JPMorgan Chase Bank, N.A., as administrative agent, providing for credit facilities in the aggregate principal amount of \$1 billion, consisting of a \$650 million revolving credit facility, or Revolving Credit Facility, available to the Company; a \$100 million Term Loan A-1, or Term Loan A-1, made to the Company; and a \$250 million Term Loan A-2, or Term Loan A-2 and, together with Term Loan A-1, the Term Loans, made to the Company. The Revolving Credit Facility matures on October 28, 2020. The Term Loan A-1 amortizes at the rate of 5.0% for the first two years, at the rate of 10.0% for the final three years and matures on October 28, 2020. The Term Loan A-2 amortizes at the rate of 1.0% per year and matures on October 28, 2022. The Term Loans are generally subject to mandatory repayment out of the net cash proceeds of asset sales which are not reinvested in operating assets. The credit facilities are secured by substantially all of the personal property of the Company and its domestic subsidiaries while the obligations of the Luxembourg-based holding subsidiaries are secured by a pledge of certain of the equity interests held in their operating subsidiaries. In December 2015, the Company prepaid the full amount of amortization for Term Loan A-1, which totaled \$40 million.

The Amended Credit Agreement amended and restated the Company's Amended and Restated Credit Agreement, dated as of December 11, 2013, which provided for a \$500 million unsecured revolving credit facility which was scheduled to mature on December 11, 2018.

The interest rate margins applicable to the Revolving Credit Facility and the Term Loans under the Amended Credit Agreement are based on a fluctuating rate of interest measured by reference to either, at the Company's option, (i) a base rate, plus an applicable margin, which ranges from 0.25% to 1.25%, in the case of the Revolving Credit Facility and Term Loan A-1, and from 0.50% to 1.50%, in the case of Term Loan A-2, or (ii) an adjusted London interbank offered rate (adjusted for maximum reserves), or LIBOR, plus an applicable margin, which ranges from 1.25% to 2.25%, in the case of the Revolving Credit Facility and Term Loan A-1, and from 1.50% to 2.50%, in the case of Term Loan A-2. The applicable margin, in each case, will be adjusted from time to time based on the Company's ratio

of net debt to EBITDA as defined in the Amended Credit Agreement. As of September 30, 2016, the average interest rate on outstanding Amended Credit Agreement borrowings was 2.31% on US Revolving Credit Facility borrowings, 1.75% on Euro Revolving Credit Facility borrowings, 2.31% on Term Loan A-1 borrowings and 2.56% on Term Loan A-2 borrowings. The weighted average effective interest rate on our debt facilities was approximately 2.34% and 1.44% for the nine months ended September 30, 2016 and 2015, respectively.

The Amended Credit Agreement also 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 maximum net debt

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to EBITDA ratio of 3.50, reducing to 3.00 after September 30, 2016 and (b) minimum interest coverage of 3.00. The Amended Credit Agreement contains provisions allowing the Company to increase the leverage ratio upon the incurrence of certain unsecured indebtedness or temporarily upon the occurrence of a material acquisition. The Company was in compliance with all of its covenants under the Amended Credit Agreement at September 30, 2016.

In conjunction with the Amended Credit Agreement, the Company capitalized approximately \$7.4 million in deferred debt issuance costs associated with the new facility which will be amortized over the term of the related debt instrument. As of September 30, 2016 and December 31, 2015, the Company's total deferred debt issuance costs, net of accumulated amortization, were \$7.4 million and \$8.7 million, respectively. Amortization expense of \$1.3 million and \$0.4 million was recorded during the nine months ended September 30, 2016 and 2015, respectively, and has been included as a component of Interest Expense in the accompanying consolidated statements of income.

#### Fair Value of Debt

At September 30, 2016 and December 31, 2015, the estimated fair values of the Company's current and long-term debt approximated the respective carrying amounts as 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 September 30, 2016 (\$ 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, net	\$ 1.5	Accrued expenses	\$ 2.2

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Foreign exchange contracts	Other Assets	1.7	Other Liabilities	0.5
Interest rate contracts	Other Assets	—	Other Liabilities	0.9
Total derivatives designated as hedges		\$ 3.2		\$ 3.6

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The following table presents the fair value of asset and liability derivatives and the respective balance sheet locations at December 31, 2015 (\$ 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, net	\$ 0.7	Accrued expenses	\$ 10.8
Foreign exchange contracts	Other Assets	—	Other Liabilities	7.0
Interest rate contracts	Other Assets	—	Other Liabilities	0.6
Total derivatives designated as hedges		\$ 0.7		\$ 18.4

The following table provides the gross 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	Unrealized Gain (Loss) Recognized in AOCI on Derivatives, Net of Tax				Loss Reclassified from AOCI			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30,		September 30,		September 30,		September 30,	
	2016	2015	2016	2015	2016	2015	2016	2015
Foreign exchange contracts	\$(0.4)	\$(15.1)	\$12.3	\$(24.6)	\$(0.4)	\$(3.7)	\$(5.7)	\$(7.3)
Interest rate contracts	0.1	(0.3)	(0.6)	(0.5)	(0.2)	—	(0.5)	—
Total	\$(0.3)	\$(15.4)	\$11.7	\$(25.1)	\$(0.6)	\$(3.7)	\$(6.2)	\$(7.3)

The Company's designated derivative instruments are highly 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 nine months ended September 30, 2016 and 2015.

The following table provides the effect that derivative instruments not designated as cash flow 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		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Foreign exchange contracts	\$0.8	\$ 0.3	\$ 1.2	\$(1.3)

## Note 12. Commitments and Contingencies

### Litigation

Imposto sobre Circulação de Mercadorias e Serviços, or ICMS, a form of value-added tax in Brazil, was assessed to our Brazilian subsidiary Schweitzer-Mauduit do Brasil Indústria e Comércio de Papel Ltda., or SWM-B, in December 2000. SWM-B 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. 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

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taxes to papers intended for printing books, newspapers and periodicals, or immune papers, and thus to the raw material inputs used to produce immune papers. 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. In October 2015, the Federal Supreme Court of Brazil denied the State's appeal of Assessment 1, in the amount of approximately \$16.0 million, a decision which is now final. The second assessment, or Assessment 2 (case number 2001.001.064544-6), pertains exclusively to periods during which SWM-B owned the Pirahy mill. Assessment 2 in the amount of approximately \$14.0 million remains pending before the Federal Supreme Court of Brazil on SWM-B's appeal on the merits and is likely to be finally decided by the action of the chamber of the court hearing the matter. No docket entry has been made yet regarding argument on Assessment 2.

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, a value-added tax similar to ICMS) taxes on interstate purchases of electricity. The State issued three sets of assessments against SWM-B, one for May 2006 - November 2007, a second for January 2008 - December 2010, and a third for September 2011 - September 2013, collectively the Electricity Assessments. SWM-B has challenged all three Electricity Assessments in administrative proceedings before the State tax council (in the first-level court Junta de Revisão Fiscal and the appellate court Conselho de Contribuintes) based on Resolution 1.610/89, which defers these taxes on electricity purchased by an "electricity-intensive consumer." In October and November 2014, a majority of the Conselho de Contribuintes sitting en banc ruled against SWM-B in each of the first and second Electricity Assessments. The State issued notices to SWM-B to pay approximately \$5.0 million in the first Electricity Assessment and \$9.0 million in the second Electricity Assessment, based on the foreign currency exchange rate at September 30, 2016. SWM-B filed separate challenges to these Electricity Assessments in further court proceedings in the State judicial system, and different chambers of the judicial court granted SWM-B preliminary injunctions against enforcement. On the State's appeal, the court required SWM-B to post security for the injunction concerning the Electricity Assessment for May 2006 - November 2007. In September 2016, the first-level administrative court (Junta de Revisão Fiscal) ruled against SWM-B's challenge to the third Electricity Assessment (approximately \$4.0 million as of September 30, 2016), a decision which SWM-B plans to appeal to the Conselho de Contribuintes.

SWM-B believes that both the remaining Raw Materials Assessment and the Electricity Assessments will ultimately be resolved in its favor. No liability has been recorded in our 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, results of operations or cash flows. However, future events, such as changes in existing laws and regulations (including the enforcement thereof), 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), or similar circumstances arising at our unconsolidated joint ventures, may give rise to additional costs which could have a material effect on the Company's

financial condition or results of operations.

#### General Matters

In the ordinary course of its 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, intellectual property rights and other matters. At this time, the Company does not expect any of these proceedings to have an adverse material effect on its reputation, business, financial condition, results of operations or cash flows.

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However, as the outcomes of such proceedings are unpredictable, 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 OPEB benefits related to postretirement healthcare and life insurance 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 nine months ended September 30, 2016 and 2015 were as follows (\$ in millions):

	Three Months Ended September 30,					
	U.S. Pension Benefits		French Pension Benefits		U.S. OPEB Benefits	
	2016	2015	2016	2015	2016	2015
Service cost	\$—	\$—	\$0.2	\$0.3	\$—	\$—
Interest cost	1.3	1.2	0.2	0.1	—	—
Expected return on plan assets	(1.7 )	(1.8 )	(0.1 )	(0.1 )	—	—
Amortizations and other	0.8	1.1	0.3	0.3	0.1	0.1
Net periodic benefit cost	\$0.4	\$0.5	\$0.6	\$0.6	\$0.1	\$0.1

  

	Nine Months Ended September 30,					
	U.S. Pension Benefits		French Pension Benefits		U.S. OPEB Benefits	
	2016	2015	2016	2015	2016	2015
Service cost	\$—	\$—	\$0.8	\$0.9	\$—	\$—
Interest cost	3.9	3.8	0.4	0.3	—	—
Expected return on plan assets	(5.1 )	(5.3 )	(0.2 )	(0.2 )	—	—
Amortizations and other	2.8	3.9	0.8	0.9	0.2	(0.1 )
Net periodic benefit cost	\$1.6	\$2.4	\$1.8	\$1.9	\$0.2	\$(0.1)

During the fiscal year ending December 31, 2016, the Company expects to recognize approximately \$3.9 million for amortization of accumulated other comprehensive loss related to its U.S. pension and OPEB plans and approximately \$1.0 million for its French pension plans.

Note 14. Income Taxes

For interim financial reporting, the Company estimates the annual tax rate based on projected taxable income for the full year and records a quarterly income tax provision in accordance with ASC No. 740-270 "Accounting for Income Taxes in Interim Periods." These interim estimates are subject to variation due to several factors, including our ability to accurately forecast our pre-tax and taxable income and loss by jurisdiction, changes in laws or regulations, and

expenses or losses for which tax benefits are not recognized. Jurisdictions with a projected loss for the year or an actual year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of including these jurisdictions on the quarterly effective tax rate calculations could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings verses annual projections. Also, the impact of discrete items and non-deductible losses on our effective tax rate is greater when our pre-tax income is lower.

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All unrecognized tax positions would impact the Company's effective tax rate if recognized. With respect to penalties and interest incurred from income tax assessments or related to unrecognized tax benefits, the Company's policy is to classify penalties as provision for income taxes and interest as interest expense in its consolidated statement of income. There were no material income tax penalties or interest accrued during the three or nine months ended September 30, 2016 or 2015.

Our effective tax rate from continuing operations was 38.8% and 18.8% for the three months ended September 30, 2016 and 2015, respectively, and increased primarily due to a higher concentration of profits generated in higher-tax jurisdictions coupled with a reduction in the generation of certain foreign tax credits and one-time discrete tax expense items. Our effective tax rate from continuing operations was 30.6% and 21.7% for the nine months ended September 30, 2016 and 2015, respectively, and increased primarily due to the same reasons as during the quarterly periods.

Note 15. Segment Information

The Company's two operating product line segments are also the Company's reportable segments: Engineered Papers and Advanced Materials & Structures. The EP segment, which consists of the Company's former Paper and Reconstituted Tobacco segments, primarily produces Cigarette Papers including LIP papers, plug wrap papers and base tipping papers used to wrap various parts of a cigarette for sale to cigarette manufacturers and RTL and wrapper and binder products for sale to cigarette and cigar manufacturers. The EP segment also includes commercial and industrial products such as lightweight printing and writing papers, battery separator paper, drinking straw wrap, filter paper and other specialized papers. These non-tobacco industry products are generally sold directly to converters and other end-users or brokers. The AMS segment primarily produces engineered resin-based, rolled goods such as films, nets, and other non-wovens for use in high-performance filtration, surface protection, medical, and industrial applications and consists of the operations of DelStar, Inc., the December 2014 acquisition of Pronamic Industries, Inc. and Smith & Nephew's Advanced Wound Management Division, and Argotec. In conjunction with the consolidation of the Paper and Reconstituted Tobacco segments into the EP segment in October 2015, the corresponding information for all prior periods presented has been restated to correspond to the presentation in the current year.

Information about Net Sales and Operating Profit

The accounting policies of these segments are the same as those described in Note 2. Summary of Significant Accounting Policies in the notes to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. The Company primarily evaluates segment performance and allocates resources based on operating profit. Expense amounts not associated with segments are referred to as unallocated expenses. The Company has recast the prior period operating profit by segment for comparative purposes to conform to current year presentation, which reflects a change in the way certain internal charges are allocated to individual business units. These changes had no impact on consolidated operating profit and were not material to the segment measurements presented.

(\$ in millions)	Net Sales							
	Three Months Ended				Nine months ended			
	September 30,		September 30,		September 30,		September 30,	
	2016		2015		2016		2015	
Engineered Papers	\$136.8	65.4 %	\$142.4	77.2 %	\$425.7	66.4 %	\$431.2	77.8 %
Advanced Materials & Structures	72.5	34.6	42.0	22.8	215.5	33.6	123.1	22.2
Total Consolidated	\$209.3	100.0%	\$184.4	100.0%	\$641.2	100.0%	\$554.3	100.0%





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(\$ in millions)	Operating Profit							
	Three Months Ended				Nine Months Ended			
	September 30, 2016		September 30, 2015		September 30, 2016		September 30, 2015	
Engineered Papers	\$32.0	103.9 %	\$31.0	97.5 %	\$103.4	103.5 %	\$85.7	109.5 %
Advanced Materials & Structures	8.7	28.2	4.8	15.1	22.8	22.8	12.8	16.3
Unallocated	(9.9 )	(32.1 )	(4.0 )	(12.6 )	(26.3 )	(26.3 )	(20.2 )	(25.8 )
Total Consolidated	\$30.8	100.0 %	\$31.8	100.0 %	\$99.9	100.0 %	\$78.3	100.0 %

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is a discussion of our financial condition and results of operations. This discussion should be read in conjunction with our unaudited condensed 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 our Annual Report on Form 10-K for the year ended December 31, 2015. The discussion of our financial condition and results of operations includes various forward-looking statements about our markets, the demand for our products, our future prospects and other matters. These statements are based on certain assumptions and estimates that we consider reasonable. For information about risks and exposures relating to us and our business, you should read the section entitled "Risk Factors" in Part 1, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 and the section entitled "Forward-Looking Statements" at the end of this Item 2. Unless the context indicates otherwise, references to "SWM", "we", "us", "our", the "Company" or similar terms include Schweitzer-Mauduit International, Inc. and our consolidated subsidiaries.

## Summary

(\$ in millions, except per share amounts)	Three Months Ended				Nine Months Ended			
	September 30, 2016		September 30, 2015		September 30, 2016		September 30, 2015	
Net sales	\$209.3	100.0%	\$184.4	100.0%	\$641.2	100.0%	\$554.3	100.0%
Gross profit	63.1	30.1	52.4	28.4	193.5	30.2	158.6	28.6
Restructuring & impairment expense	1.3	0.6	1.3	0.7	4.0	0.6	10.5	1.9
Operating profit	30.8	14.7	31.8	17.2	99.9	15.6	78.3	14.1
Interest expense	3.9	1.9	1.7	0.9	12.6	2.0	5.3	1.0
Income from continuing operations	18.7	8.9	25.6	13.9	65.8	10.3	68.9	12.4
Loss from discontinued operations	—	—	0.2	0.1	—	—	(0.9)	(0.2)
Net income	\$18.7	8.9%	\$25.8	14.0%	\$65.8	10.3%	\$68.0	12.3%
Diluted earnings per share from continuing operations	\$0.61		\$0.84		\$2.15		\$2.25	
Diluted earnings per share	\$0.61		\$0.85		\$2.15		\$2.22	
Cash provided by operations	\$30.8		\$24.5		\$83.0		\$80.2	
Capital spending	\$7.8		\$4.9		\$17.5		\$14.0	

## Third Quarter Highlights

In the three months ended September 30, 2016, SWM reported net income of \$18.7 million on total net sales of \$209.3 million. Compared to the prior-year period, net sales increased \$24.9 million due primarily to incremental net sales generated from the operations of our newly acquired Argotec business and favorable net foreign currency translation impacts in our EP segment, partially offset by the net combined unfavorable impact of changes in volumes, mix of products sold and average selling prices in our EP segment. Additionally, our AMS segment was impacted by a decline in certain air filtration sales, planned reductions of low-margin industrial sales, and a decline in water filtration sales, which offset growth in other filtration end-markets.

Gross profit increased by \$10.7 million to \$63.1 million in the three months ended September 30, 2016 compared with \$52.4 million in the prior-year period primarily due to incremental gross profit generated by the operations of our newly acquired Argotec business along with the impact of operational improvements and overall favorable foreign currency translation impacts. These factors were partially offset by other factors, including the net combined unfavorable impact of changes in overall volumes, mix of products sold, and average selling prices in the EP segment and the impact of a



decline in certain air filtration sales, planned reductions of low-margin industrial sales, and a decline in water filtration sales, which offset growth in other filtration end-markets, in the AMS segment.

Cash provided by operations was \$30.8 million in the third quarter of 2016 compared to \$24.5 million in the prior-year period. The \$6.3 million increase was due primarily to favorable net changes in operating working capital partially offset by lower net income compared to the prior-year period. Uses of cash during the three months ended September 30, 2016 included \$7.8 million of capital spending, \$12.2 million cash dividends paid to SWM stockholders and \$66.8 million in net repayments of debt.

#### Year-to-Date Highlights

In the nine months ended September 30, 2016, SWM reported net income of \$65.8 million on total net sales of \$641.2 million. Compared to the prior-year period, net sales increased \$86.9 million due primarily to incremental net sales generated from the operations of our newly acquired Argotec business, partially offset by the net combined unfavorable impact of changes in volumes, mix of products sold and average selling prices in our EP segment and unfavorable net foreign currency translation impacts. Our AMS segment was also impacted by planned reductions of low-margin industrial sales and a decline in sales of certain air filtration products which offset growth in other filtration end-markets.

Gross profit increased by \$34.9 million to \$193.5 million in the nine months ended September 30, 2016 compared with \$158.6 million in the prior-year period primarily due to incremental gross profit generated by the operations of our newly acquired Argotec business along with the net combined impact of operational improvements and net combined changes in volumes, mix of products sold, and average selling prices in our EP segment and favorable net foreign currency impacts. These factors were partially offset by other factors, including planned reductions of low-margin industrial sales and the associated unfavorable fixed cost absorption in our AMS segment along with a decline in sales of certain air filtration products which offset growth in other filtration end-markets.

Cash provided by operations was \$83.0 million in the first nine months of 2016 compared to \$80.2 million in the prior-year period. The \$2.8 million increase was due primarily to favorable changes in net working capital, partially offset by lower net income and a dividend received from our equity affiliate in the prior year. Uses of cash during the nine months ended September 30, 2016 included \$17.5 million of capital spending, \$36.6 million cash dividends paid to SWM stockholders, and \$131.6 million in net repayments of debt.

## Three Months Ended September 30, 2016 Compared with the Three Months Ended September 30, 2015

Net Sales  
(\$ in millions)

	Three Months Ended		Change	Percent Change
	September 30, 2016	September 30, 2015		
Engineered Papers	\$136.8	\$142.4	\$(5.6)	(3.9)%
Advanced Materials & Structures	72.5	42.0	30.5	72.6
Total	\$209.3	\$184.4	\$24.9	13.5%

Net sales were \$209.3 million in the three months ended September 30, 2016 compared with \$184.4 million in the prior-year period. The increase in net sales consisted of the following (\$ in millions):

	Amount	Percent
Incremental revenue from acquired companies	\$32.8	17.8%
Changes in volume, product mix and selling prices	(10.1)	(5.4)
Changes due to net foreign currency impacts	2.3	1.2
Changes due to royalties	(0.1)	(0.1)
Total	\$24.9	13.5%

EP segment net sales during the three months ended September 30, 2016 of \$136.8 million decreased by \$5.6 million, or 3.9%, versus net sales of \$142.4 million in the prior year quarter. The decrease in net sales was primarily the result of the \$9.0 million net combined unfavorable impact of changes in volumes, mix of products sold and average selling prices and \$0.1 million in lower royalties, partially offset by \$3.5 million in favorable net foreign currency translation impacts, primarily from a stronger euro, in each case compared to the prior-year period.

AMS segment net sales were \$72.5 million for the three months ended September 30, 2016 compared to \$42.0 million during the prior-year period. The increase of \$30.5 million or 72.6% was due primarily to \$32.8 million in incremental net sales generated by the operations of our newly acquired Argotec business, partially offset by \$1.2 million of unfavorable net foreign currency translation impacts, mainly from a weaker British pound and Chinese yuan. Absent the impact of the Argotec acquisition and currency movements, AMS segment net sales decreased \$1.1 million primarily due to a decline in certain air filtration sales, planned reductions of low-margin industrial sales, and a decline in water filtration sales, which offset growth in other filtration end-markets.

Gross Profit  
(\$ in millions)

	Three Months Ended			Percent of Net Sales		
	September 30, 2016	September 30, 2015	Change	Change	2016	2015
Net Sales	\$209.3	\$184.4	\$24.9	13.5%	100.0%	100.0%
Cost of products sold	146.2	132.0	14.2	10.8	69.9	71.6
Gross Profit	\$63.1	\$52.4	\$10.7	20.4%	30.1%	28.4%

Gross profit increased by \$10.7 million during the three months ended September 30, 2016 to \$63.1 million versus the prior-year period of \$52.4 million. In the EP segment, the \$2.8 million net combined favorable impact of operational improvements and lower input costs along with \$1.9 million net favorable foreign currency translation impacts were partially offset by the \$3.4 million net combined unfavorable impact of changes in overall volumes, mix of products sold and average selling prices. The AMS segment benefited from \$9.5 million in incremental gross profit associated with the operations of our newly acquired Argotec business and \$1.0 million in operational improvements and lower

input costs, partially offset by the \$0.8 million impact of lower net sales, primarily from a decline in certain air filtration

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sales, planned reductions of low-margin industrial sales, and a decline in water filtration sales, which offset growth in other filtration end-markets, and \$0.3 million of unfavorable net foreign currency translation impacts.

Nonmanufacturing Expenses  
(\$ in millions)

	Three Months Ended			Percent Change	Percent of Net Sales	
	September 2016	September 30, 2015	Change		2016	2015
Selling expense	\$ 6.0	\$ 5.5	\$ 0.5	9.1 %	2.9 %	3.0 %
Research expense	4.2	3.5	0.7	20.0	2.0	1.9
General expense	20.8	10.3	10.5	101.9	9.9	5.6
Nonmanufacturing expenses	\$ 31.0	\$ 19.3	\$ 11.7	60.6 %	14.8%	10.5%

Nonmanufacturing expenses in the three months ended September 30, 2016 increased by \$11.7 million to \$31.0 million from \$19.3 million in the prior-year period due primarily to \$4.4 million in higher incremental costs from the operations of our newly acquired Argotec business and \$7.6 million in higher general and administrative expenses including the combined impact of modestly higher legal costs relating to intellectual property litigation and proceedings in Europe, professional services fees, higher intangible assets amortization expense and general increases in other expenses, primarily due to timing of expenses year over year, along with \$0.1 million in higher research and development expenditures. These factors were partially offset by \$0.4 million in lower selling expenses.

Restructuring and Impairment Expense  
(\$ in millions)

	Three Months Ended			Percent Change	Percent of Net Sales	
	September 2016	September 30, 2015	Change		2016	2015
Engineered Papers	\$ 1.3	\$ 1.4	\$ (0.1 )	(7.1 )%	1.0%	1.0%
Advanced Materials & Structures	—	—	—	—	—	—
Unallocated expenses	—	(0.1 )	0.1	(100.0)		
Total	\$ 1.3	\$ 1.3	\$ —	— %	0.6%	0.7%

The Company incurred total restructuring and impairment expense of \$1.3 million in each of the three months ended September 30, 2016 and 2015. In the 2016 period, the restructuring expense primarily related to \$1.3 million in severance accruals for employees at our EP manufacturing operations related to the implementation of previously announced voluntary retirement programs available to certain employees at our French manufacturing facilities. This restructuring expense will be accrued over the remaining service lives of the affected employees.

In the 2015 period, the restructuring expense primarily related to the implementation of a previously announced voluntary retirement program available to certain employees at our French manufacturing facilities. This restructuring expense will be accrued over the remaining service lives of the affected employees, of which \$1.4 million was recognized during the three months ended September 30, 2015. During 2015, we also reversed \$0.1 million related to accruals for severance expenses previously recognized within supporting overhead departments which were not allocated to a specific segment.

Operating Profit  
(\$ in millions)

	Three Months Ended			Percent Change	Return on Net Sales	
	September 2016	September 2015	Change		2016	2015
Engineered Papers	\$32.0	\$ 31.0	\$ 1.0	3.2 %	23.4%	21.8%
Advanced Materials & Structures	8.7	4.8	3.9	81.3	12.0	11.4
Unallocated expenses	(9.9 )	(4.0 )	(5.9 )	147.5		
Total	\$30.8	\$ 31.8	\$(1.0 )	(3.1 )%	14.7%	17.2%

Operating profit was \$30.8 million in the three months ended September 30, 2016 compared with \$31.8 million during the prior-year period.

The EP segment's operating profit in the three months ended September 30, 2016 was \$32.0 million, an increase of \$1.0 million, or 3.2%, from \$31.0 million in the prior-year period. The increase was primarily due to the \$2.8 combined net impact of operational improvements and lower input costs, along with \$1.9 million in net favorable foreign currency translation impacts, which were partially offset by the \$3.4 million net combined unfavorable impact of changes in overall volumes, mix of products sold, and average selling prices and \$0.3 million net impact of higher nonmanufacturing expenses.

The AMS segment's operating profit in the three months ended September 30, 2016 was \$8.7 million compared to \$4.8 million in the prior-year period. The increase of \$3.9 million, or 81.3%, was positively impacted by \$5.1 million in incremental operating profit associated with the operations of our newly acquired Argotec business and the combined impact of \$1.0 million in operational improvements and lower input costs; these factors were partially offset by \$0.4 million in unfavorable net foreign currency translation impacts and includes the combined \$1.8 million impact of a decline in net sales, including certain air filtration sales, planned reductions of low-margin industrial sales, and a decline in water filtration sales, which offset growth in other filtration end-markets, along with higher net nonmanufacturing expenses compared to the prior period.

Unallocated expenses in the three months ended September 30, 2016 were \$9.9 million compared to \$4.0 million in the prior-year period. The increase of \$5.9 million, or 147.5%, in unallocated expenses during the three months ended September 30, 2016 compared to the prior-year period was primarily attributable to the combined impact of modestly higher legal costs relating to intellectual property litigation and proceedings in Europe, professional services fees and general increases in other expenses, primarily due to timing of expenses year over year.

#### Non-Operating Expenses

Interest expense was \$3.9 million in the three months ended September 30, 2016, an increase from \$1.7 million in the prior-year period. The weighted average effective interest rate on our debt facilities was approximately 2.42% and 1.47% for the three months ended September 30, 2016 and 2015, respectively. The increase in interest expense is due to higher debt balances outstanding compared to the prior-year period in conjunction with the Argotec acquisition as well as the effect of the higher effective interest rate applied to borrowings under the Amended Credit Agreement which was executed in October 2015 when compared to our previous credit agreement.

Other income, net, was \$0.7 million during the three months ended September 30, 2016. The \$0.6 million decrease in other income, net compared to \$1.3 million during the three months ended September 30, 2015 was due primarily to lower interest income from lower cash balances outstanding during the third quarter of 2016 and lower royalty income from our joint ventures in China, partially offset by lower net foreign currency transaction losses compared to the prior-year period.





### Income Taxes

A \$10.7 million provision for income taxes in the three months ended September 30, 2016 resulted in an effective tax rate of 38.8% compared with 18.8% in the prior-year period. The increase in the effective tax rate was primarily attributed to a higher concentration of profits generated in higher-tax jurisdictions coupled with a reduction in the generation of certain foreign tax credits in 2016 compared to the prior-year period and incurrence of certain one-time discrete tax expense items in the third quarter of 2016.

### Income from Equity Affiliates

Income from equity affiliates was \$1.8 million in the three months ended September 30, 2016 compared with \$0.1 million during the prior-year period and reflected the results of operations of CTM and CTS. The increase in earnings was driven primarily by higher sales volumes at CTS in the third quarter of 2016 compared to the prior-year period.

### Discontinued Operations

Because we closed our Philippines paper mill as previously reported, the results of this mill were reported as discontinued operations for all periods presented. Consequently, this mill's results have been removed from each line of 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 the discontinued operation.

### Net Income and Income per Share

Net income in the three months ended September 30, 2016 was \$18.7 million, or \$0.61 per diluted share, compared with \$25.8 million, or \$0.85 per diluted share, during the prior-year period. The decrease in net income was primarily due to the combined net unfavorable impact of changes in volumes, mix of products sold and average selling prices in our EP segment and, in our AMS segment, the impact of sales declines in certain end-markets. Additionally, the Company was impacted by higher income tax expense and higher general expenses. These factors were partially offset by incremental income earned from the operations of our newly acquired Argotec business as well as a net combined favorable impact of operational improvements in the EP segments, overall favorable net foreign currency translation impacts, and higher income from our equity affiliates.

## Nine Months Ended September 30, 2016 Compared with the Nine Months Ended September 30, 2015

## Net Sales

(\$ in millions)

	Nine Months Ended		Change	Percent Change
	September 30, 2016	September 30, 2015		
Engineered Papers	\$425.7	\$ 431.2	\$(5.5 )	(1.3 )
Advanced Materials & Structures	215.5	123.1	92.4	75.1
Total	\$641.2	\$ 554.3	\$ 86.9	15.7 %

N.M. - Not Meaningful

Net sales were \$641.2 million in the nine months ended September 30, 2016 compared with \$554.3 million in the prior-year period. The increase in net sales consisted of the following (\$ in millions):

	Amount	Percent
Incremental revenue from acquired companies	\$ 97.2	17.5 %
Changes in volume, product mix and selling prices	(8.0 )	(1.4 )
Changes due to net foreign currency impacts	(1.9 )	(0.3 )
Changes due to royalties	(0.4 )	(0.1 )
Total	\$ 86.9	15.7 %

EP segment net sales during the nine months ended September 30, 2016 of \$425.7 million decreased by \$5.5 million versus net sales of \$431.2 million in the prior-year period. The decrease in net sales was primarily the result of the \$5.4 million net combined unfavorable impact of changes in volumes, mix of products sold and average selling prices and \$0.4 million impact of lower royalties received, partially offset by \$0.3 million in favorable net foreign currency translation impacts, primarily from a stronger euro, in each case compared to the prior-year period.

AMS segment net sales were \$215.5 million for the nine months ended September 30, 2016 compared to \$123.1 million during the prior-year period. The increase of \$92.4 million or 75.1% was due primarily to \$97.2 million in incremental net sales generated by the operations of our newly acquired Argotec business. This was partially offset by several factors, including \$2.2 million of unfavorable net foreign currency translation impacts, mainly from a weaker British pound and Chinese yuan and \$2.6 million combined impact primarily from planned reductions of low margin industrial sales and a decline in sales of certain air filtration products which offset growth in other filtration end-markets.

## Gross Profit

(\$ in millions)

	Nine Months Ended			Percent of Net Sales	
	September 30, 2016	September 30, 2015	Change	2016	2015
Net Sales	\$641.2	\$ 554.3	\$ 86.9	15.7 %	100.0 %
Cost of products sold	447.7	395.7	52.0	13.1	69.8
Gross Profit	\$ 193.5	\$ 158.6	\$ 34.9	22.0 %	30.2 %

Gross profit increased by \$34.9 million during the nine months ended September 30, 2016 to \$193.5 million versus the prior-year period of \$158.6 million. In the EP segment, the \$7.8 million net favorable combined impact of operational improvements and lower input costs and net combined changes in volumes, mix of products sold and average selling prices, along with \$2.8 million in favorable net foreign currency translation impacts and \$0.7 million in lower distribution costs were partially offset by the \$0.4 million impact of lower royalty income. The AMS segment

benefited from \$27.2 million in incremental gross profit associated with the operations of our newly acquired Argotec business, partially

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offset by \$0.7 million in unfavorable net foreign currency translation impacts as well as a combined \$2.5 million impact of a decline in net sales, primarily from planned reductions of low margin industrial sales and associated unfavorable fixed cost absorption along with a decline in sales of certain air filtration products which offset growth in other filtration end-markets.

Nonmanufacturing Expenses  
(\$ in millions)

	Nine Months Ended			Percent Change	Percent of Net Sales	
	September 2016	September 2015	Change		2016	2015
Selling expense	\$ 18.8	\$ 16.0	\$ 2.8	17.5 %	2.9 %	2.9 %
Research expense	12.9	10.5	2.4	22.9	2.0	1.9
General expense	57.9	43.3	14.6	33.7	9.0	7.8
Nonmanufacturing expenses	\$ 89.6	\$ 69.8	\$ 19.8	28.4 %	13.9 %	12.6 %

Nonmanufacturing expenses in the nine months ended September 30, 2016 increased by \$19.8 million to \$89.6 million from \$69.8 million in the prior-year period due primarily to \$13.2 million in higher incremental costs from the operations of our newly acquired Argotec business along with \$1.4 million in higher research and development and selling expenditures and \$5.6 million in higher general and administrative expenses including the combined impact of modestly higher legal costs relating to intellectual property litigation and proceedings in Europe, professional services fees, higher intangible asset amortization expense and general increases in other expenses, primarily due to timing of expenses year over year. These factors were partially offset by \$0.4 million in favorable foreign currency translation impacts.

Restructuring and Impairment Expense  
(\$ in millions)

	Nine Months Ended			Percent Change	Percent of Net Sales	
	September 2016	September 2015	Change		2016	2015
Engineered Papers	\$ 3.1	\$ 10.5	\$ (7.4 )	(70.5 )%	0.7 %	2.4 %
Advanced Materials & Structures	0.6	(0.2 )	0.8	400.0	0.3	(0.2)
Unallocated expenses	0.3	0.2	0.1	50.0		
Total	\$ 4.0	\$ 10.5	\$ (6.5 )	(61.9 )%	0.6 %	1.9 %

The Company incurred total restructuring and impairment expense of \$4.0 million in the nine months ended September 30, 2016 compared with \$10.5 million in the nine months ended September 30, 2015. In the 2016 period, the restructuring expense primarily related to \$3.2 million in severance accruals for employees at our EP and AMS manufacturing operations in the U.S., France and Brazil, \$0.3 million in severance accruals within supporting overhead departments not allocated to a specific segment and \$0.5 million of impairment expense recognized on equipment at our Poland paper manufacturing facility.

In the comparable 2015 period, the restructuring expense primarily related to the implementation of a voluntary retirement program announced in late 2014 and available to certain employees at our French manufacturing facilities. This restructuring expense will be accrued over the remaining service lives of the affected employees, of which \$7.0 million was recognized during the comparable 2015 period. During 2015, the Company also recognized a loss of \$0.7 million on the sale of certain equipment from our mothballed Philippines site and \$2.8 million of loss recognized to write down equipment at that same Philippines site to its expected recoverable sales value.



Operating Profit  
(\$ in millions)

	Nine Months Ended			Percent Change	Return on Net Sales	
	September 2016	September 30, 2015	Change		2016	2015
Engineered Papers	\$103.4	\$ 85.7	\$ 17.7	20.7 %	24.3 %	19.9 %
Advanced Materials & Structures	22.8	12.8	10.0	78.1	10.6	10.4
Unallocated expenses	(26.3 )	(20.2 )	(6.1 )	30.2		
Total	\$99.9	\$ 78.3	\$ 21.6	27.6 %	15.6 %	14.1 %

Operating profit was \$99.9 million in the nine months ended September 30, 2016 compared with \$78.3 million during the prior-year period.

The EP segment's operating profit in the nine months ended September 30, 2016 was \$103.4 million, an increase of \$17.7 million, or 20.7%, from \$85.7 million in the prior-year period. The increase was primarily due to the \$7.8 million net combined impact of operational improvements and lower input costs and net combined changes in volumes, mix of products sold and average selling prices, \$3.2 million in favorable net foreign currency translation impacts, \$0.6 million in lower distribution costs and \$7.4 million in lower restructuring expenses which were partially offset by the \$0.4 million impact of lower royalty income along with the \$0.9 million impact of higher nonmanufacturing expenses.

The AMS segment's operating profit in the nine months ended September 30, 2016 was \$22.8 million compared to \$12.8 million in the prior-year period. The increase of \$10.0 million, or 78.1%, was positively impacted by \$14.0 million in incremental operating profit associated with the operations of our newly acquired Argotec business, partially offset by \$0.7 million in unfavorable net foreign currency translation impacts and \$0.8 million in higher restructuring expenses. The AMS segment was also impacted by other factors, including a combined \$2.5 million impact of a decline in net sales, including planned reductions of low margin industrial sales and associated unfavorable fixed cost absorption along with a decline in sales of certain air filtration products which offset growth in other filtration end-markets.

Unallocated expenses in the nine months ended September 30, 2016 were \$26.3 million compared to \$20.2 million in the prior-year period. The increase of \$6.1 million, or 30.2%, in unallocated expenses during the nine months ended September 30, 2016 compared to the prior-year period was primarily due to the combined impact of modestly higher legal costs relating to intellectual property litigation and proceedings in Europe, professional services fees and general increases in other expenses, primarily due to timing of expenses year over year.

#### Non-Operating Expenses

Interest expense was \$12.6 million in the nine months ended September 30, 2016, an increase from \$5.3 million in the prior-year period. The weighted average effective interest rate on our debt facilities was approximately 2.34% and 1.44% for the nine months ended September 30, 2016 and 2015, respectively. The increase in interest expense is due to higher debt balances outstanding compared to the prior-year period in connection with the Argotec acquisition as well as the effect of the higher effective interest rate applied to borrowings under the Amended Credit Agreement executed in October 2015 when compared to our previous credit agreement.

Other income, net, was \$4.0 million during the nine months ended September 30, 2016. The \$5.5 million decrease in other income, net compared to \$9.5 million during the nine months ended September 30, 2015 was due primarily to \$2.5 million lower gain recognized related to the sale of water rights at our Spotswood, New Jersey facility, \$2.2 million in lower interest income from lower cash balances outstanding during the quarter, and \$1.2 million in lower

royalties and fees earned from our joint ventures in China partially offset by \$0.6 million in lower net currency losses, in each case compared to the prior-year period.



### Income Taxes

A \$27.9 million provision for income taxes in the nine months ended September 30, 2016 resulted in an effective tax rate of 30.6% compared with 21.7% in the prior-year period. The increase in the effective tax rate was primarily attributed to a higher concentration of profits generated in higher-tax jurisdictions coupled with a reduction in the generation of certain foreign tax credits in 2016 compared to the prior-year period and incurrence of certain one-time discrete tax expense items in 2016.

### Income from Equity Affiliates

Income from equity affiliates was \$2.4 million in the nine months ended September 30, 2016 compared with \$4.3 million during the prior-year period and reflected the results of operations of CTM and CTS. The decrease in earnings was driven primarily by lower sales volumes at CTS in the first half of 2016 compared to the prior-year period. In April 2016, CTM temporarily suspended production in order to bring its operations into compliance with newly effective emissions standards in China. In June, it resumed operations. At this time, we do not expect this to have a material adverse impact on our financial results this year.

### Discontinued Operations

Because we closed our Philippines paper mill as previously reported, the results of this mill were reported as discontinued operations for all periods presented. Consequently, this mill's results have been removed from each line of 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 the discontinued operation.

### Net Income and Income per Share

Net income in the nine months ended September 30, 2016 was \$65.8 million, or \$2.15 per diluted share, compared with \$68.0 million, or \$2.22 per diluted share, during the prior-year period. The decrease in net income was primarily due to higher expenses from income taxes, interest, intangible asset amortization and other general expenses, the impact of sales declines in certain end-markets in the AMS segment along with lower income from our equity affiliates, lower interest income and lower gain on sale of water rights compared to the prior period. These factors were partially offset by incremental income earned from the operations of our newly acquired Argotec business as well as lower restructuring expenses, primarily in our EP segment, and the net combined impact of operational improvements and net combined changes in volumes, mix of products sold, and average selling prices, along with favorable net foreign currency translation impacts.

## Liquidity and Capital Resources

The Company has created a long-term capital allocation strategy which is focused on the following:

Reinvesting capital in businesses through a disciplined approach to meet global demand for value-adding solutions;

Returning at least one-third of annual free cash flow to stockholders via dividends and/or share repurchase programs;  
and

Retaining flexibility to execute growth opportunities in current and adjacent industries.

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 mix of products sold, sales volume and selling prices of our products, as well as changes in our production volumes, costs, foreign currency exchange rates and working capital. Our liquidity is supplemented by funds available under our Amended Credit Agreement with a syndicate of banks that is used as either operating conditions or strategic opportunities warrant.

As of September 30, 2016, \$67.9 million of the Company's \$89.5 million of cash and cash equivalents was held by foreign subsidiaries. Movement of cash balances may have significant tax consequences. We established a holding company in Luxembourg in 2014. As a result of the holding company structure, a portion of the foreign earnings will flow directly to the U.S. without U.S. tax consequences. We consider the undistributed earnings of other foreign subsidiaries to be indefinitely reinvested. We believe that we are able to maintain a sufficient level of liquidity for our domestic operations and commitments without further repatriation of the cash held by these other foreign subsidiaries. Certain global business realignments and other activities have been, or may be, implemented that could permit the eventual repatriation of certain additional funds without material adverse U.S. tax consequences.

Capital spending for 2016 is projected to be approximately \$30 million. We generally fund our capital projects using cash on-hand, cash generated from operations and our existing credit facilities, including the Amended Credit Agreement.

## Cash Requirements

As of September 30, 2016, we had net operating working capital of \$146.4 million and cash and cash equivalents of \$89.5 million, compared with net operating working capital of \$118.5 million and cash and cash equivalents of \$186.5 million as of December 31, 2015. These changes primarily reflect the impacts of changes in currency exchange rates, net repayments of debt and changes in operating working capital presented on the unaudited condensed consolidated statements of cash flow contained in this report.

Cash Flows from Operating Activities (\$ in millions)	Nine Months Ended	
	September 30, 2016	September 30, 2015
Net Income	\$65.8	\$ 68.0
Less: Loss from discontinued operations	—	(0.9 )
Income from continuing operations	65.8	68.9
Non-cash items included in net income:		
Depreciation and amortization	33.3	29.0
Restructuring-related impairment	0.5	3.5
Deferred income tax provision	(3.3 )	0.5
Pension and other postretirement benefits	2.7	3.4
Stock-based compensation	3.7	1.8
Income from equity affiliates	(2.4 )	(4.3 )
Gain on sale of intangible assets	(1.8 )	(4.3 )
Excess tax expense (benefits) of stock-based awards	0.2	(0.5 )
Cash dividends received from equity affiliates	—	3.9
Other items	(1.2 )	0.3
Net changes in operating working capital	(14.4 )	(22.5 )
Net cash provided by operating activities of:		
Continuing operations	83.1	79.7
Discontinued operations	(0.1 )	0.5
Net cash provided by operations	\$83.0	\$ 80.2

Net cash provided by operations was \$83.0 million in the nine months ended September 30, 2016 compared with \$80.2 million in the prior-year period. Our net cash provided by operations increased primarily due to the \$8.1 million favorable impact year-over-year of net change in operating working capital, partially offset by lower net income and a dividend received from our equity affiliate in the prior year.

Operating Working Capital (\$ in millions)	Nine Months Ended	
	September 30, 2016	September 30, 2015
Changes in operating working capital		
Accounts receivable	\$(14.7)	\$ (32.6 )
Inventories	4.9	(3.0 )
Prepaid expenses	(1.0 )	—
Accounts payable	(2.5 )	2.0
Accrued expenses	(7.2 )	(1.5 )
Accrued income taxes	6.1	12.6
Net changes in operating working capital	\$(14.4)	\$ (22.5 )

In the nine months ended September 30, 2016, net changes in operating working capital used cash of \$14.4 million compared to the prior-year period, in which net changes in operating working capital used cash of \$22.5 million. This favorable change in working capital compared to the nine months ended September 30, 2015 was primarily driven by a lower increase in accounts receivable and a decrease in inventories, partially offset by a decrease in accounts payable, a higher reduction in accrued expenses and lower increase in accrued income taxes in 2016 compared to the prior-year period.

In the nine months ended September 30, 2015, net changes in operating working capital used cash of \$22.5 million compared to the prior-year period, in which net changes in operating working capital used cash of \$27.6 million. This favorable change in working capital was primarily driven by a decrease in income taxes payable from a refund of prior year taxes paid in France, partially offset by increases in inventory compared to the fourth quarter of 2014.

Cash Flows from Investing Activities (\$ in millions)	Nine Months Ended	
	September 30, 2016	September 30, 2015
Capital spending	\$(17.5)	\$ (14.0 )
Capitalized software costs	(1.7 )	(0.7 )
Acquisitions, net of cash acquired	—	(0.4 )
Other	4.2	2.9
Cash used for investing	\$(15.0)	\$ (12.2 )

Cash used for investing activities during the nine months ended September 30, 2016 was \$15.0 million compared to \$12.2 million in the prior-year period and consisted primarily of capital spending.

Cash Flows from Financing Activities (\$ in millions)	Nine Months Ended	
	September 30, 2016	September 30, 2015
Cash dividends paid to SWM stockholders	\$(36.6 )	\$ (34.7 )
Net repayments of borrowings	(131.6 )	(32.4 )
Purchases of common stock	(0.6 )	(2.9 )
Excess tax benefits of stock-based awards	(0.2 )	0.5
Cash used for financing	\$(169.0)	\$ (69.5 )

During the nine months ended September 30, 2016, financing activities consisted primarily of share repurchases of \$0.6 million in connection with the surrender of shares by employees to satisfy their personal statutory income tax withholding obligations related to equity awards which vested during the period, cash dividends of \$36.6 million paid to SWM stockholders, and net repayments of borrowings of \$131.6 million.

During the nine months ended September 30, 2015, financing activities consisted primarily of share repurchases of \$2.9 million, cash dividends of \$34.7 million paid to SWM stockholders, and net repayments of borrowings of \$32.4 million.

#### Dividend Payments

We have declared and paid cash dividends on our common stock every fiscal quarter since the second quarter of 1996. On November 2, 2016, we announced a cash dividend of \$0.42 per share payable on December 23, 2016 to stockholders of record as of November 25, 2016. The covenants contained in our Amended Credit Agreement require that we maintain certain financial ratios, as disclosed in Note 10. Debt, of the notes to the unaudited condensed consolidated financial statements, none of which under normal business conditions we would expect to materially limit our ability to pay such dividends. We plan to continue to assess our dividend policy in light of our capital allocation strategy, cash generation, debt levels and ongoing requirements for cash to fund operations and to pursue possible strategic opportunities.

#### Share Repurchases

In the nine months ended September 30, 2016, we repurchased 19,539 shares of our common stock at a cost of \$0.6 million for the value of employees' stock-based compensation share awards surrendered to satisfy their personal

statutory income tax withholding obligations. See Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

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In the nine months ended September 30, 2015, we repurchased 63,365 shares of our common stock for \$2.9 million for the value of employees' stock-based compensation share awards surrendered to satisfy their personal statutory income tax withholding obligations.

#### Debt Instruments and Related Covenants

Debt Instruments (\$ in millions)	Nine Months Ended	
	September 30, 2016	September 30, 2015
Changes in short-term debt	\$—	\$ 0.2
Proceeds from issuances of long-term debt	35.6	35.5
Payments on long-term debt	(167.2 )	(68.1 )
Net repayments of borrowings	\$(131.6)	\$ (32.4 )

Net repayments of borrowings were \$131.6 million during the nine months ended September 30, 2016. With the current level of borrowing and forecasted results, we expect to remain in compliance with the financial covenants contained in our Amended Credit Agreement.

In October 2015, the Company, together with two of its Luxembourg-based wholly-owned holding subsidiaries, entered into the Amended Credit Agreement, which provides an aggregate principal amount of \$1 billion, consisting of a \$650 million revolving credit facility maturing in October 2020, a \$100 million Term Loan A-1 maturing in October 2020, and a \$250 million Term Loan A-2 maturing in October 2022. The Term Loans are generally subject to mandatory repayment out of the net cash proceeds of asset sales which are not reinvested in operating assets. The credit facilities are secured by substantially all of the personal property of the Company and its domestic subsidiaries while the obligations of the Luxembourg-based holding subsidiaries are secured by a pledge of certain of the equity interests held in their operating subsidiaries. Unused borrowing capacity under the Amended Credit Agreement was \$515.9 million as of September 30, 2016. We also had availability under our bank overdraft facilities of \$28.2 million as of September 30, 2016.

The Amended Credit Agreement contains representations and warranties which are customary for facilities of that type and covenants and provisions that, among other things, require the Company to maintain (a) a maximum net debt to EBITDA ratio of 3.50, reducing to 3.00 after September 30, 2016 and (b) minimum interest coverage of 3.00. The Amended Credit Agreement contains provisions allowing the Company to increase the leverage ratio upon the incurrence of certain unsecured indebtedness or temporarily upon the occurrence of a material acquisition. The Company was in compliance with all of its covenants under the Amended Credit Agreement at September 30, 2016. With the current level of borrowing and forecasted results, we expect to remain in compliance with our Amended Credit Agreement financial covenants.

Our total debt to capital ratios at September 30, 2016 and December 31, 2015 were 45.8% and 55.0%, respectively.

#### Off-Balance Sheet Arrangements

As of September 30, 2016, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

#### Other Factors Affecting Liquidity and Capital Resources

Our pension obligations are funded by our separate pension trusts, which held \$125.1 million in assets at December 31, 2015. The combined projected benefit obligation of our U.S. and French pension plans was underfunded by \$30.5 million as of December 31, 2015. We make contributions to our pension trusts based on many factors, including

regulatory guidelines, investment returns of the trusts and availability of cash for pension contributions compared to other priorities. We are not required to make contributions to our U.S. and French pension plans during 2016.

The EP segment's PDM Industries S.A.S., or PDMI, mill 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 through 2024. Future purchases are expected to be at levels that exceed such minimum levels under these contracts.

The Company has agreements with an energy cogeneration supplier in France whereby the supplier constructed and operates a cogeneration facility at certain of our mills and supplies steam that is used in the operation of these mills. The Company is committed to purchasing minimum annual amounts of steam generated by these facilities under the agreements through 2024. These minimum annual commitments total approximately \$3 million. The Company's current and expected requirements for steam at these facilities are at levels that exceed the minimum levels under the contracts.

Schweitzer-Mauduit do Brasil Industria e Comércio de Papel Ltda., our EP segment's Brazilian mill, has an agreement for the transmission and distribution of energy that covers 100% of the mill's consumption of electrical energy valued at approximately \$4 million annually through 2020. Our EP mills in France have contracts for the distribution and consumption of natural gas. The value to be provided under these natural gas contracts is estimated at approximately \$10 million in 2016.

## Outlook

As our strategic transformation progresses, we believe that our growth outlook will continue to be influenced by the global tobacco industry, and increasingly influenced by the end-segments of our AMS business, including filtration, surface protection, medical, and industrials.

For the EP segment, we expect our outlook and performance to be driven by many factors, including 1) customer-specific patterns, such as RTL usage, cigarette paper inventory management and timing of purchases, 2) macro factors, such as the expected long-term trend of reduced cigarette consumption and foreign exchange movements, and 3) potential regulatory changes in the tobacco industry, such as mandated packaging changes and/or tax-related price increases, or potential new countries adopting LIP regulations. While not consolidated into our EP segment, our tobacco operations seek to capitalize on the large Chinese cigarette industry through our two joint ventures. For example, we expect increased demand in the long-term for RTL in China, which we are strategically positioned to supply through CTS, our RTL joint venture in China.

For the AMS segment, we expect our growth outlook to be driven by demand across our primary end-segments. Despite current sales decreases, we expect water filtration to continue its long-term growth trends; however, our filtration products sold to customers sensitive to the oil, gas, and mining sectors have been adversely impacted by the volatility and reduced activity in those industries. We expect solid growth performance from the Argotec acquisition, driven by continued growth in the surface protection end-segment. Generally, we believe that our medical and industrial end-segments will perform relatively in line with broad economic growth in the U.S. and to some extent Europe and China. We continue to evaluate M&A and internal growth investment opportunities to increase the scale of AMS and improve profitability of this growth platform.

## 2016 Strategic Priorities

We expect our business to be impacted by a combination of factors, the net result of which is an expected decline in profits in 2016 compared to prior years. Positive business factors include incremental profits from the Argotec acquisition and expected internal improvements in the EP and AMS segment operations. These positive business factors are expected to be more than offset by anticipated declines in RTL volumes in our French mill, the non-recurrence of certain 2015 tax benefits, year-over-year negative currency translation comparison, and the expected reversal of a customer-driven inventory build of LIP cigarette papers that benefited fourth quarter 2015 and



first quarter 2016 results.

With our diversification activities since 2013, the Company has increased its revenue concentration from 6% of total Net Sales derived outside of the tobacco industry in 2013 to approximately 30% in 2015. The Company expects this metric to continue to increase in 2016 to the 40+% range due to the addition of a full year's revenue from Argotec, expected improved organic growth in our AMS segment, and the anticipated sales impact from an expected volume decline of more than 10% in RTL from the prior year.

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The Company's key 2016 strategic priorities include continuing to integrate Argotec, optimizing AMS segment operations and improving AMS operating margins, which includes steps taken to rationalize product lines, improve product quality and consistency, and implement an integrated AMS shared services enterprise resource planning platform across the acquired businesses. We expect this to deliver meaningful multi-year margin expansion, and, when combined with benefits of increased scale and synergies across a more integrated operation, we would expect higher total AMS profits ultimately resulting in a more balanced split of our profit pool between our tobacco and non-tobacco businesses.

Concurrently, the Company plans to continue evaluating further acquisitions and growth initiatives that complement its existing AMS technologies and end-segment exposures. For the EP segment, the Company plans to remain focused on efficiently managing and restructuring operations to match capacity and costs with demand, selectively using price concessions to gain and/or maintain market share in key product categories, and protecting our intellectual property as appropriate in key areas, such as LIP. We plan to continue to invest in diversification activities to monetize our EP segment technologies outside of the tobacco industry.

#### Forward-Looking Statements

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and other federal securities laws that are subject to the safe harbor created by such laws and other legal protections. Forward-looking statements include, without limitation, those regarding 2016 outlook and future performance, mergers and acquisitions, future market trends, future RTL sales and volume trends (including RTL demand in China and reduced sales elsewhere), smoking attrition rates, synergies or growth from acquisitions, benefits of AMS's new enterprise resource planning system, incurrence of additional debt, water filtration and global drinking water demand growth, integration, and growth prospects (including international growth), the percentage of our future revenue expected to be derived outside of the tobacco industry, the deductibility of goodwill associated with the Argotec acquisition, impact of our restructuring actions, post-retirement healthcare and life insurance payments, impact of the LIP intellectual property litigation and opposition proceedings, the amount of capital spending and/or common stock repurchases, the profitability of CTS and the impact on our financial results of CTM's temporary suspension of production, pricing pressures (including related to LIP), future cash flows, benefits associated with our global asset realignment initiative (including possible non-recurrence of one-time tax benefits and lower effective tax rates), foreign cash repatriation, purchase accounting impacts, impacts of our ongoing operational excellence and other cost-reduction initiatives, increasing revenues coming from our non-tobacco operations, and other statements generally identified by words such as "believe," "expect," "intend," "plan," "potential," "anticipate," "project," "appear," "should," "could," "may," "will," "typically" and similar words. These statements are not guarantees of future performance and involve certain risks and uncertainties that may cause actual results to differ materially from our expectations as of the date of this report. These risks include, among other things, those set forth in Part I, Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2015, as well as the following factors:

Changes in sales or production volumes, pricing or manufacturing costs of reconstituted tobacco products, cigarette paper (including for lower ignition propensity cigarettes), filtration-related products due to changing customer demands, new technologies such as e-cigarettes, inventory adjustments and rebalancings, changing regulatory requirements, competition or otherwise;

Loss of one or more significant customers, or changes in their cigarette blending approaches;

New reports as to the effect of smoking on human health or the environment;

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Risks associated with the implementation of our strategic growth initiatives, including diversification, and the Company's understanding of, and entry into, new industries and technologies;

• Changes in the source and intensity of competition in our market segments, including risk from lower cost virgin tobacco leaf or other, cheaper, cigarette fillers;

• Our ability to attract and retain key personnel, due to our prior restructuring actions, the tobacco industry in which we operate or otherwise;

Weather conditions, including potential impacts, if any, from climate change, known and unknown, seasonality factors that affect the demand and price for virgin tobacco leaf and natural disasters or unusual weather events;

Increases in commodity prices and lack of availability of such commodities, including energy, wood pulp and resins, could impact the profitability of our products;

Increases in operating costs due to inflation or otherwise, such as labor expense, compensation and benefits costs, including costs related to the comprehensive health care reform law enacted in the U.S. in 2010;

Employee retention and labor shortages;

Changes in employment, wage and hour laws and regulations in the U.S., France and elsewhere, including loi de Sécurisation de l'emploi, unionization rules and regulations by the National Labor Relations Board, equal pay initiatives, additional anti-discrimination rules or tests and different interpretations of exemptions from overtime laws;

Labor disruptions, strikes, stoppages, or other disruptions at our facilities or in the countries in which we operate;

Existing and future governmental regulation and the enforcement thereof, for example, relating to the tobacco industry, taxation and the environment (including the impact thereof on our Chinese joint ventures);

Changes in general economic, financial and credit conditions in the U.S., Europe, China and elsewhere, including the impact thereof on currency (including any weakening of the euro and Brazilian Real) and on interest rates;

Restrictions imposed on us through our Amended Credit Agreement, including as to the incurrence of additional debt, the granting of further security interests and the maintenance of certain financial ratios;

Changes in the manner in which we finance our debt and future capital needs, including potential acquisitions;

The success of, and costs associated with, our current or future restructuring initiatives, including the granting of any needed governmental approvals and the occurrence of work stoppages or other labor disruptions;

Changes in the discount rates, revenue growth, cash flow growth rates or other assumptions used by the Company in its assessment for impairment of assets and adverse economic conditions or other factors that would result in significant impairment charges;

The failure of one or more material suppliers, including energy, resin and pulp suppliers, to supply materials as needed to maintain our product plans and cost structure;

International conflicts and disputes (for example, relating to Russia and to the Ukraine), including their impact on our sales and the adoption of new LIP regulations;

The pace and extent of further international adoption of LIP cigarette standards and the nature of standards so adopted;

Risks associated with our 50%-owned, non-U.S. joint ventures relating to control and decision-making, compliance, accounting standards, transparency and customer relations, among others;

A failure in our risk management and/or currency or interest rate swaps and hedging programs, including the failures of any insurance company or counterparty;



The number, type, outcomes (by judgment or settlement) and costs of legal, tax, regulatory or administrative proceedings, litigation and/or amnesty programs, including those in Brazil;

The outcome and cost of LIP intellectual property infringement and validity litigation and European Patent Office opposition proceedings and the risk of eventual loss of our technological advantages including expiration of patents and ongoing protection of our proprietary trade secrets, or emergence of new disruptive technologies;

Risks associated with acquisitions or other strategic transactions, including acquired liabilities and restrictions, retaining customers from businesses acquired, achieving any expected results or synergies from acquired businesses, complying with new regulatory frameworks, difficulties in integrating acquired businesses or implementing strategic transactions generally and risks associated with international acquisition transactions, including in countries where we do not currently have a material presence;

Risks associated with dispositions, including post-closing claims being made against us, disruption to our other businesses during a sale process or thereafter, credit risks associated with any buyer of such disposed assets and our ability to collect funds due from any such buyer;

Risks associated with our global asset realignment initiatives, including: changes in law, treaties, interpretations or regulatory determinations; audits made by applicable regulatory authorities and our auditor; and our ability to operate our business in a manner consistent with the regulatory requirements for such realignment;

- Increased taxation on tobacco-related products;

Costs and timing of implementation and effectiveness of any upgrades to our information technology systems;

Failure by us to comply with any privacy or data security laws or to protect against theft of customer, employee and corporate sensitive information; and

Other factors described elsewhere in this document and from time to time in documents that we file with the SEC.

All forward-looking statements made in this document are qualified by these cautionary statements. These forward-looking statements are made only as of the date of this document, and we do not undertake any obligation, other than as may be required by law, to update or revise any forward-looking or cautionary statements to reflect changes in assumptions, the occurrence of events, unanticipated or otherwise, or changes in future operating results over time or otherwise.

Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance unless expressed as such, and should only be viewed as historical data.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our market risk exposure at September 30, 2016 is consistent with, and not materially different than, the market risk and discussion of exposure presented under the caption “Quantitative and Qualitative Disclosures about Market Risk” in Part II, Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2015.

### Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We currently have in place systems relating to disclosure controls and procedures designed to ensure the timely recording, processing, summarizing and reporting of information required to be disclosed in periodic reports under the Securities Exchange Act of 1934, as amended. These disclosure controls and procedures include those designed to ensure that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief

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Financial Officer, as appropriate, to allow timely decisions about required disclosure. Upon completing our review and evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2016, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures were effective as of September 30, 2016.

#### Changes in Internal Control Over Financial Reporting

No changes in our internal control over financial reporting were identified as having occurred in the fiscal quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



## PART II - OTHER INFORMATION

## Item 1. Legal Proceedings

The Company is involved in various legal proceedings and disputes. See Note 18. Commitments and Contingencies of the notes to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2015 and Note 12. Commitments and Contingencies of the notes to the unaudited condensed consolidated financial statements included in this report. Except as may have been referenced elsewhere in this report, there have been no material developments with regard to these matters.

## Item 1A. Risk Factors

As of September 30, 2016, there were no material changes in the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Purchases of Equity Securities By the Issuer and Affiliated Purchasers

The following table indicates the cost of and number of shares of the Company's common stock it repurchased during 2016:

## Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value of Shares that May Yet be Purchased Under the Programs
			(# shares) (\$ in millions)	(\$ in millions)
First Quarter 2016	18,379	\$ 32.83	— \$	—\$ —
Second Quarter 2016	159	34.21	— —	—
July 2016	1,001	37.81	— —	—
August 2016	—	—	— —	—
September 2016	—	—	— —	—
Third Quarter 2016	1,001	37.81	— \$	—\$ —
Total Year-to-Date 2016	19,539	\$ 33.10	— \$	—\$ —

From time to time, the Company uses corporate 10b5-1 plans to allow for share repurchases to be made at predetermined stock price levels, without restricting such repurchases to specific windows of time. Any future common stock repurchases will be dependent upon various factors, including the Company's stock price, strategic opportunities and cash availability.

## Item 3. Defaults Upon Senior Securities

Not applicable.

## Item 4. Mine Safety Disclosures

Not applicable.

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Item 5. Other Information

Adoption of 2016 Executive Severance Plan

On November 2, 2016, the Compensation Committee of the Board adopted and approved the Schweitzer-Mauduit International, Inc. 2016 Executive Severance Plan (the “Severance Plan”) for members of the Company’s senior executive team. The Severance Plan is intended to replace the Company’s 2012 Executive Severance Plan and provides for the payment of severance and other benefits to eligible senior executives in the event of a termination of employment with the Company. Specifically, the Severance Plan provides that in the event of a qualifying termination of a participant’s employment with the Company or certain of its affiliates within two years after a Change in Control (as defined in the Severance Plan), a participant will be entitled to:

- a cash payment in an amount equal to 3 times the highest annual compensation (base salary and annual incentive awards) paid or payable within the 3-year period ending on the date of termination; and
- specified health care and other benefits from the Company for a period of 3 years.

For qualifying terminations not following a Change in Control, a participant will be entitled to:

- a cash payment in an amount equal to the product of (i) the participant’s annual base salary divided by 12 and (ii) the number of months of severance set forth in the participation agreement with such participant (provided that such amount shall not be more than the participant’s monthly base salary multiplied by 24); and
- specified health care and other benefits from the Company for the number of months of severance set forth in the participation agreement with such participant (not to exceed 24 months).

In addition to generally updating various provisions of the plan, the Severance Plan differs from the prior version principally by providing for continued benefits during the ‘severance period’ in the absence of a change of control and eliminating the six month waiting period before the Severance Plan is effective for new eligible executives. The foregoing summary of the Severance Plan does not purport to be complete and is qualified in its entirety by the full text of the Severance Plan, which is attached hereto as Exhibit 10.1 and is incorporated herein by reference.

Item 6. Exhibits

Exhibit  
Number

- 10.1 2016 Executive Severance Plan.
- 10.2 2016 Executive Severance Plan Participation Agreement.
- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) of the Securities Exchange Act of 1934, as amended.
- 32 Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ‡
- 101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Income, (ii) the Condensed Consolidated Statements of Comprehensive Income (Loss), (iii) the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Changes in Stockholders' Equity, (v) the Condensed Consolidated Statements of Cash Flow, and (vi) Notes to Consolidated Financial Statements.

‡ This Section 906 certification is not being incorporated by reference into this Quarterly Report on Form 10-Q filing or otherwise deemed to be filed with the Securities and Exchange Commission.

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/ Allison Aden  
Allison Aden  
Executive Vice President, Finance and  
Chief Financial Officer  
(duly authorized officer and principal financial officer)

November 2, 2016

By: /s/ Robert J. Cardin  
Robert J. Cardin  
Corporate Controller  
(principal accounting officer)

November 2, 2016

## GLOSSARY OF TERMS

The following are definitions of certain terms used in this Quarterly Report on Form 10-Q filing:

"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.

"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 EBITDA ratio" is a financial measurement used in bank covenants where "Net Debt" is defined as consolidated total debt minus unrestricted domestic cash and cash equivalents and 65% of non-domestic unrestricted domestic cash and cash equivalents, in excess of \$15 million, and "EBITDA" is defined as net income plus the sum of interest expense, income tax expense, depreciation and amortization, non-cash restructuring and impairment charges less amortization of deferred revenue and interest in the earnings of equity affiliates to the extent such earnings are not distributed to the Company.

"Net foreign currency translation impacts" are estimates of the impact of changes in foreign currency rates on the translation of the Company's financial results as compared to the applicable comparable period and are derived by translating the current local currency results into U.S. Dollars based upon the foreign currency exchange rates for the applicable comparable period.

"Net debt to equity ratio" is total debt less cash and cash equivalents, divided by stockholders' equity.

"Net operating working capital" is accounts receivable, inventory, income taxes receivable and prepaid expense, less accounts payable, accrued expenses and income taxes payable.

"Non-wovens" are a fabric-like material made from long fibers, bonded together by chemical, mechanical, heat or solvent treatment. The term is used to denote fabrics, such as felt, which are neither woven nor knitted.

"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 two 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 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 and charges to reduce property, plant and equipment to its fair value.

"Reverse osmosis" is a water purification technology that uses a semipermeable membrane to remove larger particles from drinking water.

"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.

"Tobacco paper" includes cigarette paper which wraps the column of tobacco within a cigarette and has varying properties such as basis weight, porosity, opacity, tensile strength, texture and burn rate, as well as plug wrap paper which wraps the outer layer of a cigarette filter and is used to hold the filter materials in a cylindrical form, and tipping paper which joins the filter element to the tobacco-filled column of the cigarette and is both printable and glueable at high speeds.

"Total debt to capital ratio" is total debt divided by the sum of total debt and total stockholders' equity.

"Urethane" is a crystalline compound composed of organic units used in the manufacture of polyurethane and various types of films.