BUCKEYE TECHNOLOGIES INC
Form 10-Q
February 09, 2009

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

# FORM 10-Q

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

For the quarterly period ended December 31, 2008

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

For the Transition Period From ____ to ____

Commission file number: 33-60032

Buckeye Technologies Inc.
Delaware
(state or other jurisdiction of incorporation)

Internal Revenue Service — Employer Identification No. 62-1518973

1001 Tillman Street, Memphis, TN 38112
901-320-8100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

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 "accelerated filer," "large accelerated filer," and "smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one).

| | | | |
|---|---|---|---|
| Large accelerated filer ¨ | Accelerated filer x | Non-accelerated filer ¨ | Smaller reporting company ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of February 9, 2009, there were outstanding 38,649,503 Common Shares of the Registrant.

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BUCKEYE TECHNOLOGIES INC.

Item 1. Financial Statements

PART I - FINANCIAL INFORMATION

BUCKEYE TECHNOLOGIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except per share data)

| | Three Months Ended December 31 | | Six Months Ended December 31 | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net sales | $ 184,665 | $ 210,922 | $ 405,958 | $ 408,321 |
| Cost of goods sold | 161,533 | 168,943 | 347,488 | 325,687 |
| Gross margin | 23,132 | 41,979 | 58,470 | 82,634 |
| | | | | |
| Selling, research and administrative expenses | 11,266 | 11,796 | 23,476 | 23,270 |
| Goodwill impairment loss | 138,008 | - | 138,008 | - |
| Amortization of intangibles and other | 471 | 361 | 940 | 922 |
| Restructuring costs | - | - | - | 96 |
| Operating income (loss) | (126,613) | 29,822 | (103,954) | 58,346 |
| | | | | |
| Net interest expense and amortization of debt costs | (7,469) | (8,524) | (14,907) | (17,681) |
| Gain (loss) on early extinguishment of debt | 401 | 251 | 401 | (535) |
| Gain (loss) on foreign exchange and other | 213 | (94) | (618) | (262) |
| | | | | |
| Income (loss) before income taxes | (133,468) | 21,455 | (119,078) | 39,868 |
| Income tax expense (benefit) | (8,484) | 7,589 | (2,944) | 12,505 |
| | | | | |
| Net income (loss) | $ (124,984) | $ 13,866 | $ (116,134) | $ 27,363 |
| | | | | |
| Earnings (loss) per share | | | | |
| Basic | $ (3.23) | $ 0.36 | $ (3.00) | $ 0.70 |
| Diluted | $ (3.23) | $ 0.35 | $ (3.00) | $ 0.70 |
| | | | | |
| Weighted average shares for earnings per share | | | | |
| Basic | 38,670 | 38,953 | 38,688 | 38,848 |
| Effect of diluted shares | - | 495 | - | 506 |
| Diluted | 38,670 | 39,448 | 38,688 | 39,354 |

See accompanying notes.

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BUCKEYE TECHNOLOGIES INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

| | | December 31 2008 (Unaudited) | | June 30 2008 |
|---|---|---|---|---|
| Assets | | 2008 | | 2007 |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 8,491 | $ | 10,393 |
| Accounts receivable – net | | 108,111 | | 127,521 |
| Inventories – net | | 115,548 | | 110,254 |
| Deferred income taxes and other | | 11,186 | | 11,530 |
| Total current assets | | 243,336 | | 259,698 |
| | | | | |
| Property, plant and equipment | | 1,060,538 | | 1,093,759 |
| Less accumulated depreciation | | (537,753) | | (538,051) |
| | | 522,785 | | 555,708 |
| Goodwill | | 2,425 | | 163,622 |
| Intellectual property and other, net | | 26,088 | | 30,197 |
| Total assets | $ | 794,634 | $ | 1,009,225 |
| | | | | |
| Liabilities and stockholders' equity | | | | |
| Current liabilities: | | | | |
| Trade accounts payable | $ | 33,678 | $ | 49,157 |
| Accrued expenses | | 42,892 | | 50,451 |
| Current portion of capital lease obligation | | - | | 358 |
| Short-term debt | | - | | 207 |
| Total current liabilities | | 76,570 | | 100,173 |
| | | | | |
| Long-term debt | | 391,311 | | 393,910 |
| Accrued postretirement benefits | | 22,468 | | 23,868 |
| Deferred income taxes | | 48,531 | | 57,963 |
| Other liabilities | | 2,962 | | 3,754 |
| Stockholders' equity | | 252,792 | | 429,557 |
| Total liabilities and stockholders' equity | $ | 794,634 | $ | 1,009,225 |

See accompanying notes.

BUCKEYE TECHNOLOGIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

| | Six Months Ended December 31 2008 | 2007 |
|---|---|---|
| Operating activities | | |
| Net income (loss) | $ (116,134) | $ 27,363 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation | 24,769 | 25,409 |
| Amortization | 1,252 | 1,126 |
| (Gain) loss on early extinguishment of debt | (401) | 535 |
| Deferred income taxes and other | (5,861) | 11,560 |
| Goodwill impairment loss | 138,008 | - |
| Excess tax benefit from stock based compensation | - | (44) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 11,580 | (775) |
| Inventories | (9,381) | (3,405) |
| Other assets | 323 | 336 |
| Accounts payable and other current liabilities | (15,615) | (7,970) |
| Net cash provided by operating activities | 28,540 | 54,135 |
| Investing activities | | |
| Purchases of property, plant and equipment | (25,011) | (18,692) |
| Other | (73) | (135) |
| Net cash used in investing activities | (25,084) | (18,827) |
| Financing activities | | |
| Net borrowings under lines of credit | 2,541 | 82,000 |
| Payments on long-term debt and other | (5,358) | (113,817) |
| Purchase of treasury shares | (494) | - |
| Payments for debt issuance costs | - | (1,401) |
| Net proceeds from sale of equity interests | - | 5,742 |
| Excess tax benefit from stock based compensation | - | 44 |
| Net cash used in financing activities | (3,311) | (27,432) |
| Effect of foreign currency rate fluctuations on cash | (2,047) | 900 |
| Increase (decrease) in cash and cash equivalents | (1,902) | 8,776 |
| Cash and cash equivalents at beginning of period | 10,393 | 14,790 |
| Cash and cash equivalents at end of period | $ 8,491 | $ 23,566 |

See accompanying notes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

(In thousands)

NOTE 1: BASIS OF PRESENTATION

Our accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended December 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2009. All significant intercompany accounts and transactions have been eliminated in consolidation. For further information and a listing of our significant accounting policies, refer to the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended June 30, 2008, which was filed with the Securities and Exchange Commission on August 27, 2008 ("Annual Report"). Except as otherwise specified, references to years indicate our fiscal year ending June 30, 2009 or ended June 30 of the year referenced and comparisons are to the corresponding period of the prior year.

Translation adjustment

Management has determined that the local currency of our German, Canadian, and Brazilian subsidiaries is the functional currency, and accordingly European euro, Canadian dollar, and Brazilian real denominated balance sheet accounts are translated into U.S. dollars at the rate of exchange in effect at the balance sheet date. Income and expense activity for the period is translated at the weighted average exchange rate during the period. Translation adjustments are included as a separate component of stockholders' equity.

Use of estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from the estimates and assumptions used.

Changes in estimates are recognized in accordance with the accounting rules for the estimate, which is typically in the period when new information becomes available to management. Areas where the nature of the estimate makes it reasonably possible that actual results could materially differ from amounts estimated include: impairment assessments on long-lived assets (including goodwill), allowance for doubtful accounts, inventory reserves, income tax liabilities and contingent liabilities.

NOTE 2: SEGMENT INFORMATION

We report results for two segments, specialty fibers and nonwoven materials. The specialty fibers segment consists of our chemical cellulose, customized fibers and fluff pulp product lines which are cellulosic fibers based on both wood and cotton. Management makes financial decisions and allocates resources based on the sales and operating income of each segment. We allocate selling, research, and administrative expenses to each segment and management uses the resulting operating income to measure the performance of the segments. The financial information attributed to these segments is included in the following tables:

| Three Months Ended December 31 | | Specialty Fibers | Nonwoven Materials | Corporate | Total |
|---|---|---|---|---|---|
| Net sales | 2008 | $ 137,739 | $ 56,841 | $ (9,915) | $ 184,665 |
| | 2007 | 148,208 | 71,966 | (9,252) | 210,922 |
| Operating income (loss) | 2008 | 11,339 | 1,506 | (139,458) | (126,613) |
| | 2007 | 26,117 | 5,383 | (1,678) | 29,822 |
| Depreciation and amortization of | 2008 | 8,060 | 3,497 | 940 | 12,497 |
| Intangibles | 2007 | 8,157 | 4,241 | 744 | 13,142 |
| Capital expenditures | 2008 | 11,855 | 1,558 | 516 | 13,929 |
| | 2007 | 8,468 | 737 | 497 | 9,702 |

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| Six Months Ended December 31 | | Specialty Fibers | Nonwoven Materials | Corporate | Total |
|---|---|---|---|---|---|
| Net sales | 2008 | $ 302,718 | $ 122,703 | $ (19,463) | $ 405,958 |
| | 2007 | 283,909 | 143,596 | (19,184) | 408,321 |
| Operating income (loss) | 2008 | 31,457 | 5,099 | (140,510) | (103,954) |
| | 2007 | 48,088 | 13,291 | (3,033) | 58,346 |
| Depreciation and amortization of | 2008 | 16,408 | 7,542 | 1,759 | 25,709 |
| Intangibles | 2007 | 16,172 | 8,473 | 1,688 | 26,333 |
| Capital expenditures | 2008 | 21,952 | 2,336 | 723 | 25,011 |
| | 2007 | 16,388 | 1,444 | 860 | 18,692 |

Management evaluates operating performance of the specialty fibers and nonwoven materials segments excluding amortization of intangibles, the impact of impairment of long-lived assets, the impact of goodwill impairment, charges related to restructuring, unallocated at-risk compensation and unallocated stock-based compensation for executive officers and certain other employees. Therefore, the corporate segment includes operating elements such as segment eliminations, amortization of intangibles, impairment of long-lived assets, goodwill impairment, charges related to restructuring, unallocated at-risk compensation and unallocated stock-based compensation for executive officers and certain other employees. We have reclassified the at-risk compensation and stock-based compensation from the specialty fibers and nonwovens segments for the three and six months ended December 31, 2007 for comparability. Corporate net sales represent the elimination of intersegment sales included in the specialty fibers reporting segment. Intersegment sales are at current market prices.

NOTE 3: RESTRUCTURING COSTS AND ASSETS HELD FOR SALE

During fiscal 2007, we entered into a restructuring program that complemented our operations' consolidations and involved consolidation in our European sales offices, product and market development and corporate overhead. The total cost of this program was $1,358 and was completed during the first quarter of the 2008 fiscal year. The remaining accrual of $102 will be paid in fiscal year 2009. As a result of this restructuring, 22 positions were eliminated.

NOTE 4: INVENTORIES

Inventories are valued at the lower of cost or market. The costs of manufactured cotton-based specialty fibers and costs for nonwoven raw materials are generally determined on the first-in, first-out basis. Other manufactured products and raw materials are generally valued on an average cost basis. Manufactured inventory costs include material, labor and manufacturing overhead. Slash pine timber, cotton fibers and chemicals are the principal raw materials used in the manufacture of our specialty fiber products. Fluff pulp is the principal raw material used in our nonwoven materials products. We take physical counts of inventories at least annually, and we review periodically the provision for potential losses from obsolete, excess or slow-moving inventories.

The components of inventory consist of the following:

| | December 31 2008 | June 30 2008 |
|---|---|---|
| Raw materials | $ 37,448 | $ 40,758 |
| Finished goods | 53,824 | 45,184 |
| Storeroom and other supplies | 24,276 | 24,312 |

| | | | | |
|---|---|---|---|---|
| | $ | 115,548 | $ | 110,254 |

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NOTE 5: GOODWILL

In accordance with Statement of Financial Accounting Standard No. 142, Goodwill and Other Intangible Assets (SFAS 142), we perform a goodwill impairment analysis on an annual basis and, if certain events or circumstances indicate that an impairment loss may have been incurred, on an interim basis. Goodwill is measured at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair market value of the reporting unit. The analysis of potential impairment of goodwill requires a two-step process. The first step is the estimation of fair value. If step one indicates that impairment potentially exists, the second step is performed to measure the amount of impairment, if any. Goodwill impairment exists when the implied fair value of goodwill is less than its carrying value.

Based on the current economic environment and the recent steep decline in the price of our stock, which created a significant gap between the book and market value of our equity, we concluded that there were sufficient indicators to require us to perform an interim goodwill impairment analysis as of December 31, 2008. We engaged an independent valuation firm to assist with the testing of the carrying value of goodwill. For purposes of this analysis, estimates of fair value were based on a combination of the income approach, which estimates the fair value of our reporting units based on future discounted cash flows, and the market approach, which estimates the fair value of our reporting units on comparable market prices. As of this filing, we have not completed this analysis, due to the complexities involved in determining the implied fair value of the goodwill of each reporting unit. However, based on the work performed to date, we have concluded that an impairment loss is probable and can be reasonably estimated. Accordingly, we recorded a $138,008 non-cash goodwill impairment charge, representing our best estimate of the impairment loss, during the three months ended December 31, 2008. Since this goodwill impairment charge is non-cash, it does not affect our liquidity or financial covenants.

We expect to finalize our goodwill impairment analysis during the third quarter of fiscal 2009. There could be adjustments to the goodwill impairment charge when the goodwill impairment analysis is completed. Any adjustment to our preliminary estimates will be recorded in our financial statements for the quarter ending March 31, 2009.

The changes in the carrying amount of goodwill for the six months ended December 31, 2008 are as follows:

| | Specialty Fibers Segment | Nonwovens Segment | Total |
|---|---|---|---|
| Balance as of June 30, 2008 | $ 49,759 | $ 113,863 | $ 163,622 |
| Change due to fluctuation in foreign currency exchange rate | (7,007) | (16,182) | (23,189) |
| Impairment losses | (42,752) | (95,256) | (138,008) |
| Balance as of December 31, 2008 | $ - | $ 2,425 | $ 2,425 |

NOTE 6: DEBT

The components of long-term debt consist of the following:

| | December 31 2008 | June 30 2008 |
|---|---|---|
| Senior Notes due: | | |
| 2013 | $ 200,000 | $ 200,000 |
| Senior Subordinated Notes due: | | |
| 2010 | 110,620 | 115,830 |
| Credit facility | 80,691 | 78,080 |

| | | | | |
|---|---|---|---|---|
| | $ | 391,311 | $ | 393,910 |

Senior Notes

During September 2003, we placed privately $200,000 in aggregate principal amount of 8.5% senior notes due October 1, 2013 (the "2013 Notes"). In fiscal year 2004, we exchanged these outstanding notes for public notes with the same terms. The notes are unsecured obligations and are senior to any of our subordinated debt. The notes are guaranteed by our direct and indirect domestic subsidiaries that are also guarantors on our senior secured indebtedness. The senior notes are redeemable at our option, in whole or part, at any time on or after October 1, 2008, at redemption prices varying from 104.25% of principal amount to 100% of principal amount on or after October 1, 2011, together with accrued and unpaid interest to the date of redemption.

Senior Subordinated Notes

During July 1996, we completed a public offering of $100,000 principal amount of 9.25% unsecured Senior Subordinated Notes due September 15, 2008 (the “2008 Notes”). These notes were redeemable at our option, in whole or in part, at any time after September 15, 2004, at a redemption price of 100% of principal amount together with accrued and unpaid interest to the date of redemption.

Through fiscal year 2007, we redeemed $40,000 of the 2008 Notes. During the six months ended December 31, 2007, we redeemed the remaining $60,000 of the 2008 Notes. As a result of this redemption, we wrote off the remaining balance of deferred financing costs and unamortized discount related to the 2008 Notes. During the six months ended December 31, 2007, we recorded non-cash expenses of $205 related to the early extinguishment of this debt.

During June 1998, we completed a private placement of $150,000 principal amount of 8% unsecured Senior Subordinated Notes due October 15, 2010 (the “2010 Notes”). In fiscal 1999, we exchanged these outstanding notes for public notes with the same terms. These notes have been redeemable at our option, in whole or in part, at any time since October 15, 2006, at a redemption price of 100% of principal amount together with accrued and unpaid interest to the date of redemption.

On December 1, 2008, we redeemed $5,000 of the 2010 Notes. During the six months ended December 31, 2007, we redeemed $20,000 of these notes. In fiscal year 2008, we redeemed a total of $35,000 of these notes. As a result of these redemptions, we wrote off a portion of the deferred financing costs and unamortized discount related to the 2010 notes. During the three and six months ended December 31, 2008, we recorded non-cash gains of $401 related to the early extinguishment of this debt and during the six months ended December 31, 2007 we recorded non-cash expenses of $153 related to the early extinguishment of this debt.

Revolving Credit Facility

On July 25, 2007, we established a $200,000 senior secured revolving credit facility with a maturity date of July 25, 2012. This facility amended and restated the Company's old credit facility. Initially, we used the proceeds from this new credit facility to pay the outstanding balance on the former credit facility plus fees and expenses. The interest rate applicable to borrowings under the revolver is the agent’s prime rate plus 0.25% to 1.00% or a LIBOR-based rate ranging from LIBOR plus 1.25% to LIBOR plus 2.00%. We used the proceeds from this facility to redeem the remaining $60,000 of our 2008 notes, to redeem $20,000 of the 2010 notes in mid-September 2007, and for general corporate purposes. The credit facility is secured by substantially all of our assets located in the United States.

The credit facility contains covenants customary for financing of this type. The financial covenants include: maximum total leverage ratio of consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization (“EBITDA”), and minimum ratio of consolidated EBITDA to consolidated interest expense. At December 31, 2008, we were in compliance with the financial covenants under our credit facility.

On December 31, 2008, we had $8,491 of cash and cash equivalents and we had $113,957 borrowing capacity on our credit facility. The credit facility also contains a $50,000 increase option. Our credit facility allows for a sublimit on letters of credit of $50,000. As of December 31, 2008, $44,648 of the sublimit was unused.

The commitment fee on the unused portion of the revolving credit facility ranges from 0.25% to 0.40% per annum based on a grid related to our leverage ratio. Total costs for the issuance of the facility were approximately $1,300 and are being amortized to interest expense using the effective interest method over the life of the facility. During the six months ended December 31, 2007, $177 was expensed as early extinguishment of debt related to the write-off of deferred financing costs for the term loan portion of the former credit facility.

On September 17, 2007, we entered into an interest rate swap agreement for $30,000 of debt under our revolving credit facility maturing on September 17, 2009. The swap involves the exchange of interest payments from a floating-rate three month LIBOR plus the applicable margin on the revolving credit facility to a fixed rate of 4.79% plus the same applicable margin. This arrangement qualifies as a cash flow hedge under SFAS 133. Therefore, the net effect from the interest rate swap is being recorded as part of interest expense. During the three and six months ended December 31, 2008, the swap increased our interest expense by $163 and $315, respectively. During the three and six months ended December 31, 2007, the swap reduced our interest expense by $61 and $71, respectively. At December 31, 2008, our liability on the interest rate swap agreement was $781.

NOTE 7: FAIR VALUE MEASURMENTS

In accordance with the provisions of FASB Staff Position FAS 157-2, we have partially applied the provisions of SFAS No. 157 only to our financial assets and liabilities recorded at fair value, which consist of derivative contracts, including interest rate swaps, foreign currency forward contracts, and other financial instruments that are used to hedge exposures to interest rate, commodity and currency risks. For these financial instruments, fair value is determined at each balance sheet date using an income approach, which consists of a discounted cash flow model that takes into account the present value of future cash flows under the terms of the contracts using current market information as of the reporting date, such as prevailing interest rates and foreign currency spot and forward rates. The following table provides a summary of the inputs used to develop these estimated fair values under the hierarchy defined in SFAS No. 157:

| | Fair Value Measurements at December 31, 2008 | | | |
|---|---|---|---|---|
| | Total | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets: | | | | |
| Foreign currency hedge | $ 654 | $ - | $ 654 | $ - |
| Total | 654 | - | 654 | - |
| | | | | |
| Liabilities: | | | | |
| Natural gas hedge | 236 | - | 236 | - |
| Interest rate swap | 781 | - | 781 | - |
| Total | $ 1,017 | $ - | $ 1,017 | $ - |

NOTE 8: STOCKHOLDERS' EQUITY

The change in stockholders' equity was due mainly to the change in comprehensive income as shown in the chart below. The components of comprehensive income consist of the following:

| | Three Months Ended December 31 | | Six Months Ended December 31 | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | $ (124,984) | $ 13,866 | $ (116,134) | $ 27,363 |
| Foreign currency translation adjustments – net | (35,449) | 7,513 | (61,540) | 22,422 |
| Unrealized losses on hedging activities | (177) | (485) | (255) | (485) |
| Comprehensive income (loss) | $ (160,610) | $ 20,894 | $ (177,929) | $ 49,300 |

For the three and six months ended December 31, 2008, the change in the foreign currency translation adjustment was due to fluctuations in the exchange rate of the U.S. dollar against the euro of ($2,466) and ($11,468), the Brazilian real of ($12,029) and ($24,114) and the Canadian dollar of ($20,954) and ($25,958), respectively.

For the three and six months ended December 31, 2007, the change in the foreign currency translation adjustment was primarily due to fluctuations in the exchange rate of the U.S. dollar against the euro of $3,109 and $6,827, the

Brazilian real of $2,147 and $4,640 and the Canadian dollar of $2,257 and $10,955, respectively.

NOTE 9: INCOME TAXES

On July 1, 2007, we adopted the provisions of FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes." FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. As a result of the adoption, we recorded an adjustment of approximately $878 to reduce retained earnings at July 1, 2007. At adoption, our unrecognized tax benefits totaled $1,806. Cumulative potential interest and penalties accrued related to unrecognized tax benefits at the date of adoption totaled $164. We include interest and penalties related to income tax matters as a component of income before income taxes. All unrecognized tax benefits at adoption would affect the effective tax rate, if recognized. During the three months ended December 31, 2008, as a result of the resolution of a North Carolina audit, we were able to reduce our unrecognized tax benefits by $228 and our related interest and penalties by $101. These reductions leave a balance in unrecognized tax benefits and our related interest and penalties of $1,578 and $63, respectively.

We file income tax returns with federal, state, local and foreign jurisdictions. As of December 31, 2008, we remain subject to examinations of our United States federal and state income tax returns for the years 2003 through 2007, Canadian income tax returns for the years 2001 through 2007 and German tax filings for the years 2002 through 2007.

Our effective tax rates for the three and six month periods ended December 31, 2008 were 6.4% and 2.5%, respectively. Our effective tax rates for the same periods of 2007 were 35.4% and 31.4%, respectively. We recorded a $138,008 goodwill impairment charge in the three months ended December 31, 2008. Accordingly, we recognized a tax benefit of $10,410 in connection with the goodwill impairment charge. In addition, the rate change for the three month period ended December 31, 2008 was the result of a correction to our deferred taxes and the resolution of the North Carolina audit (mentioned above) which together had a net unfavorable impact of $300 during the three months ended December 31, 2008. The increase, before the goodwill impairment charge, in the effective tax rate for the six month period over the same period in 2007 was affected by the items which impacted the three months ended December 31, 2008 comparison plus a German tax rate law change which reduced our taxes by approximately $2,200 during the six months ended December 31, 2007. Our income tax expense differs from the amount computed by applying the statutory federal income tax rate of 35% to income before income taxes due to the following:

| | Three Months Ended December 31 | | Six Months Ended December 31 | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Expected tax expense at 35% | $ (46,714) | $ 7,509 | $ (41,677) | $ 13,953 |
| Nondeductible goodwill impairment charge | 37,892 | - | 37,892 | - |
| German tax rate change | - | - | - | (2,245) |
| Effect of foreign operations | (301) | (397) | 10 | (78) |
| Brazilian valuation allowance | 692 | 404 | 1,157 | 847 |
| Other | (53) | 73 | (326) | 28 |
| Income tax expense | $ (8,484) | $ 7,589 | $ (2,944) | $ 12,505 |

NOTE 10: EMPLOYEE BENEFIT PLANS

In September 2006, the FASB issued SFAS 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS 158). On July 1, 2008, we adopted the measurement date provisions of SFAS No. 158. SFAS No. 158 requires the measurement date of the plan's funded status to be the same as our fiscal year end. The adoption of the measurement date provisions of SFAS No. 158 resulted in a decrease in accrued postretirement benefits of $1,175, an increase in deferred tax liabilities of $435, an increase in accumulated other comprehensive income of $882 and a decrease in the opening balance of retained earnings of $142. The adoption of the measurement date provisions of SFAS No. 158 had no material effect on our consolidated statement of income for the six months ended December 31, 2008 or for any prior period presented, and it will not materially affect our operating results in future periods.

We provide medical, dental and life insurance postretirement plans covering certain U.S. employees who meet specified age and service requirements. Pursuant to an amendment, effective January 1, 2006, Medicare eligible retirees age 65 or older are no longer covered under the self-funded plan. Instead, they are provided a subsidy towards the purchase of supplemental insurance. The components of net periodic benefit costs are as follows:

| | Three Months Ended December 31 | | Six Months Ended December 31 | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Service cost for benefits earned | $ 121 | $ 151 | $ 241 | $ 302 |
| Interest cost on benefit obligation | 374 | 350 | 747 | 700 |

| | | | | |
|---|---|---|---|---|
| Amortization of unrecognized prior service cost | (251) | (250) | (502) | (501) |
| Actuarial loss | 69 | 146 | 139 | 292 |
| Total cost | $ 313 | $ 397 | $ 625 | $ 793 |

NOTE 11: CONTINGENCIES

On January 3, 2008, K.T. Equipment (International) Inc., (K.T.), filed a claim in the United States District Court, Western District of Tennessee, against us, in which K.T. alleged that we breached our obligation under the Stac-Pac® acquisition agreement to pay K.T. a contingent promissory note in the principal amount of $5,000 plus accrued interest of approximately $2,830 as of December 31, 2008. Payment of the contingent note was dependent on the satisfaction of certain specified conditions relating to the rights obtained by us with regard to the intellectual property assets. When these conditions were not met pursuant to the terms of the Stac-Pac® acquisition agreement, we canceled the contingent note in the year ended June 30, 2007, as reported in our 10-K filed September 7, 2007. We believe we have meritorious defenses to K.T.'s claim and intend to vigorously defend against the claim.

The Foley Plant, located in Perry, Florida, discharges treated wastewater into the Fenholloway River. Under the terms of an agreement with the Florida Department of Environmental Protection ("FDEP"), approved by the U. S. Environmental Protection Agency ("the EPA") in 1995, we agreed to a comprehensive plan to attain Class III ("fishable/swimmable") status for the Fenholloway River under applicable Florida law (the "Fenholloway Agreement"). The Fenholloway Agreement requires us, among other things, to (i) make process changes within the Foley Plant to reduce the coloration of its wastewater discharge, (ii) restore certain wetlands areas, (iii) relocate the wastewater discharge point into the Fenholloway River to a point closer to the mouth of the river, and (iv) provide oxygen enrichment to the treated wastewater prior to discharge at the new location. We have completed the process changes within the Foley Plant as required by the Fenholloway Agreement. In making these in-plant process changes, we incurred significant expenditures, and, as discussed in the following paragraph, we expect to incur significant additional capital expenditures to comply with the remaining obligations under the Fenholloway Agreement.

The EPA objected to the draft National Pollutant Discharge Elimination System (NPDES) permit prepared in connection with the Fenholloway Agreement and requested additional environmental studies to identify possible alternatives to the relocation of the wastewater discharge point, and some members of the public have also challenged the permit. Based on the requirements anticipated in the proposed permit, we expect to incur capital expenditures of approximately $9,500 dollars over the four year period that began in fiscal year 2009 on in-plant process changes, and additional capital expenditures of at least $50,000 dollars over at least five years, possibly beginning as early as fiscal year 2015. See Note 17 "Contingencies" to the financial statements included in our Annual Report for the year ended June 30, 2008.

NOTE 12: CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The guarantor subsidiaries presented below represent our subsidiaries that are subject to the terms and conditions outlined in the indenture governing the senior notes and that guarantee the notes, jointly and severally, on a senior unsecured basis. The non-guarantor subsidiaries presented below represent the foreign subsidiaries that do not guarantee the senior notes. Each subsidiary guarantor is 100% owned directly or indirectly by us and all guarantees are full and unconditional.

Our supplemental financial information and our guarantor subsidiaries and non-guarantor subsidiaries for the senior notes are presented in the following tables.

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
Three Months Ended December 31, 2008

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Net sales | $ 26,414 | $ 132,816 | $ 36,355 | $ (10,920) | $ 184,665 |
| Cost of goods sold | 25,652 | 112,160 | 34,515 | (10,794) | 161,533 |
| Gross margin | 762 | 20,656 | 1,840 | (126) | 23,132 |
| | | | | | |
| Selling, research and administrative expenses, and other | (3,528) | 12,991 | 2,274 | - | 11,737 |
| Goodwill impairment loss | 20,230 | 24,922 | 92,856 | | 138,008 |
| | | | | | |
| Operating loss | (15,940) | (17,257) | (93,290) | (126) | (126,613) |
| | | | | | |
| Other income (expense): | | | | | |
| Net interest income (expense) and amortization of debt costs | (7,889) | 358 | 62 | - | (7,469) |
| Other income (expense), including equity income (loss) in affiliates | (205,966) | (197) | 343 | 206,434 | 614 |
| Intercompany interest income (expense) | 7,719 | (6,703) | (1,016) | - | - |
| | | | | | |
| Income (loss) before income taxes | (222,076) | (23,799) | (93,901) | 206,308 | (133,468) |
| | | | | | |
| Income tax expense (benefit) | (96,890) | 639 | (4,357) | 92,124 | (8,484) |
| | | | | | |
| Net income (loss) | $ (125,186) | $ (24,438) | $ (89,544) | $ 114,184 | $ (124,984) |

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
Six Months Ended December 31, 2008

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Net sales | $ 62,685 | $ 277,341 | $ 87,548 | $ (21,616) | $ 405,958 |
| Cost of goods sold | 59,456 | 228,125 | 81,897 | (21,990) | 347,488 |
| Gross margin | 3,229 | 49,216 | 5,651 | 374 | 58,470 |
| | | | | | |
| Selling, research and administrative expenses, and other | (7,665) | 26,748 | 5,333 | - | 24,416 |
| Goodwill impairment loss | 20,230 | 24,922 | 92,856 | | 138,008 |
| | | | | | |
| Operating income (loss) | (9,336) | (2,454) | (92,538) | 374 | (103,954) |
| | | | | | |
| Other income (expense): | | | | | |
| Net interest income (expense) and amortization of debt costs | (15,646) | 639 | 100 | - | (14,907) |
| Other income (expense), including equity income (loss) in affiliates | (199,234) | (273) | (444) | 199,734 | (217) |
| Intercompany interest income (expense) | 15,437 | (13,244) | (2,193) | - | - |
| | | | | | |
| Income (loss) before income taxes | (208,779) | (15,332) | (95,075) | 200,108 | (119,078) |
| | | | | | |
| Income tax expense (benefit) | (92,442) | 3,434 | (3,985) | 90,049 | (2,944) |
| | | | | | |
| Net income (loss) | $ (116,337) | $ (18,766) | $ (91,090) | $ 110,059 | $ (116,134) |

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
Three Months Ended December 31, 2007

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Net sales | $ 28,124 | $ 138,312 | $ 54,866 | $ (10,380) | $ 210,922 |
| Cost of goods sold | 24,815 | 105,566 | 48,989 | (10,427) | 168,943 |
| Gross margin | 3,309 | 32,746 | 5,877 | 47 | 41,979 |
| | | | | | |
| Selling, research and administrative expenses, and other | (5,271) | 14,271 | 3,157 | - | 12,157 |
| | | | | | |
| Operating income | 8,580 | 18,475 | 2,720 | 47 | 29,822 |
| | | | | | |
| Other income (expense): | | | | | |
| Net interest income (expense) and amortization of debt costs | (8,631) | (48) | 155 | - | (8,524) |
| Other income (expense), including equity income | 10,866 | 21 | (145) | (10,585) | 157 |

| | | | | | |
|---|---|---|---|---|---|
| (loss) in affiliates | | | | | |
| Intercompany interest income (expense) | 8,332 | (6,468) | (1,864) | - | - |
| Income (loss) before income taxes | 19,147 | 11,980 | 866 | (10,538) | 21,455 |
| | | | | | |
| Income tax expense (benefit) | 5,281 | 4,297 | 530 | (2,519) | 7,589 |
| | | | | | |
| Net income (loss) | $ 13,866 | $ 7,683 | $ 336 | $ (8,019) | $ 13,866 |

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
Six Months Ended December 31, 2007

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Net sales | $ 55,727 | $ 266,039 | $ 108,094 | $ (21,539) | $ 408,321 |
| Cost of goods sold | 47,848 | 204,252 | 95,128 | (21,541) | 325,687 |
| Gross margin | 7,879 | 61,787 | 12,966 | 2 | 82,634 |
| | | | | | |
| Selling, research and administrative expenses, and other | (9,517) | 27,453 | 6,256 | - | 24,192 |
| Restructuring and impairment costs | 69 | - | 27 | - | 96 |
| | | | | | |
| Operating income | 17,327 | 34,334 | 6,683 | 2 | 58,346 |
| | | | | | |
| Other income (expense): | | | | | |
| Net interest income (expense) and amortization of debt costs | (17,770) | (116) | 205 | - | (17,681) |
| Other income (expense), including equity income (loss) in affiliates | 27,444 | 191 | (640) | (27,792) | (797) |
| Intercompany interest income (expense) | 16,663 | (13,014) | (3,649) | - | - |
| | | | | | |
| Income (loss) before income taxes | 43,664 | 21,395 | 2,599 | (27,790) | 39,868 |
| | | | | | |
| Income tax expense (benefit) | 16,301 | 7,294 | (807) | (10,283) | 12,505 |
| | | | | | |
| Net income (loss) | $ 27,363 | $ 14,101 | $ 3,406 | $ (17,507) | $ 27,363 |

CONDENSED CONSOLIDATING BALANCE SHEETS
As of December 31, 2008

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | $ 362 | $ 3 | $ 8,126 | $ - | $ 8,491 |
| Accounts receivable, net | 10,435 | 70,988 | 26,688 | - | 108,111 |
| Inventories, net | 32,399 | 65,019 | 18,860 | (730) | 115,548 |
| Other current assets | 5,476 | 5,281 | 429 | - | 11,186 |
| Intercompany accounts receivable | - | 69,978 | - | (69,978) | - |
| Total current assets | 48,672 | 211,269 | 54,103 | (70,708) | 243,336 |
| | | | | | |
| Property, plant and equipment, net | 59,265 | 338,703 | 124,817 | - | 522,785 |
| Goodwill and intangibles, net | 15,717 | 2,425 | - | - | 18,142 |
| Intercompany notes receivable | 363,717 | - | - | (363,717) | - |
| Other assets, including investment in subsidiaries | 250,441 | 265,074 | 101,136 | (606,280) | 10,371 |
| Total assets | $ 737,812 | $ 817,471 | $ 280,056 | $ (1,040,705) | $ 794,634 |
| | | | | | |
| Liabilities and stockholders' equity | | | | | |
| Current liabilities | | | | | |
| Trade accounts payable | $ 6,056 | $ 23,847 | $ 3,775 | $ - | $ 33,678 |
| Other current liabilities | 16,398 | 19,086 | 7,408 | - | 42,892 |
| Intercompany accounts payable | 68,796 | - | 1,182 | (69,978) | - |
| Total current liabilities | 91,250 | 42,933 | 12,365 | (69,978) | 76,569 |
| | | | | | |
| Long-term debt | 391,311 | - | - | - | 391,311 |
| Deferred income taxes | (6,990) | 47,039 | 8,482 | - | 48,531 |
| Other long-term liabilities | 9,449 | 14,176 | 1,805 | - | 25,430 |
| Intercompany notes payable | - | 273,228 | 90,489 | (363,717) | - |
| Stockholders'/invested equity | 252,792 | 440,095 | 166,915 | (607,010) | 252,792 |
| Total liabilities and stockholders' equity | $ 737,812 | $ 817,471 | $ 280,056 | $ (1,040,705) | $ 794,634 |

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CONDENSED CONSOLIDATING BALANCE SHEETS
As of June 30, 2008

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | $ 491 | $ 137 | $ 9,765 | $ - | $ 10,393 |
| Accounts receivable, net | 18,909 | 70,379 | 38,233 | - | 127,521 |
| Inventories, net | 31,034 | 57,499 | 22,826 | (1,105) | 110,254 |
| Other current assets | 3,565 | 6,702 | 1,263 | - | 11,530 |
| Intercompany accounts receivable | - | 87,036 | - | (87,036) | - |
| Total current assets | 53,999 | 221,753 | 72,087 | (88,141) | 259,698 |
| | | | | | |
| Property, plant and equipment, net | 60,090 | 334,367 | 161,251 | - | 555,708 |
| Goodwill and intangibles, net | 36,843 | 27,347 | 116,045 | - | 180,235 |
| Intercompany notes receivable | 368,217 | - | - | (368,217) | - |
| Other assets, including investment in subsidiaries | 411,183 | 262,661 | 116,461 | (776,721) | 13,584 |
| Total assets | $ 930,332 | $ 846,128 | $ 465,844 | $ (1,233,079) | $ 1,009,225 |
| | | | | | |
| Liabilities and stockholders’ equity | | | | | |
| Current liabilities | | | | | |
| Trade accounts payable | $ 10,353 | $ 29,211 | $ 9,593 | $ - | $ 49,157 |
| Other current liabilities | 18,360 | 22,009 | 10,647 | - | 51,016 |
| Intercompany accounts payable | 78,510 | - | 8,526 | (87,036) | - |
| Total current liabilities | 107,223 | 51,220 | 28,766 | (87,036) | 100,173 |
| | | | | | |
| Long-term debt | 393,910 | - | - | - | 393,910 |
| Deferred income taxes | (10,211) | 51,551 | 16,623 | - | 57,963 |
| Other long-term liabilities | 9,853 | 15,749 | 2,020 | - | 27,622 |
| Intercompany notes payable | - | 258,728 | 109,489 | (368,217) | - |
| Stockholders’/invested equity | 429,557 | 468,880 | 308,946 | (777,826) | 429,557 |
| Total liabilities and stockholders’ equity | $ 930,332 | $ 846,128 | $ 465,844 | $ (1,233,079) | $ 1,009,225 |

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
Six Months Ended December 31, 2008

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidated |
|---|---|---|---|---|
| Net cash provided by operations | $ 4,507 | $ 21,782 | $ 2,251 | $ 28,540 |
| | | | | |
| Investing activities: | | | | |
| Purchases of property, plant and equipment | (1,754) | (21,485) | (1,772) | (25,011) |
| Other | - | (73) | - | (73) |
| Net cash used in investing activities | (1,754) | (21,558) | (1,772) | (25,084) |
| | | | | |
| Financing activities | | | | |
| Net borrowings (payments) under lines of credit | 2,612 | - | (71) | 2,541 |
| Net payments on long-term debt and other | (5,000) | (358) | - | (5,358) |
| Purchase of treasury shares | (494) | - | - | (494) |
| Net cash used in financing activities | (2,882) | (358) | (71) | (3,311) |
| | | | | |
| Effect of foreign currency rate fluctuations on cash | - | - | (2,047) | (2,047) |
| | | | | |
| Decrease in cash and cash equivalents | (129) | (134) | (1,639) | (1,902) |
| Cash and cash equivalents at beginning of period | 491 | 137 | 9,765 | 10,393 |
| Cash and cash equivalents at end of period | $ 362 | $ 3 | $ 8,126 | $ 8,491 |

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
Six Months Ended December 31, 2007

| | Buckeye Technologies Inc. | Guarantors US Subsidiaries | Non-Guarantor Subsidiaries | Consolidated |
|---|---|---|---|---|
| Net cash provided by operations | $ 25,912 | $ 15,374 | $ 12,849 | $ 54,135 |
| | | | | |
| Investing activities: | | | | |
| Purchases of property, plant and equipment | (2,286) | (15,452) | (954) | (18,692) |
| Other | - | (135) | - | (135) |
| Net cash used in investing activities | (2,286) | (15,587) | (954) | (18,827) |
| | | | | |
| Financing activities | | | | |
| Net borrowings under line of credit | 81,495 | - | 505 | 82,000 |
| Net payments on long-term debt and other | (113,578) | (195) | | (113,773) |

| | | | | |
|---|---|---|---|---|
| Net proceeds from sale of equity interests | 5,742 | - | - | 5,742 |
| Payments for debt issuance costs | (1,401) | - | - | (1,401) |
| Net cash provided by (used in) financing activities | (27,742) | (195) | 505 | (27,432) |
| | | | | |
| Effect of foreign currency rate fluctuations on cash | - | - | 900 | 900 |
| | | | | |
| Increase (decrease) in cash and cash equivalents | (4,116) | (408) | 13,300 | 8,776 |
| Cash and cash equivalents at beginning of period | 6,329 | 447 | 8,014 | 14,790 |
| Cash and cash equivalents at end of period | $ 2,213 | $ 39 | $ 21,314 | $ 23,566 |

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") summarizes the significant factors affecting our results of operations, liquidity, capital resources and contractual obligations, as well as discussing our critical accounting policies. This discussion should be read in conjunction with the accompanying unaudited financial statements and our Annual Report on Form 10-K for the year ended June 30, 2008 ("Annual Report"), which include additional information about our significant accounting policies, practices and transactions that underlie our financial results. Our MD&A is composed of four major sections: Executive Summary, Results of Operations, Financial Condition, and Critical Accounting Policies.

Except as otherwise specified, references to years indicate our fiscal year ending June 30, 2009 or ended June 30 of the year referenced and comparisons are to the corresponding period of the prior year. The following discussion includes a comparison of the results of operations for the three and six months ended December 31, 2008 to the three and six months ended December 31, 2007.

### Executive Summary

Buckeye manufactures and distributes value-added cellulose-based specialty products used in numerous applications, including disposable diapers, personal hygiene products, engine, air and oil filters, food casings, cigarette filters, rayon filaments, acetate plastics, thickeners and papers. Our products are produced in the United States, Canada, Germany and Brazil, and we sell these products in approximately 60 countries worldwide. We generate revenues, operating income and cash flows from two reporting segments: specialty fibers and nonwoven materials. Specialty fibers are derived from wood and cotton cellulose materials using wetlaid technologies. Our nonwoven materials are derived from wood pulps, synthetic fibers and other materials using an airlaid process.

Our strategy is to continue to strengthen our position as a leading supplier of cellulose-based specialty products. The key focus areas for Buckeye over the next twelve months include “living within our means,” generating free cash flow and paying down debt. We believe that we can continue to expand market share, improve profitability and decrease our exposure to cyclical downturns by pursuing the following strategic objectives: focus on technically demanding niche markets, develop and commercialize innovative proprietary products, strengthen long-term alliances with customers, provide our products at an attractive value, evaluate external growth opportunities that match our specialty market focus and continue to reduce debt.

The October – December period was a challenging quarter for Buckeye as the global economic recession began to impact demand for some of our products. Sales for the three months ended December 31, 2008 of $185 million were down $26 million or 12.4% versus the same period in 2007. Reduced shipment volume had a negative $42 million impact on sales compared to the year ago quarter while increased selling prices added $18 million. While the demand for most of our specialty wood fibers products has held up well, aside from some weakness in fluff pulp and the auto filtration markets, demand for specialty cotton fibers has weakened significantly. We took market downtime at our Foley facility, primarily in fluff pulp, and at our Memphis and Americana plants in cotton pulp during the quarter to match production to shipments and to control working capital. We are committed to matching production with sales to ensure we minimize our cash investment in inventories. Shipment volume for our airlaid nonwovens products was down 21% versus the same quarter a year ago partly due to the loss of a significant piece of business with a major customer in January 2008, which has not been completely replaced, and partly due to reduced demand in the quarter primarily caused by customer inventory reductions. The key end-market segments into which we sell airlaid nonwovens products are store brand baby wipes, feminine care products and tabletop products. We believe that demand in all of these segments is holding up well. Selling prices were up year over year across both segments of the business in response to sharply higher costs, particularly in the specialty fibers segment.

The operating loss for the three months ended December 31, 2008 was $156.4 million worse when compared to the same period in 2007. A goodwill impairment loss of $138.0 million was the primary cause of the reduction. The remaining reduction of $18.4 million was almost entirely due to the lower sales volume and associated market-related downtime taken during the quarter. Selling price increases were sufficient to offset substantial increases in costs for raw materials, chemicals, energy and transportation costs. During the quarter, we began to see a reversal of some of these rising cost trends as raw material costs were flat and energy and transportation costs declined compared to the July-September 2008 period. Chemical costs continued to move higher during the October-December quarter, and this upward trend is expected to continue for the January-March quarter. We expect to see our chemical costs, particularly caustic, begin to decline in the April-June quarter. While our variable costs are starting to decrease, they are still significantly higher than they were in the October-December 2007 period.

The net loss for the three months ended December 31, 2008 of ($125.0) million was unfavorable by $138.9 million compared to the same period in 2007. The decrease in operating income versus the three months ended December 31, 2007 was partially offset by $1.1 million reduction in interest expense. The effective tax rate decreased from 35.4% for the three months ended December 31, 2007 to 6.4% for the three months ended December 31, 2008. The main driver of the lower tax rate was that a large portion of the goodwill impairment did not produce a tax benefit. In addition, we recorded a correction to our deferred taxes partially offsetting a favorable tax ruling which together had a net unfavorable impact of $0.3 million during the three months ended December 31, 2008.

Cash from operations for the six months ended December 31, 2008 was $28.5 million, which was down $25.6 million compared to the six months ended December 31, 2007. This reduction was primarily driven by lower gross margin (down $24.2 million), which was partially offset by a reduction of $2.8 million in interest expense. In addition, there was a small increase in cash taxes paid ($0.4 million), as we utilized all of our United States net operating losses. Our inventory also increased by $9.4 million during the period, which was $6.0 million more than the inventory increase during the prior year period. The increase in inventory was in finished goods in the specialty fibers segment and we plan to reduce both our finished goods and raw materials inventories significantly over the remaining two quarters of the fiscal year. Compared to the same six month period in 2007, both accounts receivable and accounts payable decreased by a larger amount due to lower production and sales volumes for a net decrease in cash usage of $4.7 million. Capital expenditures for the six months ended December 31, 2008 were $25.0 million compared to $18.7 million in the same period in 2007 due to increased expenditures on the Foley Energy Project, which totaled $8.2 million for the period.

We are focused on reducing cost, maintaining a tight control on working capital and building sales. This makes our focus on Lean Enterprise Methods all the more crucial as we continue the work to reduce cost by eliminating waste throughout our operations.

In addition to our focus on cost reduction, we have reduced our planned capital spending for the fiscal year from $64 million to $40 million in order to accelerate debt reduction efforts. We remain committed to the energy cost reduction project at Foley and are teaming with local and State of Florida public officials to help us obtain funding for the necessary capital investments.

We have established a goal of paying down our debt to $350 million by December 31, 2009. By doing so we believe that we will have sufficient borrowing capacity on our $200 million revolving credit facility to pay off the $110 million in bonds that mature in October 2010 without going to the credit markets for new financing.

Results of Operations

Consolidated results

The following table compares components of operating income for the three and six months ended December 31, 2008 and 2007.

| (millions) | Three Months Ended December 31 | | | | Six Months Ended December 31 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | 2007 | Change | % Change | 2008 | 2007 | Change | % Change |
| Net sales | $ 184.7 | $ 210.9 | $ (26.2) | (12.4)% | $ 406.0 | $ 408.3 | $ (2.3) | (0.6)% |
| Cost of goods sold | 161.5 | 168.9 | (7.4) | (4.4)% | 347.5 | 325.7 | 21.8 | 6.7 % |
| Gross margin | 23.2 | 42.0 | (18.8) | (44.8)% | 58.5 | 82.6 | (24.1) | (29.2)% |
| Selling, research and administrative expenses | 11.3 | 11.8 | (0.5) | (4.2)% | 23.5 | 23.3 | 0.2 | 0.9 % |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Goodwill impairment loss | | 138.0 | | - | | 138.0 | N/A | | 138.0 | | - | | 138.0 | N/A |
| Restructuring costs | | - | | - | | - | - | | - | | 0.1 | | (0.1) | N/A |
| Amortization of intangibles and other | | 0.5 | | 0.4 | | 0.1 | 25.0 % | | 0.9 | | 0.9 | | - | - |
| Operating income (loss) | $ | (126.6) | $ | 29.8 | $ | (156.4) | (524.8)% | $ | (103.9) | $ | 58.3 | $ | (162.2) | (278.2)% |

Net sales for the three months ended December 31, 2008 were lower than the same period in 2007 due to lower shipment volume in both segments of our business. Higher prices for all of our products partially offset the lower volume. For the six months ended December 31, 2008, net sales were slightly lower than the same period in the prior year. The impact of lower shipment volume was mostly offset by higher prices across all of our plants.

Gross margin was lower for the three and six months ended December 31, 2008 versus the same periods in 2007. For the three and six months ended December 31, 2008, the lower shipment volume and associated market-related production downtime, resulted in lost margin on reduced shipments and higher costs due to lower capacity utilization rates. For both the three and six month periods, selling price increases were sufficient to offset substantial increases in costs for raw materials, chemicals, energy and transportation costs compared to the year-ago periods.

Selling, research and administrative expenses decreased slightly for the three months ended December 31, 2008 and increased slightly for the six months ended December 31, 2008 versus the same periods in the prior year.

Based on the current economic environment and the recent steep decline in the price of our stock, which created a significant gap between the book and market value of our equity, we concluded that there were sufficient indicators to require us to perform an interim goodwill impairment analysis as of December 31, 2008. Although we have not completed this analysis, we have concluded that an impairment loss is probable and can be reasonably estimated. Accordingly, we recorded a $138.0 million non-cash goodwill impairment charge during the three months ended December 31, 2008. Since this goodwill impairment charge is non-cash, it does not affect our liquidity or financial covenants.

We expect to finalize our goodwill impairment analysis during the third quarter of fiscal 2009. There could be adjustments to the goodwill impairment charge when the goodwill impairment test is completed.

Segment results

Although nonwoven materials, processes, customers, distribution methods and regulatory environment are similar to specialty fibers, we believe it is appropriate for nonwoven materials to be disclosed as a separate reporting segment from specialty fibers. The specialty fibers segment consists of our chemical cellulose, customized fibers and fluff pulp product lines which are cellulosic fibers based on both wood and cotton. We make separate financial decisions and allocate resources based on the sales and operating income of each segment. We allocate selling, research, and administrative expense to each segment, and we use the resulting operating income to measure the performance of the two segments. We exclude items that are not included in measuring business performance, such as restructuring costs, asset impairment, goodwill impairment, amortization of intangibles, certain financing and investing costs and unallocated at-risk and stock-based compensation. We have reclassified the at-risk compensation and stock-based compensation from the specialty fibers and nonwovens segments for the three and six months ended December 31, 2007 for comparability.

Specialty fibers

The following table compares specialty fibers net sales and operating income for the three and six months ended December 31, 2008 and 2007.

| (millions) | Three Months Ended December 31 | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | % Change |
| Net sales | $ 137.7 | $ 148.2 | $ (10.5) | (7.1)% |
| Operating income | 11.3 | 26.1 | (14.8) | (56.7)% |

| (millions) | Six Months Ended December 31 | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | % Change |
| Net sales | $ 302.7 | $ 283.9 | $ 18.8 | 6.6 % |
| Operating income | 31.5 | 48.1 | (16.6) | (34.5)% |

Net sales were down due to lower shipment volumes for the three months ended December 31, 2008 versus the same period in 2007 as the global economic downturn began to impact demand for some of our products. Shipment volume for the specialty fibers segment was down 17% compared to the same quarter a year ago, with specialty wood fibers shipments off 14% and specialty cotton fibers shipments off 28%. Demand for most of our specialty wood fibers products has held up well, but we have seen some weakness in the fluff pulp and auto filtration markets. The recession has had a more severe impact on demand for our specialty cotton fibers products, particularly on the end market for LCD TV screens. The impact of lower volume was partially offset by higher prices. Prices were up about

20% on our cotton and wood specialty products as a result of price increases implemented over the last twelve months.  Fluff pulp pricing increased by $32 per ton compared to the same period a year ago.

For the six months ended December 31, 2008, higher prices were more than sufficient to offset the impact of lower shipment volume on sales.  Specialty products prices were up approximately 19% over the same six month period last year and fluff pulp prices increased $47 per ton.

During the three months ended December 31, 2008, lower sales volumes and associated production downtime accounted for most of the $15 million reduction in operating income compared to the three months ended December 31, 2007. Price increases implemented over the course of the past 12 months added $16 million to earnings for the quarter and offset significant increases in input costs incurred during that same period. Increased prices on cotton linters accounted for approximately $5 million of the cost increase. In addition, chemical and energy prices increased significantly along with higher transportation costs, accounting for additional cost of approximately $9 million.

Operating income for the six months ended December 31, 2008 decreased versus the six months ended December 31, 2007. Higher sales prices were sufficient to offset higher costs for raw material, chemicals, energy and transportation, but earnings were down year over year primarily due to lower sales volumes and associated production downtime.

Going into our third fiscal quarter, energy and transportation costs should trend down compared to the second quarter. We expect caustic prices to start coming down in February from peak levels in January, but our third quarter costs for caustic will still be higher than our costs in the second quarter and we won’t see any sequential reduction in these costs until our fiscal fourth quarter. With lower diesel prices and increasing amount of announced pulp mill downtime, we also expect some relief in wood prices. The cost of cotton fiber, both in Brazil and the United States, is also falling, but we won’t see the benefit of that in the United States until the fourth quarter after we work through current fiber inventories.

Nonwoven materials

The following tables compare nonwoven materials net sales and operating income for the three and six months ended December 31, 2008 and 2007.

| (millions) | Three Months Ended December 31 | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | % Change |
| Net sales | $ 56.8 | $ 72.0 | $ (15.2) | (21.1)% |
| Operating income | 1.5 | 5.4 | (3.9) | (72.2)% |

| (millions) | Six Months Ended December 31 | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | % Change |
| Net sales | $ 122.7 | $ 143.6 | $ (20.9) | (14.6)% |
| Operating income | 5.1 | 13.3 | (8.2) | (61.7)% |

Nonwoven material sales decreased during the three and six months ended December 31, 2008 versus the same periods in 2007. Sales were down due to lower shipment volume, mainly because of the loss of a significant piece of business with a major customer in January 2008 which has not been completely replaced, and also partly due to some customer inventory reductions during the three months ended December 31, 2008. We expect an increase in sales for this segment in the three months ended March 31, 2009 compared to the three months ended December 31, 2008 after the seasonally weak December quarter in Europe.

Operating income decreased for the three and six months ended December 31, 2008 versus the same periods in 2007, primarily due to the loss of business mentioned above and the resulting drop in capacity utilization.

Corporate

The following tables compare corporate net sales and operating loss for the three and six months ended December 31, 2008 and 2007.

| (millions) | Three Months Ended December 31 | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | % Change |
| Net sales | $ (9.9) | $ (9.3) | $ (0.6) | (6.5)% |
| Operating loss | (139.5) | (1.7) | (137.8) | N/A |

| (millions) | Six Months Ended December 31 | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | % Change |
| Net sales | $ (19.5) | $ (19.2) | $ (0.3) | (1.6)% |
| Operating loss | (140.5) | (3.0) | (137.5) | N/A |

The operating loss for the three and six months ended December 31 consists of:

| | Three Months Ended December 31 | | Six Months Ended December 31 | |
|---|---|---|---|---|
| (millions) | 2008 | 2007 | 2008 | 2007 |
| Unallocated at-risk compensation | $ (0.4) | $ (1.1) | $ (1.0) | $ (1.6) |
| Unallocated stock based compensation | (0.4) | (0.2) | (0.9) | (0.4) |
| Goodwill impairment | (138.0) | | (138.0) | |
| Intellectual property amortization | (0.5) | (0.4) | (0.9) | (0.9) |
| Restructuring expenses | - | - | - | (0.1) |
| Gross margin on intercompany sales | (0.2) | - | 0.3 | - |
| | $ (139.5) | $ (1.7) | $ (140.5) | $ (3.0) |

Net interest expense and amortization of debt costs

Net interest expense and amortization of debt costs decreased $1.1 million and $2.8 million for the three and six months ending December 31, 2008, respectively, versus the same period in the prior year. Net interest expense decreased primarily due to debt reduction of $22 million at December 31, 2008 versus December 31, 2007. The weighted average effective interest rate on our variable rate debt, which totaled $80.7 million at December 31, 2008 decreased from 6.1% at December 31, 2007 to 4.6% at December 31, 2008.

Income tax

On July 1, 2007, we adopted the provisions of FASB Interpretation No. (“FIN”) 48, “Accounting for Uncertainty in Income Taxes.” FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. As a result of the adoption, we recorded an adjustment of approximately $0.9 million to reduce retained earnings at July 1, 2007. At adoption, our unrecognized tax benefits totaled $1.8 million. Cumulative potential interest and penalties accrued related to unrecognized tax benefits at the date of adoption totaled $0.2 million. We include interest and penalties related to income tax matters as a component of income before income taxes. All unrecognized tax benefits at adoption would affect the effective tax rate, if recognized. During the three months ended December 31, 2008, as a result of the resolution of a North Carolina audit, we were able to reduce our unrecognized tax benefits by $0.2 million and our related interest and penalties by $0.1 million. These reductions leave a balance in unrecognized tax benefits and our related interest and penalties of $1.6 million and $0.1 million, respectively.

We file income tax returns with federal, state, local and foreign jurisdictions. As of December 31, 2008, we remain subject to examinations of our United States federal and state income tax returns for the years 2003 through 2007, Canadian income tax returns for the years 2001 through 2007 and German tax filings for the years 2002 through 2007.

Our effective tax rates for the three and six month periods ended December 31, 2008 were 6.4% and 2.5%, respectively. Our effective tax rates for the same periods of 2007 were 35.4% and 31.4%, respectively. We recorded a $138.0 million goodwill impairment charge in the three months ended December 31, 2008. Accordingly, we recognized a tax benefit of $10.4 million in connection with the goodwill impairment charge. In addition, the rate change for the three month period ended December 31, 2008 was the result of a correction to our deferred taxes and the resolution of the North Carolina audit (mentioned above) which together had a net unfavorable impact of $0.3 million during the three months ended December 31, 2008. The increase, before the goodwill impairment charge, in the effective tax rate for the six month period over the same period in 2007 was affected by the items which impacted the three months ended December 31, 2008 comparison plus a German tax rate law change which reduced our taxes by approximately $2.2 million during the six months ended December 31, 2007.

Financial Condition

Liquidity and capital resources

We have the following major sources of financing: senior secured credit facility, senior notes and senior subordinated notes. Our senior secured credit facility, senior notes and senior subordinated notes contain various covenants. We were in compliance with these covenants as of December 31, 2008, and believe we will continue to remain in compliance for the foreseeable future. Our senior notes limit the amount of funds we can use to make dividend payments, repurchase stock or retire our 2010 notes prior to October 2009. The amount of funds available includes fifty percent of net income or losses since October 2003. Since we recorded a $138.0 million non-cash goodwill impairment, our net losses over this period restrict us from these activities.

On December 31, 2008, we had $8.5 million of cash and cash equivalents and $114.0 million borrowing capacity on our revolving credit facility. As of December 31, 2008, our liquidity, including available borrowings and cash and cash equivalents, was approximately $122.5 million.

While we can offer no assurances, we believe that our cash flow from operations, together with current cash and cash equivalents, will be sufficient to fund necessary capital expenditures, meet operating expenses and service our debt obligations for the foreseeable future.

Cash Flow

The following table provides a summary of cash flows for the six month periods ended December 31, 2008 and December 31, 2007.

| | Six Months Ended December 31 | |
|---|---|---|
| (millions) | 2008 | 2007 |
| Operating activities: | | |
| Net income (loss) | $ (116.1) | $ 27.4 |
| Noncash charges and credits, net | 157.7 | 38.5 |
| Changes in operating assets and liabilities, net | (13.1) | (11.8) |
| Net cash provided by operating activities | 28.5 | 54.1 |
| | | |
| Investing activities: | | |
| Purchases of property, plant and equipment | (25.0) | (18.7) |
| Other investing activities | (0.1) | (0.1) |
| Net cash used in investing activities | (25.1) | (18.8) |
| | | |
| Financing activities: | | |
| Net borrowings under lines of credit | 2.5 | 82.0 |
| Net payments on long-term debt and other | (5.3) | (113.7) |
| Net proceeds from sale of equity interests | - | 5.7 |
| Purchase of treasury shares | (0.5) | - |
| Payments for debt issuance costs | - | (1.4) |
| Net cash used in financing activities | (3.3) | (27.4) |
| | | |
| Effect of foreign currency rate fluctuations on cash | (2.0) | 0.9 |

| | | | | |
|---|---|---|---|---|
| Net (decrease) increase in cash and cash equivalents | $ | (1.9) | $ | 8.8 |

Cash provided by operating activities

Cash provided by operating activities for the six months ended December 31, 2008 was $25.6 million less than for the same period in 2007. The majority of the decrease was due to lower gross margin (down $24.2 million), which was partially offset by a reduction of $2.8 million in interest expense. In addition, there was a small increase in cash taxes paid ($0.4 million), as we utilized all of our United States net operating losses. Our inventory also increased by $9.4 million during the period, which was $6.0 million more than the inventory increase during the prior year period. The increase in inventory was in finished goods in the specialty fibers segment and we plan to reduce both our finished goods and raw materials inventories significantly over the remaining two quarters of the fiscal year. Compared to the same six month period in 2007, both accounts receivable and accounts payable decreased by a larger amount due to lower production and sales volumes for a net decrease in cash usage of $4.7 million.

Net cash used in investing activities

Purchases of property, plant and equipment increased to $25.0 million during the six months ended December 31, 2008 versus $18.7 million during the same period in 2007 primarily due to spending at our Perry, Florida specialty fibers facility. Spending on the Foley Energy Project accounted for $8.2 million of our capital spending for the six months ended December 31, 2008. Due to the current economic conditions, we have reduced our planned capital spending, for fiscal 2009, from $64 million to $40 million in order to accelerate debt reduction efforts. We remain committed to the energy cost reduction project at Foley and are teaming with local and State of Florida public officials to help us obtain funding for the necessary capital investments.

Net cash used in financing activities

During the six months ended December 31, 2007, we established a $200 million senior secured revolving credit facility with a maturity date of July 25, 2012. Initially, we used the proceeds from this new credit facility to pay the outstanding balance on the former credit facility plus fees and expenses. We also used proceeds from this facility to redeem the remaining $60 million of our 2008 notes and to redeem $20 million of the 2010 notes in mid-September 2007.

Treasury stock

During fiscal years 1997 to 2001 the Board of Directors authorized total repurchases of 6.0 million shares of common stock. At December 31, 2008, a total of 5.4 million shares have been repurchased under these authorizations. On August 8, 2008 the Board of Directors authorized the repurchase of 5.0 million shares of common stock in addition to the 6.0 million shares of common stock previously authorized. Repurchased shares will be held as treasury stock and will be available for general corporate purposes, including the funding of employee benefit and stock-related plans.

Contractual obligations

There have been no material changes to our contractual obligations since our disclosure in our Annual Report on Form 10-K. The following table summarizes our significant contractual cash obligations as of December 31, 2008. Certain of these contractual obligations are reflected in our balance sheet, while others are disclosed as future obligations under accounting principles generally accepted in the United States.

| (millions) | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Fiscal 2009 (1) | Fiscal 2010 and 2011 | Fiscal 2012 and 2013 | Thereafter |
| Long-term obligations (2) | $ 506.6 | $ 14.7 | $ 164.8 | $ 118.6 | $ 208.5 |
| Operating lease obligations | 3.8 | 1.2 | 2.1 | 0.5 | - |
| Timber commitments | 21.0 | 6.4 | 14.6 | - | - |
| Linter commitments(3) | 10.4 | 10.4 | - | - | - |
| Other purchase commitments (4) | 25.6 | 12.2 | 7.8 | 4.5 | 1.1 |
| Total contractual cash obligations | $ 567.4 | $ 44.9 | $ 189.3 | $ 123.6 | $ 209.6 |

(1) Cash obligations for the remainder of fiscal 2009.

(2) Amounts include related interest payments. Interest payments for variable debt of $80.7 million are based on the effective rate as of December 31, 2008 of 4.6% per annum.

(3) Linter commitments are take-or-pay contracts made in the ordinary course of business that usually are less than one year in length.

(4) The majority of other purchase commitments are take-or-pay contracts made in the ordinary course of business related to utilities and raw material purchases.

Note: The cash flow to fund post-retirement benefit obligations has not materially changed since June 30, 2008. These obligations are not included in the table above as the total obligation is based on the present value of the payments and would not be consistent with the contractual cash obligations disclosures included in the table above. See Note 12, Employee Benefit Plans, to the Consolidated Financial Statements in our Annual Report for further information.

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to adopt accounting policies and make significant judgments and estimates to develop amounts reflected and disclosed in the financial statements. Management bases these estimates and assumptions on historical data and trends, current fact patterns, expectations and other sources of information they believe are reasonable. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of our accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and the receipt of new or better information.

The four critical accounting policies that we believe either require the most managerial judgment, or involve the selection or application of alternative accounting policies, and that are material to our financial statements are those relating to allowance for doubtful accounts, deferred income taxes, depreciation and long-lived assets. Further information regarding our “Critical Accounting Policies” can be found in the "Management's Discussion and Analysis of

Financial Condition and Results of Operations" in our Annual Report. Management has discussed the development and selection of these critical accounting policies and estimates with the Audit Committee of our Board of Directors and with our independent registered public accounting firm. In addition, Note 1 to the financial statements in our Annual Report contains a summary of our significant accounting policies.



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Forward-Looking Statements

This document contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements within the meaning of section 27A of the Securities Act of 1933, as amended, and section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are not based on historical facts, but rather reflect management's current expectations concerning future results and events. These forward-looking statements generally can be identified by the use of statements that include phrases such as "believe," "expect," "anticipate," "intend," "plan," "foresee," "likely," "will" or other similar words or phrases. Similarly, statements that describe management's objectives, plans or goals are or may be forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors that are difficult to predict and which may cause the actual results, performance or achievements to be different from any future results, performance and achievements expressed or implied by these statements. The following important factors, among others, could affect future results, causing these results to differ materially from those expressed in our forward-looking statements: pricing fluctuations and worldwide economic conditions; dependence on a single customer; fluctuation in the costs of raw materials and energy resources; competition; changes in fair values of long-lived assets; inability to predict the scope of future environmental compliance costs or liabilities; inability to predict the scope of future restructuring costs or liabilities; and the ability to obtain additional capital, maintain adequate cash flow to service debt as well as meet operating needs. The forward-looking statements included in this document are only made as of the date of this document and we do not have any obligation to publicly update any forward-looking statements to reflect subsequent events or circumstances. For additional factors that could impact future results, please see our Annual Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of December 31, 2008, there were a few areas where circumstances merit an update to our annual report.

Foreign Currency Exchange Rates: While we have global operations, the majority of our transactions are denominated in U.S. dollars. The principal foreign currency exchange rate risks to which we are exposed are the Canadian dollar, Brazilian real and European euro. We currently have two minor hedges in place which will not have a material effect on the company.

Availability and Cost of Raw Materials: The amounts we pay for wood, cotton fiber and fluff pulp represent the largest components of our variable costs of production. Significant decreases in availability or increases in the cost of wood or cotton fiber to the extent not reflected in the prices for our products could materially affect our business results. During the July to September 2008 quarter, our production was constrained at two of our plants by the availability of cotton fibers. We have experienced significant increases in the cost of cotton fibers, which we passed on to our customers through increased selling prices. In the October to December 2008 quarter, prices for cotton linters have moderated due to the global economic recession and reduction in global demand for cotton fibers. Currently, our production is not constrained by fiber availability, but is instead constrained by reduced demand for our specialty cotton fiber products. Long-term, cotton fiber availability and cost remain risks for the business.

Industry Cyclicality: The recent downturn in the global economy has impacted demand in some of the markets we serve. The cyclicality of the fluff pulp market was highlighted in our Annual Report, and the index price for fluff pulp delivered to both North America and Europe has dropped by $80 per ton, or nine percent, between October 2008 and January 2009. We have seen some demand weakness in the three months ended December 31, 2008 in the fluff pulp market, but we believe that supply and demand is still relatively in balance in this market. Buckeye's selling price for fluff pulp only dropped by $9 per ton between the three months ended September 30, 2008 and the three months ended December 31, 2008, but it is possible that over the next six months we will see further price decreases. Demand for our high-end specialty wood products has held up well aside from some weakness in the auto filtration markets, but demand for our specialty cotton fibers has been impacted by the recession, particularly in the LCD, ethers, plastics and nitrates markets.

## Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation as of December 31, 2008 of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective.

No changes in our internal control over financial reporting occurred during the quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

Items 1A, 2, 3, and 5 are not applicable and have been omitted.

### Item 1. Legal Proceedings

On January 3, 2008, K.T. Equipment (International) (K.T.), Inc. filed a claim in the United States District Court, Western District of Tennessee, against us, in which K.T. alleged that we breached our obligation under the Stac-Pac® acquisition agreement to pay K.T. a contingent promissory note in the principal amount of $5 million plus accrued interest of approximately $2.8 million as of December 31, 2008. Payment of the contingent note was dependent on the satisfaction of certain specified conditions relating to the rights obtained by us with regard to the intellectual property assets. When these conditions were not met pursuant to the terms of the Stac-Pac® acquisition agreement, we canceled the contingent note in the year ended June 30, 2007, as reported in our 10-K filed September 7, 2007. We believe we have meritorious defenses to K.T.'s claim and intend to vigorously defend against the claim.

### Item 4. Submission of Matters to a Vote of Security Holders

On November 5, 2008, we held our Annual Meeting of Stockholders. At the meeting George W. Bryan, R. Howard Cannon, and Katherine Buckman Gibson were each re-elected as Class I directors to hold office for a three-year term or until their successors are elected and qualified. For Mr. Bryan, 36,188,973 votes were cast in favor and 274,812 votes were withheld. For Mr. Cannon, 32,253,034 votes were cast in favor and 4,210,751 were withheld. For Ms. Gibson, 35,734,123 votes were cast in favor and 729,662 were withheld.

Following the election, our Board of Directors consisted of George W. Bryan, R. Howard Cannon, Katherine Buckman Gibson, Red Cavaney, John B. Crowe, David B. Ferraro, Lewis E. Holland, Kristopher J. Matula, and Virginia B. Wetherell.

The stockholders also ratified the appointment of Ernst & Young LLP, as our independent auditors. 35,448,356 votes were cast in favor of the ratification, 1,010,614 were cast against and 4,815 votes abstained.

### Item 6. Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1 Section 1350 Certification of Chief Executive Officer
32.2 Section 1350 Certification of Chief Financial Officer

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.

BUCKEYE TECHNOLOGIES INC.

By: /s/ John B. Crorwe

John B. Crowe, Chairman of the Board and Chief Executive Officer

Date: February 9, 2009

By: /s/ Steven G. Dean

Steven G. Dean, Senior Vice President and Chief Financial Officer

Date: February 9, 2009