

ALBANY INTERNATIONAL CORP /DE/  
Form 10-Q  
August 07, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended: June 30, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-16214

**ALBANY INTERNATIONAL CORP.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**14-0462060**

(IRS Employer  
Identification No.)

**1373 Broadway, Albany, New York**

(Address of principal executive offices)

**12204**

(Zip Code)

Registrant's telephone number, including area code 518-445-2200

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The registrant had 26,220,209 shares of Class A Common Stock and 3,236,098 shares of Class B Common Stock outstanding as of June 30, 2007.

**ALBANY INTERNATIONAL CORP.**

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**ALBANY INTERNATIONAL CORP.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands except per share data)  
(unaudited)

| Three Months Ended<br>June 30, |           |                    | Six Months Ended<br>June 30, |           |
|--------------------------------|-----------|--------------------|------------------------------|-----------|
| 2007                           | 2006      |                    | 2007                         | 2006      |
| \$267,269                      | \$261,630 | Net sales          | \$525,007                    | \$512,853 |
| 170,661                        | 157,621   | Cost of goods sold | 330,013                      | 304,868   |
| 96,608                         | 104,009   | Gross profit       | 194,994                      | 207,985   |

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| Three Months Ended<br>June 30,               |           |   | Six Months Ended<br>June 30, |           |
|--|-----------|---|------------------------------|-----------|
| 82,594                                       | 75,064    | Selling, technical, general and research expenses   | 157,312                      | 149,626   |
| 7,112  |           | Restructuring and other                             | 14,721                       |           |
| 6,902  | 28,945    | Operating income                                    | 22,961                       | 58,359    |
| 3,710  | 2,712     | Interest expense, net                               | 7,012                        | 4,591     |
| 1,051  | (137)     | Other expense/(income), net                         | 1,021                        | 772       |
| 2,141  | 26,370    | Income before income taxes                          | 14,928                       | 52,996    |
| (2,214)                                      | 7,749     | Income tax (benefit)/expense                        | 983                          | 15,737    |
| 4,355  | 18,621    | Income before associated companies                  | 13,945                       | 37,259    |
| 50   | 66        | Equity in earnings/(losses) of associated companies | (235)                        | 243       |
| \$ 4,405                                     | \$ 18,687 | Net income  | \$ 13,710                    | \$ 37,502 |
| Earnings per share:                          |           |   |                              |           |
| \$ 0.15                                      | \$ 0.63   | Basic   | \$ 0.47                      | \$ 1.23   |
| \$ 0.15                                      | \$ 0.62   | Diluted   | \$ 0.46                      | \$ 1.21   |
| Shares used in computing earnings per share: |           |   |                              |           |
| 29,380                                       | 29,554    | Basic   | 29,323                       | 30,481    |
| 29,818                                       | 30,094    | Diluted   | 29,751                       | 31,019    |
| \$ 0.11                                      | \$ 0.10   | Dividends per share                                 | \$ 0.21                      | \$ 0.19   |

The accompanying notes are an integral part of the financial statements.

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**ALBANY INTERNATIONAL CORP.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share data)**

|                                      | (unaudited)<br>June 30,<br>2007 | December 31,<br>2006 |
|--------------------------------------|---------------------------------|----------------------|
| <b>ASSETS</b>                        |                                 |                      |
| Cash and cash equivalents            | \$ 60,666                       | \$ 68,237            |
| Accounts receivable, net             | 221,807                         | 202,611              |
| Inventories                          | 251,380                         | 224,210              |
| Income taxes receivable and deferred | 35,111                          | 23,586               |
| Prepaid expenses                     | 13,974                          | 10,552               |
| Total current assets                 | 582,938                         | 529,196              |
| Property, plant and equipment, net   | 428,423                         | 397,521              |
| Investments in associated companies  | 6,166                           | 6,634                |
| Intangibles                          | 8,448                           | 9,343                |

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|   | (unaudited)<br>June 30,<br>2007 | December 31,<br>2006 |
|---|---------------------------------|----------------------|
| Goodwill  | 185,824                         | 172,890              |
| Deferred taxes                                  | 115,353                         | 112,280              |
| Cash surrender value of life insurance policies | 43,001                          | 41,197               |
| Other assets                                    | 45,425                          | 37,486               |
| Total assets                                    | \$ 1,415,578                    | \$ 1,306,547         |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>      |                                 |                      |
| Notes and loans payable                         | \$ 28,347                       | \$ 12,510            |
| Accounts payable                                | 51,307                          | 50,214               |
| Accrued liabilities                             | 138,334                         | 101,995              |
| Current maturities of long-term debt            | 1,215                           | 11,167               |
| Income taxes payable and deferred               | 5,933                           | 20,099               |
| Total current liabilities                       | 225,136                         | 195,985              |
| Long-term debt                                  | 380,644                         | 354,587              |
| Other noncurrent liabilities                    | 224,130                         | 219,774              |
| Deferred taxes and other credits                | 56,891                          | 37,076               |
| Total liabilities                               | 886,801                         | 807,422              |

Commitments and Contingencies

**SHAREHOLDERS EQUITY**

|  |              |              |
|--|--------------|--------------|
| Preferred stock, par value \$5.00 per share; authorized 2,000,000 shares; none issued  |              |              |
| Class A Common Stock, par value \$.001 per share; authorized 100,000,000 shares; issued 34,750,275 in 2007 and 34,518,870 in 2006. | 35           | 35           |
| Class B Common Stock, par value \$.001 per share; authorized 25,000,000 shares; issued and outstanding 3,236,098 in 2007 and 2006  | 3            | 3            |
| Additional paid in capital   | 323,650      | 316,164      |
| Retained earnings  | 546,658      | 541,602      |
| Accumulated items of other comprehensive income:   |              |              |
| Translation adjustments  | (481)        | (18,348)     |
| Pension liability adjustment   | (82,065)     | (81,071)     |
|  | 787,800      | 758,385      |
| Less treasury stock (Class A), at cost (8,530,066 shares in 2007 and 8,540,882 in 2006)  | 259,023      | 259,260      |
| Total shareholders equity  | 528,777      | 499,125      |
| Total liabilities and shareholders equity  | \$ 1,415,578 | \$ 1,306,547 |

The accompanying notes are an integral part of the financial statements.

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(in thousands)  
(unaudited)

|   | Six Months Ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2007                         | 2006      |
| <b>OPERATING ACTIVITIES</b>   |                              |           |
| Net income  | \$ 13,710                    | \$ 37,502 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |           |
| Equity in losses/(earnings) of associated companies                               | 235                          | (243)     |
| Depreciation  | 28,700                       | 26,936    |
| Amortization  | 2,342                        | 1,961     |
| Provision for deferred income taxes, other credits and long-term liabilities      | 2,444                        | 5,024     |
| Provision for write-off of equipment  | 1,032                        | 321       |
| Increase in cash surrender value of life insurance                                | (1,803)                      | (1,708)   |
| Unrealized currency transaction gains and losses                                  | (334)                        | 1,436     |
| Shares contributed to ESOP  | 3,013                        | 4,183     |
| Stock option expense  | 400                          | 770       |
| Tax benefit of options exercised  | (730)                        | (529)     |
| Issuance of shares under long-term incentive plan                                 | 937                          |           |
| Changes in operating assets and liabilities, net of business acquisition:         |                              |           |
| Accounts receivable   | (8,011)                      | (7,976)   |
| Note receivable   |                              | (505)     |
| Inventories   | (21,724)                     | (20,055)  |
| Income taxes prepaid and receivable   | (10,982)                     |           |
| Prepaid expenses  | (2,984)                      | (999)     |
| Accounts payable  | (1,208)                      | (3,048)   |
| Accrued liabilities   | 29,626                       | 8,834     |
| Income taxes payable  | 296                          | (2,551)   |
| Other, net  | (193)                        | (3,562)   |
| Net cash provided by operating activities   | 34,766                       | 45,791    |
| <b>INVESTING ACTIVITIES</b>   |                              |           |
| Purchases of property, plant and equipment  | (52,050)                     | (32,352)  |
| Purchased software  | (7,493)                      | (147)     |
| Acquisitions, net of cash acquired  | (9,233)                      | (8,112)   |
| Net cash (used in) investing activities   | (68,776)                     | (40,611)  |
| <b>FINANCING ACTIVITIES</b>   |                              |           |
| Proceeds from borrowings  | 47,761                       | 192,996   |
| Principal payments on debt  | (15,787)                     | (15,677)  |
| Purchase of treasury shares   |                              | (131,499) |
| Purchase of call options on common stock  |                              | (47,688)  |
| Sale of common stock warrants   |                              | 32,961    |
| Proceeds from options exercised   | 2,244                        | 1,926     |
| Tax benefit of options exercised  | 730                          | 529       |
| Debt issuance costs   |                              | (5,434)   |
| Dividends paid  | (5,853)                      | (5,658)   |

|  | Six Months Ended<br>June 30, |            |
|--|------------------------------|------------|
| Net cash provided by financing activities        | 29,095                       | 22,456     |
| Effect of exchange rate changes on cash flows    | (2,656)                      | 3,168      |
| (Decrease)/increase in cash and cash equivalents | (7,571)                      | 30,804     |
| Cash and cash equivalents at beginning of year   | 68,237                       | 72,771     |
| Cash and cash equivalents at end of period       | \$ 60,666                    | \$ 103,575 |

The accompanying notes are an integral part of the financial statements.

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**ALBANY INTERNATIONAL CORP.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of only normal, recurring adjustments, necessary for a fair presentation of results for such periods. The results for any interim period are not necessarily indicative of results for the full year. The preparation of financial statements for interim periods does not require all of the disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. These consolidated financial statements should be read in conjunction with financial statements and notes thereto for the year ended December 31, 2006.

Effective January 1, 2007, the Company adopted FASB Interpretation Number 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB statement No. 109. As permitted by the Interpretation, 2006 financial statements were not restated.

**2. Inventories**

Inventories consist of the following:

| (in thousands)            | June 30,<br>2007 | December 31,<br>2006 |
|---------------------------|------------------|----------------------|
| Finished goods            | \$ 128,077       | \$ 120,158           |
| Work in process           | 68,494           | 59,738               |
| Raw material and supplies | 54,809           | 44,314               |
| Total inventories         | \$ 251,380       | \$ 224,210           |

Inventories are stated at the lower of cost or market and are valued at average cost, net of reserves. The Company records a provision for obsolete inventory based on the age and category of the inventories.

**3. Goodwill and other Intangible Assets**

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The Company accounts for goodwill and other intangible assets under the provisions of Statement of Financial Accounting Standards No. 142 (FAS No. 142), Goodwill and Other Intangible Assets. FAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually.

The Company performs the test for goodwill impairment during the second quarter of each year. As a result of the test performed in the second quarter of 2007, no impairment provision was required. Goodwill and other long-lived assets are reviewed for impairment whenever events, such as significant changes in the business climate, plant closures, changes in product offerings, or other circumstances indicate that the carrying amount may not be recoverable.

The Company is continuing to amortize certain patents, trade names and customer contracts that have finite lives.

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The changes in intangible assets and goodwill from December 31, 2006 to June 30, 2007, were as follows:

| (in thousands)                        | Balance at<br>December 31,<br>2006 | Amortization | Currency<br>translation | Other<br>Changes | Balance at<br>June 30, 2007 |
|---------------------------------------|------------------------------------|--------------|-------------------------|------------------|-----------------------------|
| <b>Amortized intangible assets:</b>   |                                    |              |                         |                  |                             |
| Trade names                           | \$ 2,339                           | (\$268)      | (\$57)                  |                  | \$ 2,014                    |
| Patents                               | 2,450                              | (207)        | (60)                    |                  | 2,183                       |
| Customer contracts                    | 4,202                              | (291)        |                         |                  | 3,911                       |
| Technology                            | 352                                | (12)         |                         |                  | 340                         |
| Total amortized intangible assets     | \$ 9,343                           | (\$778)      | (\$117)                 |                  | \$ 8,448                    |
| <b>Unamortized intangible assets:</b> |                                    |              |                         |                  |                             |
| Goodwill                              | \$172,890                          |              | \$4,339                 | \$8,595          | \$185,824                   |

The \$8,595,000 other change in goodwill is comprised of an \$138,000 adjustment made to deferred tax liabilities in connection with the acquisition of Texas Composite Inc. (TCI) and an \$8,733,000 goodwill addition related to the acquisition of R-Bac Industries, LLC (R-Bac). The R-Bac acquisition has been integrated into the Albany Doors Systems segment of the Company.

In June 2007, the Company acquired the assets and business of R-Bac Industries for \$9,233,000 in cash plus the assumption of certain liabilities. While the Company has not yet completed the purchase price allocation, it has preliminarily allocated \$8,733,000 of the purchase price to goodwill.

As of June 30, 2007, goodwill included \$123,524,000 in the Paper Machine Clothing segment, \$23,095,000 in the Applied Technologies segment, and \$39,205,000 in the Albany Door Systems segment.

Estimated amortization expense of intangibles for the years ending December 31, 2007 through 2011, is as follows:

| Year | Annual<br>amortization<br>(in thousands) |
|------|--|
| 2007 | \$ 1,900                                 |
| 2008 | 1,900                                    |
| 2009 | 1,700                                    |
| 2010 | 1,400                                    |
| 2011 | 500                                      |

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\$ 7,400

**4. Other Expense/(Income), Net**

Other expense/(income), net consists of the following:

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| (in thousands)              | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|-----------------------------|--------------------------------|-----------|------------------------------|-----------|
|                             | 2007                           | 2006      | 2007                         | 2006      |
| Currency transactions       | (\$200)                        | (\$1,520) | (\$693)                      | (\$2,283) |
| Debt costs                  | 512                            | 447       | 899                          | 928       |
| Securitization program      |                                | 889       |                              | 1,681     |
| Other miscellaneous expense | 739                            | 47        | 815                          | 446       |
| Total                       | \$ 1,051                       | (\$137)   | \$ 1,021                     | \$ 772    |

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**5. Earnings Per Share**

Earnings per share are computed using the weighted average number of shares of Class A Common Stock and Class B Common Stock outstanding during the period. Diluted earnings per share include the effect of all potentially dilutive securities.

The amounts used in computing earnings per share, including the effect on income and the weighted average number of shares of potentially dilutive securities, are as follows:

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| (in thousands, except market price data)   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
|  | 2007                           | 2006      | 2007                         | 2006      |
| Net income available to common shareholders                                      | \$ 4,405                       | \$ 18,687 | \$ 13,710                    | \$ 37,502 |
| <b>Weighted average number of shares:</b>  |                                |           |                              |           |
| Weighted average number of shares used in calculating basic earnings per share   | 29,380                         | 29,554    | 29,323                       | 30,481    |
| <b>Effect of dilutive stock-based compensation plans:</b>                        |                                |           |                              |           |
| Stock options  | 400                            | 491       | 390                          | 489       |
| Long-term incentive plan   | 38                             | 49        | 38                           | 49        |
| Weighted average number of shares used in calculating diluted earnings per share | 29,818                         | 30,094    | 29,751                       | 31,019    |
| Average market price of common stock used for calculation of dilutive shares     | \$ 38.40                       | \$ 39.68  | \$ 36.18                     | \$ 38.38  |
| <b>Earnings per share:</b>   |                                |           |                              |           |
| Basic  | \$ 0.15                        | \$ 0.63   | \$ 0.47                      | \$ 1.23   |
| Diluted  | \$ 0.15                        | \$ 0.62   | \$ 0.46                      | \$ 1.21   |



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There were no option shares that were excluded from the computation of diluted earnings per share in any of the periods presented. As of June 30, 2007, there was no dilution resulting from the convertible debt instrument, purchased call option, and warrant that are described in Note 12.

The following table presents the number of shares issued and outstanding:

|                   | Class A<br>Shares | Class B<br>Shares | Less: Class A<br>Treasury shares | Net shares<br>Outstanding |
|-------------------|-------------------|-------------------|----------------------------------|---------------------------|
| December 31, 2006 | 34,518,870        | 3,236,098         | (8,540,882)                      | 29,214,086                |
| March 31, 2007    | 34,633,542        | 3,236,098         | (8,540,882)                      | 29,328,758                |
| June 30, 2007     | 34,750,275        | 3,236,098         | (8,530,066)                      | 29,456,307                |

### 6. Comprehensive Income

Comprehensive income consists of the following:

| (in thousands)  | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2007                           | 2006      | 2007                         | 2006      |
| Net income  | \$ 4,405                       | \$ 18,687 | \$ 13,710                    | \$ 37,502 |
| Other comprehensive income:                             |                                |           |                              |           |
| Foreign currency translation adjustments                | 13,350                         | 22,019    | 17,867                       | 28,736    |
| Amortization of pension liability adjustment, after tax | (497)                          |           | (994)                        |           |
| Other comprehensive income, net of tax                  | 12,853                         | 22,019    | 16,873                       | 28,736    |
| Comprehensive income                                    | \$ 17,258                      | \$ 40,706 | \$ 30,583                    | \$ 66,238 |

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### 7. Changes in Stockholders' Equity

The following table summarizes changes in Stockholders' Equity:

| (in thousands)                  | Class A<br>Common<br>Stock | Class B<br>Common<br>Stock | Additional<br>paid in<br>capital | Retained<br>earnings | Accumulated<br>items of other<br>comprehensive<br>income | Treasury<br>stock | Total<br>Shareholders<br>Equity |
|---------------------------------|----------------------------|----------------------------|----------------------------------|----------------------|--|-------------------|---------------------------------|
| December 31, 2006               | \$ 35                      | \$ 3                       | \$ 316,164                       | \$ 541,602           | (\$99,419)   | (\$259,260)       | \$ 499,125                      |
| Net income                      |                            |                            |                                  | 13,710               |  |                   | 13,710                          |
| Shares contributed to ESOP      |                            |                            | 3,013                            |                      |  |                   | 3,013                           |
| Proceeds from options exercised |                            |                            | 2,244                            |                      |  |                   | 2,244                           |

|  |       |      |            |            |            |             |            |
|--|-------|------|------------|------------|------------|-------------|------------|
| Dividends declared   |       |      |            | (6,166)    |            |             | (6,166)    |
| Stock option expense   |       | 400  |            |            |            |             | 400        |
| Tax benefit of options exercised                             |       | 730  |            |            |            |             | 730        |
| Issuance of shares under long-term incentive plan            |       | 937  |            |            |            |             | 937        |
| Cumulative change in liability for unrecognized tax benefits |       |      |            | (2,491)    |            |             | (2,491)    |
| Amortization of pension liability adjustment                 |       |      |            |            | (994)      |             | (994)      |
| Cumulative translation adjustment/other                      |       |      | 162        | 3          | 17,867     | 237         | 18,269     |
| June 30, 2007  | \$ 35 | \$ 3 | \$ 323,650 | \$ 546,658 | (\$82,546) | (\$259,023) | \$ 528,777 |

## 8. Reportable Segment Data

The following table shows data by reportable segment, reconciled to consolidated totals included in the financial statements:

| (in thousands)                            | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2007                           | 2006       | 2007                         | 2006       |
| <b>Net Sales</b>                          |                                |            |                              |            |
| Paper Machine Clothing                    | \$ 188,667                     | \$ 194,466 | \$ 370,971                   | \$ 378,359 |
| Applied Technologies                      | 45,278                         | 37,764     | 86,217                       | 75,607     |
| Albany Door Systems                       | 33,324                         | 29,400     | 67,819                       | 58,887     |
| Consolidated total                        | \$ 267,269                     | \$ 261,630 | \$ 525,007                   | \$ 512,853 |
| <b>Operating Income</b>                   |                                |            |                              |            |
| Paper Machine Clothing                    | \$ 24,279                      | \$ 38,168  | \$ 51,357                    | \$ 77,501  |
| Applied Technologies                      | 4,617                          | 4,678      | 8,938                        | 10,255     |
| Albany Door Systems                       | (2,189)                        | 690        | (457)                        | 2,464      |
| Research expense                          | (5,705)                        | (5,560)    | (10,717)                     | (11,564)   |
| Unallocated expenses                      | (14,100)                       | (9,031)    | (26,160)                     | (20,297)   |
| Operating income before reconciling items | 6,902                          | 28,945     | 22,961                       | 58,359     |
| <b>Reconciling items:</b>                 |                                |            |                              |            |
| Interest expense, net                     | (3,710)                        | (2,712)    | (7,012)                      | (4,591)    |
| Other (expense)/income, net               | (1,051)                        | 137        | (1,021)                      | (772)      |
| Consolidated income before income taxes   | \$ 2,141                       | \$ 26,370  | \$ 14,928                    | \$ 52,996  |

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Segment operating income in 2007 includes restructuring and other, and costs associated with performance improvement initiatives, as illustrated below:

| (in thousands)          | Three Months Ended<br>June 30, 2007            |  |            | Six Months Ended<br>June 30, 2007              |  |            |
|-------------------------|--|--|------------|--|--|------------|
|                         | Operating income<br>Restructuring<br>and other | effect of<br>Performance<br>improvement<br>initiatives | Total      | Operating income<br>Restructuring<br>and other | effect of<br>Performance<br>improvement<br>initiatives | Total      |
| <b>Operating income</b> |  |  |            |  |  |            |
| Paper Machine Clothing  | (\$2,678)                                      | (\$1,841)  | (\$4,519)  | (\$9,342)                                      | (\$2,023)  | (\$11,365) |
| Applied Technologies    |  |  |            |  |  |            |
| Albany Door Systems     | (2,224)  |  | (2,224)    | (2,224)  |  | (2,224)    |
| Research                |  |  |            |  |  |            |
| Unallocated             | (2,210)  | (3,102)  | (5,312)    | (3,155)  | (4,626)  | (7,781)    |
| Consolidated total      | (\$7,112)                                      | (\$4,943)  | (\$12,055) | (\$14,721)                                     | (\$6,649)  | (\$21,370) |

Beginning in the first quarter of 2007, segment operating income includes expenses associated with product engineering activities, which is consistent with a change in the Company's internal reporting structure. These expenses were previously included in Research expense. The following table illustrates the impact on the 2006 segment operating income that resulted from this change:

| (in thousands)          | Three Months Ended<br>June 30, 2006 |                  |                | Six Months Ended<br>June 30, 2006 |                  |                |
|-------------------------|-------------------------------------|------------------|----------------|-----------------------------------|------------------|----------------|
|                         | As originally<br>Reported           | Reclassification | As<br>Adjusted | As originally<br>Reported         | Reclassification | As<br>Adjusted |
| <b>Operating income</b> |                                     |                  |                |                                   |                  |                |
| Paper Machine Clothing  | \$40,232                            | (\$2,064)        | \$38,168       | \$80,788                          | (\$3,287)        | \$77,501       |
| Applied Technologies    | 5,107                               | (429)            | 4,678          | 11,255                            | (1,000)          | 10,255         |
| Albany Door Systems     | 1,214                               | (524)            | 690            | 3,499                             | (1,035)          | 2,464          |
| Research expense        | (7,997)                             | 2,437            | (5,560)        | (16,536)                          | 4,972            | (11,564)       |
| Unallocated expenses    | (9,611)                             | 580              | (9,031)        | (20,647)                          | 350              | (20,297)       |
| Consolidated total      | \$28,945                            | \$               | \$28,945       | \$58,359                          | \$               | \$58,359       |

## 9. Income Taxes

Income tax expense for the second quarter of 2007 was a tax benefit of \$2,214,000. The tax benefit includes favorable discrete adjustments of \$2,749,000 related to changes in estimated tax liabilities and prior year income tax contingencies. Income tax expense for the second quarter of 2006 was \$7,749,000. The second quarter income tax expense for 2006 was reduced by \$200,000 due to a favorable resolution of an income tax contingency in a non-us taxing jurisdiction.

The effective tax rate before discrete items was 25.0% for the first six months of 2007, as compared to 30.0% for the same period of 2006. The reduction in the effective tax rate was primarily due to a reduction in the amount of profit before tax compared to 2006 and a change in the distribution of income or loss amongst countries. The company currently expects that the consolidated effective tax rate for 2007 will remain at approximately 25.0%, before discrete items. However, there can be no assurance that this will not change in future periods.

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. The cumulative effect of adopting FIN 48 was an increase in tax reserves and a decrease in the

beginning of the year retained earnings of \$2,491,000. Upon adoption, the liability for unrecognized tax benefits, including applicable interest and penalties, was \$16,918,000 of which \$13,780,000, if recognized, would favorably impact the effective tax rate. Consistent with the provisions of FIN 48, the company has classified \$1,002,000 of the liability as current and \$15,916,000 as non-current in the consolidated balance sheet.

During the first six months of 2007, the Company recognized in the consolidated balance sheet additional tax liabilities related to uncertain tax positions taken in the current and prior years of \$1,687,000 and \$245,000,

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respectively. The company, also, decreased the reserves by \$983,000 due to settlements with tax authorities. Additionally, the company recorded \$561,000 in potential interest and penalties on existing tax reserves in the consolidated statements of income. No significant changes in the reserves occurred during the quarter.

As of January 1, 2007, the Company was under audit in U.S. and non-U.S. taxing jurisdictions. It is reasonably possible that a reduction in the unrecognized tax benefits may occur related to one of these audits in 2007. The possible reduction could range from \$600,000 to \$1,000,000. No other significant changes are anticipated within the twelve months following the date of the adoption of FIN 48. There has not been any material change in this position through June 30, 2007.

The Company recognizes interest and penalties related to unrecognized tax benefits within its global operations as a component of income tax expense. This accounting policy did not change as a result of the adoption of FIN 48. Accrued interest and penalties recognized in the consolidated balance sheet were \$3,545,000 and \$4,319,000 as of January 1, 2007 and June 30, 2007, respectively.

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business the company is subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United Kingdom, Brazil, Finland and Italy. Open tax years in these major jurisdictions range from 2001-2006.

## 10. Contingencies

Albany International Corp. ( Albany ) is a defendant in suits brought in various courts in the United States by plaintiffs who allege that they have suffered personal injury as a result of exposure to asbestos-containing products previously manufactured by Albany. Albany produced asbestos-containing paper machine clothing synthetic dryer fabrics marketed during the period from 1967 to 1976 and used in certain paper mills. Such fabrics generally had a useful life of three to twelve months.

Albany was defending against 18,813 claims as of July 27, 2007. This compares with 19,120 claims as of April 27, 2007, 19,388 such claims as of February 16, 2007, 19,416 claims as of December 31, 2006, 19,283 claims as of October 27, 2006, 24,451 claims as of December 31, 2005, 29,411 claims as of December 31, 2004, 28,838 claims as of December 31, 2003, 22,593 claims as of December 31, 2002, 7,347 claims as of December 31, 2001, 1,997 claims as of December 31, 2000, and 2,276 claims as of December 31, 1999. These suits allege a variety of lung and other diseases based on alleged exposure to products previously manufactured by Albany.

Albany anticipates that additional claims will be filed against it and related companies in the future, but is unable to predict the number and timing of such future claims. These suits typically involve claims against from twenty to more than two hundred defendants, and the complaints usually fail to identify the plaintiffs work history or the nature of the plaintiffs alleged exposure to Albany s products. Pleadings and discovery responses in those cases in which work histories have been provided indicate claimants with paper mill exposure in less than 10% of total claims reported, and only a portion of those claimants have alleged time spent in a paper mill to which Albany is believed to have supplied asbestos-containing products.

As of July 27, 2007, approximately 12,612 of the claims pending against Albany are pending in Mississippi. Of these, approximately 12,031 are in federal court, at the multidistrict litigation panel ( MDL ), either through removal or original jurisdiction. (In addition to the 12,031 Mississippi claims pending against the Company at the MDL, there are approximately 850 claims pending against the Company at the MDL removed from various United States District Courts in other states.)

The MDL s past practice was to place all nonmalignant claims on an inactive docket until such time as the plaintiff developed a malignant disease. The MDL would also administratively dismiss, without prejudice, the claims of plaintiffs resulting from mass-screenings who had not otherwise demonstrated that they suffered from an asbestos-related disease. Because the court continued to exercise jurisdiction over these claims, it would allow the claims to be reinstated following the diagnosis of an asbestos-related disease. Any such administratively dismissed

claims are included in the total number of pending claims reported.

The MDL has now issued a new order addressing the cases on its inactive docket. That order, signed on May 31, 2007, requires each plaintiff to provide detailed information regarding, among other things, alleged asbestos-related medical diagnoses. Contrary to expectations described in other reports, the order does not require plaintiffs to produce information about alleged exposure. The first set of plaintiffs are required to submit their filings with the

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Court by August 1, 2007, with deadlines for additional sets of plaintiffs monthly thereafter until December 1, 2007, by which time all plaintiffs are required to be compliant. The order states that the Court may dismiss the claims of any plaintiff who fails to comply.

Because the order of the MDL does not require the submission of alleged exposure information, the Company cannot reasonably expect many dismissals to follow the initial filings. After these filings, the MDL will begin conducting settlement conferences, at which plaintiffs will be required to submit short position statements setting forth exposure information. The Company does not expect the MDL to begin the process of scheduling the settlement conference for several months. Consequently, the Company believes that the effects of the new order will not be fully realized for some time.

Based on past experience, communications from certain plaintiffs' counsel, and the advice of the Company's Mississippi counsel, the Company expects the percentage of Mississippi claimants able to demonstrate time spent in a paper mill to which Albany supplied asbestos-containing products during a period in which Albany's asbestos-containing products were in use to be considerably lower than the total number of pending claims. However, due to the large number of inactive claims pending in the MDL and the lack of alleged exposure information, the Company does not believe a meaningful estimate can be made regarding the range of possible loss with respect to these remaining claims.

It is the position of Albany and the other paper machine clothing defendants that there was insufficient exposure to asbestos from any paper machine clothing products to cause asbestos-related injury to any plaintiff. Furthermore, asbestos contained in Albany's synthetic products was encapsulated in a resin-coated yarn woven into the interior of the fabric, further reducing the likelihood of fiber release. While the Company believes it has meritorious defenses to these claims, it has settled certain of these cases for amounts it considers reasonable given the facts and circumstances of each case. The Company's insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of July 27, 2007, the Company had resolved, by means of settlement or dismissal, 21,563 claims. The total cost of resolving all claims was \$6,706,000. Of this amount, \$6,671,000, or 99%, was paid by the Company's insurance carrier. The Company has approximately \$130 million in confirmed insurance coverage that should be available with respect to current and future asbestos claims, as well as additional insurance coverage that it should be able to access.

#### **Brandon Drying Fabrics, Inc.**

Brandon Drying Fabrics, Inc. ( Brandon ), a subsidiary of Geschmay Corp., which is a subsidiary of the Company, is also a separate defendant in many of the asbestos cases in which Albany is named as a defendant. Brandon was defending against 9,023 claims as of July 27, 2007. This compares with 9,089 claims as of April 27, 2007, 9,189 claims as of February 16, 2007, 9,114 such claims as of December 31, 2006, 8,992 claims as of October 27, 2006, 9,566 claims as of December 31, 2005, 9,985 claims as of December 31, 2004, 10,242 claims as of December 31, 2003, 11,802 claims as of December 31, 2002, 8,759 claims as of December 31, 2001, 3,598 claims as of December 31, 2000, and 1,887 claims as of December 31, 1999. The Company acquired Geschmay Corp., formerly known as Wangner Systems Corporation, in 1999. Brandon is a wholly-owned subsidiary of Geschmay Corp. In 1978, Brandon acquired certain assets from Abney Mills ( Abney ), a South Carolina textile manufacturer. Among the assets acquired by Brandon from Abney were assets of Abney's wholly-owned subsidiary, Brandon Sales, Inc. which had sold, among other things, dryer fabrics containing asbestos made by its parent, Abney. It is believed that Abney ceased production of asbestos-containing fabrics prior to the 1978 transaction. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. Under the terms of the Assets Purchase Agreement between Brandon and Abney, Abney agreed to indemnify, defend, and hold Brandon harmless from any actions or claims on account of products manufactured by Abney and its related corporations prior to the date of the sale, whether or not the product was sold subsequent to the date of the sale. It appears that Abney has since been dissolved. Nevertheless, a representative of Abney has been notified of the pendency of these actions and demand has been made that it assume the defense of these actions. Because Brandon did not manufacture asbestos-containing products, and because it does not believe that it was the legal successor to, or otherwise responsible for obligations of Abney with respect to products manufactured by Abney, it believes it has strong defenses to the claims that have been asserted against it. In some instances, plaintiffs have voluntarily dismissed claims against it, while in others it has entered into what it considers to be reasonable settlements. As of July 27, 2007, Brandon has resolved, by means of settlement or dismissal, 8,530 claims for a total of \$152,499. Brandon's insurance carriers initially agreed to pay 88.2% of the total indemnification and defense costs related to these proceedings, subject to the standard reservation of rights. The remaining 11.8%

of the costs had been borne directly by Brandon. During 2004, Brandon's insurance carriers agreed to cover 100% of indemnification and defense costs, subject to policy limits and the standard reservation of rights, and to reimburse Brandon for all indemnity and defense costs paid directly by Brandon related to these proceedings.

### Mount Vernon

In some of these asbestos cases, the Company is named both as a direct defendant and as the successor in interest to Mount Vernon Mills (Mount Vernon). The Company acquired certain assets from Mount Vernon in 1993. Certain plaintiffs allege injury caused by asbestos-containing products alleged to have been sold by Mount Vernon many years prior to this acquisition. Mount Vernon is contractually obligated to indemnify the Company against any liability arising out of such products. The Company denies any liability for products sold by Mount Vernon prior to the acquisition of the Mount Vernon assets. Pursuant to its contractual indemnification obligations, Mount Vernon has assumed the defense of these claims. On this basis, the Company has successfully moved for dismissal in a number of actions.

While the Company does not believe, based on currently available information and for the reasons stated above, that a meaningful estimate of a range of possible loss can be made with respect to such claims, based on its understanding of the insurance policies available, how settlement amounts have been allocated to various policies, its recent settlement experience, the absence of any judgments against the Company or Brandon, the ratio of paper mill claims to total claims filed, and the defenses available, the Company currently does not anticipate any material liability relating to the resolution of the aforementioned pending proceedings in excess of existing insurance limits. Consequently, the Company currently does not anticipate, based on currently available information, that the ultimate resolution of the aforementioned proceedings will have a material adverse effect on the financial position, results of operations or cash flows of the Company. Although the Company cannot predict the number and timing of future claims, based on the foregoing factors and the trends in claims against it to date, the Company does not anticipate that additional claims likely to be filed against it in the future will have a material adverse effect on its financial position, results of operations, or cash flows. The Company is aware that litigation is inherently uncertain, especially when the outcome is dependent primarily on determinations of factual matters to be made by juries. The Company is also aware that numerous other defendants in asbestos cases, as well as others who claim to have knowledge and expertise on the subject, have found it difficult to anticipate the outcome of asbestos litigation, the volume of future asbestos claims, and the anticipated settlement values of those claims. For these reasons, there can be no assurance that the foregoing conclusions will not change.

### 11. Pensions and Other Benefits

The Company sponsors defined benefit pension plans in various countries. The amount of contributions to the plans is based on several factors including the funding rules in each country. The Company expects to contribute approximately \$18,600,000 to its pension plans in 2007. The Company also provides certain medical, dental and life insurance benefits (Other Benefits) for retired United States employees that meet program qualifications. The Company currently funds this plan as claims are paid.

The components of net periodic benefit cost for the three months ended June 30, 2007 and 2006 are, as follows:

| (in thousands)                 | Pension Plans |          | Other Benefits |          |
|--------------------------------|---------------|----------|----------------|----------|
|                                | 2007          | 2006     | 2007           | 2006     |
| Service cost                   | \$ 1,898      | \$ 1,761 | \$ 641         | \$ 556   |
| Interest cost                  | 5,269         | 4,471    | 1,540          | 1,366    |
| Expected return on plan assets | (5,390)       | (4,405)  |                |          |
| Amortization:                  |               |          |                |          |
| Transition obligation          | 8             | 27       |                |          |
| Prior service cost/(credit)    | 226           | 237      | (1,052)        | (1,138)  |
| Net actuarial loss             | 1,365         | 1,361    | 891            | 980      |
| Net periodic benefit costs     | \$ 3,376      | \$ 3,452 | \$ 2,020       | \$ 1,764 |

The components of net periodic benefit cost for the six months ended June 30, 2007 and 2006 are, as follows:

| (in thousands)                 | Pension Plans |          | Other Benefits |          |
|--------------------------------|---------------|----------|----------------|----------|
|                                | 2007          | 2006     | 2007           | 2006     |
| Service cost                   | \$ 3,796      | \$ 3,522 | \$ 1,282       | \$ 1,308 |
| Interest cost                  | 10,538        | 8,942    | 3,080          | 2,919    |
| Expected return on plan assets | (10,780)      | (8,810)  |                |          |
| Amortization:                  |               |          |                |          |
| Transition obligation          | 16            | 54       |                |          |
| Prior service cost/(credit)    | 452           | 474      | (2,104)        | (2,276)  |
| Net actuarial loss             | 2,730         | 2,722    | 1,782          | 2,183    |
| Net periodic benefit costs     | \$ 6,752      | \$ 6,904 | \$ 4,040       | \$ 4,134 |

In September 2006, the FASB issued FAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS No. 158). The initial impact of this Standard, adopted by the Company in the fourth quarter of 2006, was the recognition in the balance sheet of the funded status of each defined benefit and other postretirement benefit plan. Effective December 31, 2008, FAS No. 158 will require plan assets and benefit obligations to be measured at December 31. The Company currently performs this measurement at September 30. In addition, beginning in the fourth quarter of 2007, the Standard will eliminate the use of a three-month lag period when recognizing the impact of curtailments or settlements, and instead, recognize these amounts in the period in which they occur.

## 12. Long Term Debt

Long term debt consists of the following:

| (in thousands)   | June 30,<br>2007 | December 31,<br>2006 |
|--|------------------|----------------------|
| Convertible notes issued in March 2006 with fixed interest rates of 2.25%, due in year 2026.   | \$ 180,000       | \$ 180,000           |
| Private placement with a fixed interest rate of 5.34%, due in years 2013 through 2017.   | 150,000          | 150,000              |
| April 2006 credit agreement with borrowings outstanding at an average interest rate of 5.87%.  | 50,000           | 23,000               |
| Various notes and mortgages relative to operations principally outside the United States, at an average rate of 5.64% in 2007 and 5.81% in 2006 due in varying amounts through 2021. | 1,109            | 1,822                |
| Industrial revenue financings at an average interest rate of 1.75% in 2007 and 7.06% in 2006, due in varying amounts through 2009.   | 750              | 10,932               |
| Long term debt   | 381,859          | 365,754              |

|  |            |            |
|--|------------|------------|
| Less: current portion                  | (1,215)    | (11,167)   |
| Long term debt, net of current portion | \$ 380,644 | \$ 354,587 |

The weighted average rate for all debt was 3.95% as of June 30, 2007 and 3.91% as of December 31, 2006.

On April 14, 2006, the Company entered into a \$460 million five-year revolving credit agreement (the Credit Agreement), under which \$50 million was outstanding as of June 30, 2007. The agreement replaced a similar \$460 million revolving credit facility. The applicable interest rate for borrowings under the agreement is LIBOR plus a spread, based on the Company's leverage ratio at the time of borrowing. The agreement includes covenants that could limit the Company's ability to purchase Common Stock, pay dividends, or acquire other companies or dispose of its assets.

In March 2006, the Company issued \$180 million principal amount of 2.25% convertible notes. The notes are convertible upon the occurrence of specified events and at any time on or after February 15, 2013, into cash

up to the principal amount of notes converted and shares of the Company's Class A common stock with respect to the remainder, if any, of the Company's conversion obligation at a conversion rate of 22.487 shares per \$1,000 principal amount of notes (equivalent to a conversion price of \$44.47 per share of Class A common stock).

In connection with the offering, the Company entered into convertible note hedge and warrant transactions with respect to its Class A common stock at a net cost of \$14,727,000. These transactions are intended to reduce the potential dilution upon conversion of the notes by providing the Company with the option, subject to certain exceptions, to acquire shares which offset the delivery of newly issued shares upon conversion of the notes.

Emerging Issues Task Force (EITF) Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, (EITF 00-19) provides guidance for distinguishing between permanent equity, temporary equity and assets and liabilities. The convertible feature of the notes, the convertible note hedge, and the warrant transactions each meet the requirements of EITF 00-19 to be accounted for as equity instruments. As such, the convertible feature of the notes has not been accounted for as a derivative (which would be marked to market each reporting period) and in the event the debt is converted, no gain or loss would be recognized as the cash payment of principal reduces the recorded liability and the issuance of common shares would be recorded in stockholders' equity.

In addition, the amount paid for the call option and the premium received for the warrant were recorded as additional paid-in capital in the accompanying consolidated balance sheet and are not accounted for as derivatives (which would be marked to market each reporting period). Incremental net shares for the convertible note feature and the warrant agreement will be included in future diluted earnings per share calculations for those periods in which the Company's average common stock price exceeds \$44.47 per share in the case of the Senior Notes and \$52.16 per share in the case of the warrants. The purchased call option is anti-dilutive and is excluded from the diluted earnings per share calculation.

In October 2005, the Company entered into a Note Agreement and Guaranty (the Prudential Agreement) with the Prudential Insurance Company of America, and certain other purchasers, in an aggregate principal amount of \$150,000,000. The notes bear interest at a rate of 5.34% and have a maturity date of October 25, 2017, with mandatory prepayments of \$50,000,000 on October 25, 2013 and October 25, 2015. At the noteholders election, certain prepayments may also be required in connection with certain asset dispositions or financings. The notes may not otherwise be prepaid without a premium. The Note Agreement contains customary terms, as well as affirmative covenants, negative covenants and events of default comparable to those in the Company's current principal revolving credit facility.

Reflecting, in each case, the effect of subsequent amendments to each agreement, the Company is required to maintain a leverage ratio of not greater than 3.50 to 1.00 under the Credit Agreement, and a leverage ratio of not greater than 3.00 to 1.00 (or 3.50 to 1.00 for a period of six fiscal quarters following a material acquisition, as defined) under the Prudential Agreement. The Company is also required to maintain minimum interest coverage of 3.00 to 1.00 under each agreement. As of June 30, 2007, the Company's leverage ratio under the agreement was 2.09 to 1.00 and the interest coverage ratio was 9.78 to 1.00. Under the Credit Agreement, the Company may purchase its Common Stock or pay dividends to



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the extent its leverage ratio remains at or below 3.50 to 1.00; under the Prudential Agreement, such payments or purchases are permitted to the extent that the leverage ratio remains at or below 3.00 to 1.00.

### 13. Restructuring

The Company has ongoing restructuring activities related to the centralization of administrative functions in its European paper machine clothing (PMC) operations, the discontinuation of press fabric manufacturing in Järvenpää, Finland, and the reduction of manufacturing capacity in North America, which resulted in charges of \$9,342,000 for the first six months of 2007.

On May 7, 2007, the Company announced its plan to discontinue operations at its door manufacturing facility in Halmstad, Sweden, as part of a plan to match installed capacity with business demands. Door manufacturing in Europe will be consolidated in the Lippstadt, Germany, facility. The actions taken resulted in restructuring charges of \$2,224,000 for the first six months of 2007.

The Company has also taken actions to reduce its Corporate overhead expenses that has resulted in restructuring charges of \$3,155,000 for the first six months of 2007.

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The following table summarizes charges reported in the Statement of Income under Restructuring and other :

| (in thousands)         | Total<br>restructuring<br>costs incurred | Termination and<br>other costs | Plant and<br>equipment<br>writedowns |
|------------------------|--|--------------------------------|--------------------------------------|
| Paper Machine Clothing | \$ 9,342                                 | \$ 8,410                       | \$ 932                               |
| Albany Door Systems    | 2,224                                    | 2,224                          |                                      |
| Corporate Headquarters | 3,155                                    | 3,155                          |                                      |
| Total                  | \$ 14,721                                | \$ 13,789                      | \$ 932                               |

The Company expects that any additional restructuring costs related to the actions described above will not be significant.

On August 2, 2007, the Company announced its intention to discontinue operations at its press fabric manufacturing facility in East Greenbush, New York, and to cease the manufacture of dryer fabrics in Menands, New York. Discussions with the local bargaining units will begin shortly, and the resulting charges associated with the closings will be disclosed as they become available.

All of the actions taken in the PMC segment are in response to the continuing consolidation within the paper industry and the need to balance the Company's paper machine clothing manufacturing capacity in with anticipated paper mill demand, as well as improving administrative efficiency.

The Company expects that substantially all of its accruals for restructuring liabilities will be paid out within one year. The table below presents a year to date summary of changes in restructuring liabilities:

| (in thousands)            | Restructuring<br>charges<br>accrued | Payments  | Currency<br>translation/other | June 30,<br>2007 |
|---------------------------|-------------------------------------|-----------|-------------------------------|------------------|
| Termination costs         | \$ 10,717                           | (\$4,413) | (\$47)                        | \$ 6,257         |
| Other restructuring costs | 3,072                               | (1,781)   | (1)                           | 1,290            |
| Total                     | \$ 13,789                           | (\$6,194) | (\$48)                        | \$ 7,547         |

#### 14. Recent Accounting Pronouncements

In February 2006, the FASB issued FAS No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB statements No. 133 and 140 (FAS No. 155). This Standard resolves and clarifies the accounting and reporting for certain financial instruments, including hybrid financial instruments with embedded derivatives, interest-only strips, and securitized financial instruments. FAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company's adoption of this Standard on January 1, 2007 did not have a material effect on its financial statements.

In March 2006, the FASB issued FAS No. 156, Accounting for Servicing of Financial Assets, an amendment of FAS No. 140. This Standard amends the accounting treatment with respect to separately recognized servicing assets and servicing liabilities, and is effective for fiscal years beginning after September 15, 2006. The Company's adoption of this Standard on January 1, 2007 did not have a material effect on its financial statements.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FAS No. 109 (FIN 48). This interpretation clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognizing, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company's adoption of this interpretation on January 1, 2007 resulted in an increase in liabilities and a decrease in retained earnings of \$2,491,000.

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements (FAS No. 157). FAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the Standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. The Company does not expect the adoption of FAS No. 157 to have a material effect on its financial statements.

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In February 2007, the FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (FAS No. 159). FAS No. 159 provides companies with a choice to measure certain financial assets and liabilities at fair value that are not currently required to be measured at fair value (the Fair Value Option). Election of the Fair Value Option is made on an instrument-by-instrument basis and is irrevocable. At the adoption date, unrealized gains and losses on financial assets and liabilities for which the Fair Value Option has been elected would be reported as a cumulative adjustment to beginning retained earnings. The Fair Value Option for certain financial assets and liabilities requires that unrealized gains and losses, due to changes in their fair value, be reported in earnings at each subsequent reporting date. FAS No. 159 is effective as of January 1, 2008. The Company does not expect the adoption of FAS No. 159 to have a material effect on its financial statements.

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

**For the Three and Six Month Periods Ended June 30, 2007**

#### **Overview**

Albany International Corp. (the Registrant, the Company, or we) and its subsidiaries are engaged in three business segments.

The Paper Machine Clothing segment includes fabrics and belts used in the manufacture of paper and paperboard (PMC or paper machine clothing). The Company designs, manufactures, and markets paper machine clothing for each section of the paper machine. It manufactures and sells more paper machine clothing worldwide than any other company. PMC consists of large continuous belts of custom-designed and custom-manufactured engineered fabrics that are installed on paper machines and carry the paper stock through each stage of the paper production process. PMC products are consumable products of technologically sophisticated design that utilize polymeric materials in a complex structure. The design and material composition of PMC can have a considerable effect on the quality of paper products produced and the

efficiency of the paper machines on which it is used. Principal products in the PMC segment include forming, pressing and dryer fabrics, and process belts. A forming fabric assists in sheet formation and conveys the very dilute sheet through the section. Press fabrics are designed to carry the sheet through the presses, where water pressed from the sheet is carried through the press nip in the fabric. In the dryer section, dryer fabrics manage air movement and hold the sheet against heated cylinders to enhance drying. Process belts are used in the press section to increase dryness and enhance sheet properties, as well as in other sections of the machine to improve runnability and enhance sheet qualities. The Company's customers in the PMC segment are paper industry companies, some of which operate in multiple regions of the world. The Company's manufacturing processes and distribution channels for PMC are substantially the same in each region of the world in which it operates.

The Applied Technologies segment includes the emerging businesses that apply the Company's core competencies in advanced textiles and materials to other industries including specialty materials and composite structures for aircraft and other applications (Albany Engineered Composites); fabrics, wires, and belting products for the nonwovens and pulp industries, and industrial process belts for tannery, textile, and corrugator applications (Albany Engineered Fabrics); specialty filtration products for wet and dry applications (Albany Filtration Technologies); and insulation for personal outerwear and home furnishings (PrimaLoft®). No class of similar products or services within this segment accounted for 10% or more of the Company's consolidated net sales in any of the past three years.

Albany Door Systems (ADS) designs, manufactures, sells, and services high-speed, high-performance industrial doors worldwide, for a wide range of interior, exterior, and machine protection industrial applications. Already a high performance door leader, ADS further expanded its market position in North America with the second-quarter 2007 acquisition of the assets and business of R-Bac Industries, the fastest growing high performance door company in North America, whose product lines are complementary to Albany's. Albany/R-Bac now becomes the largest North American high performance door supplier, with expertise in both product sales and after market support.

#### **Trends**

The Company's primary segment, Paper Machine Clothing, accounted for more than 70% of consolidated revenues during 2006. Paper machine clothing is purchased primarily by manufacturers of paper and paperboard. According to data published by RISI, Inc., world paper and paperboard production volumes have grown at an annual rate of approximately 2.7% over the last ten years. Based on data from Pöyry Forest Industry Consulting, world demand for paper is expected to grow for at least the next decade, driven by expected increases in global population and per capita paper consumption in less developed regions of the world. The paper and paperboard industry has been characterized by an evolving but essentially stable manufacturing technology based on the wet-forming papermaking process. This process, of which paper machine clothing is an integral element, requires a very large capital investment. Consequently, management does not believe that a commercially feasible substitute technology to paper machine clothing is likely to be developed and incorporated into the paper production process by paper manufacturers in the foreseeable future. For this reason, management expects that demand for paper machine clothing will continue into the foreseeable future.

The world paper and paperboard industry tends to be cyclical, with periods of healthy paper prices followed by increases in new capacity, which then leads to increased production and higher inventories of paper and paperboard, followed by a period of price competition and reduced profitability among the Company's customers. Although sales of paper machine clothing do not tend to be as cyclical, the Company may experience somewhat greater demand during periods of increased production and somewhat reduced demand during periods of lesser production.

The world paper and paperboard industry experienced a significant period of consolidation and rationalization from approximately 2000 through 2004. During this period, reduced global consumption of paper machine clothing contributed to a decline in the Company's year-on-year sales of paper machine clothing products in each of 2002, 2003 and 2004, after adjusting for currency translation effects.

While significant consolidation among paper and paperboard suppliers slowed after 2004, machine closures, or announcements of additional machine closures, continued during 2005 and 2006 in North America as well as Europe. During this period, a number of older, less efficient machines in areas (such as North America) where significant established capacity existed were closed or were the subject of planned closure announcements, while at the same time a number of newer, faster and more efficient machines began production or plans for the installation of such newer machines were announced in areas of growing demand for paper and paperboard (such as Asia). Management anticipates that this trend is likely to continue in the near term.

At the same time, technological advances in paper machine clothing, while contributing to the papermaking efficiency of customers, have lengthened the useful life of many of the Company's products and reduced the number of pieces required to produce the same volume of paper. As the Company introduces new value creating products and services, it is often able to charge higher prices or increase market share in certain

areas as a result of these improvements. However, increased prices and share have not always been sufficient to offset completely a decrease in the number of fabrics sold.

In July 2006, the Company reported that price competition in Europe could have an adverse impact on the Company's operating results in this segment. In the third and fourth quarters of 2006, and in the first two quarters of 2007, sales of paper machine clothing to customers in Europe were significantly lower than the same quarter of the previous year, as the Company lost sales on its least differentiated products to lower priced offerings. These declines reduced operating income within this segment, as well as overall operating income, during these quarters. Management expects to regain volume as the result of taking action to close the gap between the Company's pricing and that of the competition.

The Company's strategy for dealing with the trends in this segment is to continue to focus on providing solutions for customers through new products and services, and to continue to reduce costs within this segment. During 2006, the Company reorganized its PMC research and product development function and priorities, thereby enhancing its ability to provide more added-value products to market faster. In addition, management continued to pursue cost-saving and process improvement opportunities, and the ongoing investments in new capacity in Asia and Latin America should further improve operating efficiency and further align production capacity to match shifting global demand.

The Applied Technologies segment has experienced significant growth in net sales during the last few years, due both to the introduction of new products as well as growth in demand and application for previously existing products. Sales in this segment increased 14.8% during 2006, excluding the effect of changes in currency translation rates, while operating income declined as the Company ramped-up manufacturing and engineering to meet higher order backlog. During 2006, management commented on the significant growth prospects for the businesses within this segment, including Albany Engineered Composites. Since sales in this business are heavily dependent upon the production schedules of a few key customers, it can be more difficult to predict the precise timing of revenue and income streams. Management believes that the principal challenges and opportunities in this segment involve managing the growth opportunity.

The Albany Door Systems segment derives most of its revenue from the sale of high-performance doors, particularly to customers in Europe. The purchase of these doors is normally a capital expenditure item for customers and, as such, market opportunities tend to fluctuate with industrial capital spending. If economic conditions weaken, customers may reduce levels of capital expenditures, which could have a negative effect on sales and earnings in the Albany Door Systems segment. The large amount of revenue derived from sales and manufacturing outside the United States could cause the reported financial results for the Albany Door Systems segment to be more

sensitive than the other segments of the Company to changes in currency rates. As a result of the Company's acquisition of R-Bac Industries in the second quarter of 2007, management expects to see accelerated growth in the North American market.

#### **Foreign Currency**

Albany International operates in many geographic regions of the world and has more than half of its business in countries outside the United States. A substantial portion of the Company's sales are denominated in euros or other currencies. In some locations, the profitability of transactions is affected by the fact that sales are denominated in a currency different from the currency in which the costs to manufacture and distribute the products are denominated. As a result, changes in the relative values of U.S. dollars, euros and other currencies affect revenues and profits as the results are translated into U.S. dollars in the consolidated financial statements.

From time to time, the Company enters into foreign currency or other derivative contracts in order to enhance cash flows or to mitigate volatility in the financial statements that can be caused by changes in currency exchange rates.

#### **Results of Operations:**

*Total Company three months ended June 30, 2007*

Net sales were \$267.3 million for the three months ended June 30, 2007 as compared to \$261.6 million for the same period of 2006. The following table presents 2007 and 2006 net sales by segment and the effect of changes in currency translation rates:

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| (in thousands)         | Three months ended<br>June 30, |            | Percent<br>change | Increase due<br>to<br>changes in<br>currency<br>translation<br>rates | Percent<br>change<br>Excluding<br>currency<br>rate effect |
|------------------------|--------------------------------|------------|-------------------|--|---|
|                        | 2007                           | 2006       |                   |  |   |
| Paper Machine Clothing | \$ 188,667                     | \$ 194,466 | 3.0%              | \$ 5,076   | 5.6%  |
| Applied Technologies   | 45,278                         | 37,764     | 19.9%             | 1,844  | 15.0%   |
| Albany Door Systems    | 33,324                         | 29,400     | 13.3%             | 1,962  | 6.7%  |
| Consolidated total     | \$ 267,269                     | \$ 261,630 | 2.2%              | \$ 8,882   | 1.2%  |

Gross profit was 36.1 percent of net sales in the second quarter of 2007, compared to 39.8 percent in the second quarter of 2006. The decrease is principally due to production inefficiencies in North America PMC operations and the impact of lower PMC prices and volume in Europe.

In the second quarter of 2007, the Company incurred costs related to performance improvement initiatives totaling \$4.9 million (\$0.13 per share). Included in Selling, Technical, General and Research were costs of \$4.3 million related to the implementation of SAP and the transition to a centralized European administration. In addition, \$0.6 million of cost related to start-ups and equipment relocation is included in Cost of Goods Sold.

Selling, technical, general, and research (STG&R) expenses were \$82.6 million in the second quarter of 2007, in comparison to \$75.1 million in the second quarter of 2006. The increase includes \$3.1 million related to the effect of changes in currency translation rates and the \$4.3 million of expenses noted above, related to performance improvement initiatives.

In the second quarter of 2007, the Company recorded restructuring charges of \$7.1 million (\$0.18 per share) related to reductions in corporate staffing, closure of the Doors segment plant in Sweden, charges associated with centralization of administration functions in Europe, the announced closure of a PMC plant in Finland, and other initiatives. The actions taken are part of a plan to match manufacturing capacity to business demands, and also to improve administrative efficiency. The Company expects that any additional restructuring costs related to the actions described above will not be significant.

Operating income was \$6.9 million in the second quarter of 2007, compared to \$28.9 million for the same period of 2006, reflecting a lower gross profit percentage and the 2007 charges related to restructuring and performance improvement initiatives.

| (in thousands)                            | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2007                           | 2006      | 2007                         | 2006      |
| <b>Operating Income</b>                   |                                |           |                              |           |
| Paper Machine Clothing                    | \$ 24,279                      | \$ 38,168 | \$ 51,357                    | \$ 77,501 |
| Applied Technologies                      | 4,617                          | 4,678     | 8,938                        | 10,255    |
| Albany Door Systems                       | (2,189)                        | 690       | (457)                        | 2,464     |
| Research expense                          | (5,705)                        | (5,560)   | (10,717)                     | (11,564)  |
| Unallocated expenses                      | (14,100)                       | (9,031)   | (26,160)                     | (20,297)  |
| Operating income before reconciling items | 6,902                          | 28,945    | 22,961                       | 58,359    |

**Reconciling items:**

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|   |          |          |           |           |
|---|----------|----------|-----------|-----------|
| Interest expense, net                   | (3,710)  | (2,712)  | (7,012)   | (4,591)   |
| Other (expense)/income, net             | (1,051)  | 137      | (1,021)   | (772)     |
| Consolidated income before income taxes | \$ 2,141 | \$26,370 | \$ 14,928 | \$ 52,996 |

Segment operating income in 2007 includes restructuring and costs associated with performance improvement initiatives, as illustrated below:

| (in thousands)          | Three Months Ended<br>June 30, 2007 |   |            | Six Months Ended<br>June 30, 2007 |   |            |
|-------------------------|-------------------------------------|---|------------|-----------------------------------|---|------------|
|                         | Restructuring                       | Operating income effect of<br>Performance<br>improvement<br>initiatives | Total      | Restructuring                     | Operating income effect of<br>Performance<br>improvement<br>initiatives | Total      |
| <b>Operating income</b> |                                     |   |            |                                   |   |            |
| Paper Machine Clothing  | (\$2,678)                           | (\$1,841)   | (\$4,519)  | (\$9,342)                         | (\$2,023)   | (\$11,365) |
| Applied Technologies    |                                     |   |            |                                   |   |            |
| Albany Door Systems     | (2,224)                             |   | (2,224)    | (2,224)                           |   | (2,224)    |
| Research                |                                     |   |            |                                   |   |            |
| Unallocated             | (2,210)                             | (3,102)   | (5,312)    | (3,155)                           | (4,626)   | (7,781)    |
| Consolidated total      | (\$7,112)                           | (\$4,943)   | (\$12,055) | (\$14,721)                        | (\$6,649)   | (\$21,370) |

Beginning in the first quarter of 2007, segment operating income includes expenses associated with product engineering activities, which is consistent with a change in the Company's internal reporting structure. These expenses were previously included in Research expense. The following table illustrates the impact on the 2006 segment operating income that resulted from this change:

| (in thousands)          | Three Months Ended<br>June 30, 2006 |                  |                | Six Months Ended<br>June 30, 2006 |                  |                |
|-------------------------|-------------------------------------|------------------|----------------|-----------------------------------|------------------|----------------|
|                         | As originally<br>Reported           | Reclassification | As<br>Adjusted | As originally<br>Reported         | Reclassification | As<br>Adjusted |
| <b>Operating income</b> |                                     |                  |                |                                   |                  |                |
| Paper Machine Clothing  | \$40,232                            | (\$2,064)        | \$38,168       | \$ 80,788                         | (\$3,287)        | \$ 77,501      |
| Applied Technologies    | 5,107                               | (429)            | 4,678          | 11,255                            | (1,000)          | 10,255         |
| Albany Door Systems     | 1,214                               | (524)            | 690            | 3,499                             | (1,035)          | 2,464          |
| Research expense        | (7,997)                             | 2,437            | (5,560)        | (16,536)                          | 4,972            | (11,564)       |
| Unallocated expenses    | (9,611)                             | 580              | (9,031)        | (20,647)                          | 350              | (20,297)       |
| Consolidated total      | \$28,945                            | \$               | \$28,945       | \$ 58,359                         | \$               | \$ 58,359      |

Research expense increased \$0.1 million as compared to the second quarter of 2006. Unallocated expenses, which consist primarily of corporate headquarters expenses, increased \$5.1 million compared to the second quarter of 2006. The net increase included expenses of \$2.2 million for restructuring, and an additional \$3.1 million related to performance improvement initiatives.

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Interest expense, net, was \$3.7 million for the second quarter of 2007, compared to \$2.7 million for the same period of 2006. The increase is due principally to higher average borrowings principally resulting from the Company's investments in property, plant and equipment.

Other expense/income, net, was \$1.1 million of expense for the second quarter of 2007, compared to \$0.1 million of income for the same period of 2006. The higher expense in 2007 was principally due to gains on currency transactions of \$1.5 million in 2006, compared to \$0.2 million in 2007.

The effective income tax rate for second quarter of 2007 was 25 percent, excluding the impact of discrete tax items; the effective income tax rate for the second quarter of 2006 was 29.4 percent, which included a minor discrete tax item. Income tax adjustments had the effect of increasing second-quarter 2007 net income by \$0.09 per share.

Net income for the second quarter of 2007 was \$0.15 per share, after restructuring charges of \$0.18 per share, costs related to performance improvement initiatives of \$0.13 per share, and the favorable income tax adjustment of \$0.09 per share. Net income for the second quarter of 2007 includes a loss of \$0.05 per share in the Albany Engineered Composites business, and disappointing results in the Albany Doors segment.

Net income per share was \$0.63 in the second quarter of 2006.

### Results of Operations:

*Total Company six months ended June 30, 2007*

Net sales were \$525.0 million for the six months ended June 30, 2007 as compared to \$512.9 million for the same period of 2006. The following table presents 2007 and 2006 net sales by segment and the effect of changes in currency translation rates:

| (in thousands)         | Six months ended<br>June 30, |           | Percent<br>change | Increase due<br>to<br>changes in<br>currency<br>translation<br>rates | Percent<br>change<br>Excluding<br>currency<br>rate effect |
|------------------------|------------------------------|-----------|-------------------|--|---|
|                        | 2007                         | 2006      |                   |  |   |
| Paper Machine Clothing | \$370,971                    | \$378,359 | 2.0%              | \$10,346   | 4.7%  |
| Applied Technologies   | 86,217                       | 75,607    | 14.0%             | 3,071  | 10.0%   |
| Albany Door Systems    | 67,819                       | 58,887    | 15.2%             | 4,356  | 7.8%  |
| Consolidated total     | \$525,007                    | \$512,853 | 2.4%              | \$17,773   | 1.1%  |

Gross profit was 37.1 percent of net sales for the first six months of 2007, compared to 40.6 percent for the same period of 2006. The decrease is principally due to the impact of lower PMC prices and volume in Europe.

Selling, technical, general, and research (STG&R) expenses were \$157.3 million for the first six months of 2007, in comparison to \$149.6 million for the same period of 2006. The increase includes \$6.0 million related to the effect of changes in currency translation rates and the \$5.8 million of expenses related to performance improvement initiatives.

Operating income was \$23.0 million for the first six months of 2007, compared to \$58.4 million for the same period of 2006, reflecting a lower gross profit percentage and the 2007 charges related to restructuring and performance improvement initiatives.

Research expense decreased \$0.8 million as compared to the first six months of 2006 principally due to lower professional fees for intellectual property. Unallocated expenses, which consist primarily of corporate headquarters expenses, increased \$5.9 million compared to the first six months of 2006. The net increase included expenses of \$3.2 million for restructuring, and an additional \$4.6 million related to performance improvement initiatives.

Interest expense, net, was \$7.0 million for the first six months of 2007, compared to \$4.6 million for the same period of 2006. The increase is due principally higher average borrowings required by the Company's investments in property, plant and equipment.

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The effective income tax rate for first six months of 2007 was 25.0 percent, excluding the impact of discrete tax items; the effective income tax rate for the same period of 2006 was 29.7 percent, which included a minor discrete tax item. Income tax adjustments had the effect of increasing net income for the first six months of 2007 by \$0.09 per share.

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Net income for the first six months of 2007 was \$0.47 per share, after restructuring charges of \$0.38 per share, costs related to performance improvement initiatives of \$0.17 per share, and the favorable income tax adjustment of \$0.09 per share. Net income per share was \$1.23 for the first six months of 2006.

### *Paper Machine Clothing Segment three months ended June 30, 2007*

Second-quarter net sales of PMC decreased 3.0 percent compared to the same period last year. Excluding the effect of changes in currency translation rates, net sales for the quarter decreased 5.6 percent. The decline in net sales compared to the first quarter of 2006 resulted principally from lower sales in Europe.

Compared to the same quarter last year, the Americas net sales were flat and orders improved, and in Asia, both sales and orders improved. Although sales in Europe declined compared to the second quarter of 2006, orders improved significantly.

During the quarter, the Company announced its intention to discontinue operations at its press fabric facility in Järvenpää, Finland. On August 2, 2007, the Company announced its intention to discontinue operations at its press fabric manufacturing facility in East Greenbush, New York, and to cease the manufacture of dryer fabrics in Menands, New York. These actions are in response to the continuing consolidation within the paper industry in the U.S. and Canada and the need to balance the Company's PMC manufacturing capacity in North America with anticipated paper mill demand. Discussions with the local bargaining units will begin shortly, and the resulting charges associated with the closings will be disclosed as they become available.

Gross profit as a percentage of net sales for the Paper Machine Clothing segment was 39.2 percent for the second quarter of 2007 compared to 42.5 percent for the same period of 2006. The decrease was principally due to production inefficiencies in North America PMC operations and the impact of lower PMC prices and volume in Europe. Operating income decreased from \$38.2 million for the second quarter of 2006, to \$24.3 million, after \$2.7 million of restructuring charges and additional expenses of \$1.8 million related to performance improvement initiatives.

### *Paper Machine Clothing Segment six months ended June 30, 2007*

Year to date net sales of PMC decreased 2.0 percent compared to the same period last year. Excluding the effect of changes in currency translation rates, net sales for the quarter decreased 4.7 percent. The decline in net sales was due principally to lower sales in Europe.

Gross profit as a percentage of net sales for the Paper Machine Clothing segment was 40.5 percent for the first six months of 2007 compared to 43.5 percent for the same period of 2006. The decrease is principally due to the impact of lower PMC prices and volume in Europe. Operating income decreased from \$77.5 million for the first six months of 2006, to \$51.4 million for the same period of 2007, after \$9.3 million of restructuring charges and additional expenses of \$2.0 million related to performance improvement initiatives.

### *Applied Technologies Segment three months ended June 30, 2007*

Second-quarter net sales in the Applied Technologies segment increased 19.9 percent compared to the same period of 2006 and increased 15.0 percent excluding the effect of changes in currency translation rates.

Albany Engineered Composites (AEC) net sales increased 35.2 percent and, as expected, sales in Engineered Fabrics recovered with an increase of 4.2 percent. The improvement in Engineered Fabrics resulted in part from increases in original equipment manufacturer activity during the quarter. The order backlog in the Applied Technologies segment is strong.

The Applied Technologies segment gross profit as a percentage of net sales was 29.4 percent for the second quarter of 2007 compared to 33.3 percent for the same period of 2006. The decrease was due to a change in the sales mix within the segment. Second-quarter operating income was \$4.6 million in 2007 and \$4.7 million in 2006 as the increase in sales was offset by a lower gross profit percentage.

### *Applied Technologies Segment six months ended June 30, 2007*



Year to date net sales in the Applied Technologies segment increased 14.0 percent compared to the same period of 2006 and increased 10.0 percent excluding the effect of changes in currency translation rates. The increases were principally in the Filtration Technologies and Engineered Composites businesses.

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The Applied Technologies segment gross profit as a percentage of net sales was 30.0 percent for the first six months of 2007 compared to 33.6 percent for the same period of 2006. The decrease was principally due to a lower gross profit percentage in the Composites business and a change in the sales mix with the segment. Year to date operating income was \$8.9 million in 2007 and \$10.3 million in 2006 as the increase in sales was offset by a lower gross profit percentage.

*Albany Door Systems Segment three months ended June 30, 2007*

Second-quarter net sales in the Door Systems segment increased 13.3 percent compared to the same period of 2006 and increased 6.7 percent excluding the effect of changes in currency translation rates.

The order backlog remained strong, reflecting the impact of new products and the European sales reorganization completed last year. During the quarter, the Company announced its plan to discontinue operations at its door manufacturing facility in Halmstad, Sweden. Door manufacturing in Europe will be consolidated in the Lippstadt, Germany, facility.

On June 29, 2007, the Company acquired the assets and business of R-Bac Industries, the fastest growing high-performance door company in North America. R-Bac began shipping in late 2005 with total net sales in excess of \$7.0 million through 2006, and was operating at an annualized run rate in excess of \$9.0 million through the first half of 2007.

Gross profit as a percentage of net sales was 31.3 percent for the second quarter of 2007 compared to 33.0 percent for the same period of 2006. The decrease was due to higher costs of materials. Operating income decreased from income of \$0.7 million for the second quarter of 2006 to a loss of \$2.2 million, which included restructuring charges of \$2.2 million.

*Albany Door Systems Segment six months ended June 30, 2007*

Year to date net sales in the Door Systems segment increased 15.2 percent compared to the same period of 2006 and increased 7.8 percent excluding the effect of changes in currency translation rates.

Gross profit as a percentage of net sales was 32.4 percent for the first six months of 2007 compared to 34.6 percent for the same period of 2006. The decrease was due to higher costs of materials. Operating income decreased from income of \$2.5 million for the first six months of 2006 to a loss of \$0.5 million for the same period of 2007, principally due to restructuring charges of \$2.2 million and a lower gross profit percentage.

**Liquidity and Capital Resources:**

The Company finances its business activities primarily with cash generated from operations and borrowings, primarily under \$180 million of 2.25% convertible bonds issued in March 2006, \$150 million of 5.34% long-term indebtedness to Prudential Capital Group issued in October 2005, and its revolving credit agreement as described in Notes to Consolidated Financial Statements. Company subsidiaries outside of the United States may also maintain working capital lines with local banks, but borrowings under such local facilities tend not to be significant.

Net cash provided by operating activities was \$34.8 million for the first six months of 2007 in comparison with \$45.8 million for the same period of 2006. The decrease is principally due to lower net income in 2007. Additionally, advance payments of income taxes and taxes receivable reduced net cash provided by operating activities by \$11.0 million for the first six months of 2007, while no comparable item existed for the same period of 2006. Capital spending for the first six months of 2007 was \$52.1 million, in comparison to \$32.4 million for the same period of 2006.

Construction of the greenfield PMC plant in China and the expansion of the Company's manufacturing capacity in Korea are progressing on plan. As a result, the Company expects capital spending to be consistent with the previously announced plans which call for \$160 million of spending in 2007. Depreciation and amortization were \$28.7 million and \$2.3 million, respectively, for the first six months of 2007, and are expected to be approximately \$60 million and \$5 million, respectively, for the full year. The Company currently forecasts that depreciation will be approximately \$68 million in 2008 and \$72 million in 2009, while amortization is expected to be approximately \$11 million in 2008 and \$10 million in 2009. Capital spending in 2008 is expected to be approximately \$100 million, and will substantially complete the previously

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announced PMC expansion. Beyond 2008, the Company expects annual capital spending to be approximately \$65 million, including currently foreseen opportunities for strategic growth investments in the emerging businesses.

On June 29, 2007, the Company acquired the assets and business of R-Bac Industries for \$9.2 million in cash, and the assumption of certain liabilities.

The year to date effective income tax rate, before discrete tax items was 25 percent in 2007, compared to 29.7 percent in 2006, which included a minor discrete item. The lower rate in 2007 is attributable to changes in the amount and mix of geographical income.

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Under Trends, management discussed certain recent trends in its paper machine clothing segment that have had a negative impact on demand for the Company's products within that segment, as well as its strategy for addressing these trends. Although the Company was able to improve segment sales in 2005 and 2006 despite these trends, there can be no assurance that it will continue to be successful. Management also discussed pricing competition within this segment and the negative effect of such competition on segment sales and earnings. If these trends continue, and if management's strategy for addressing them should prove inadequate, the Company's operating cash flow could be adversely affected. In any event, although historical cash flows may not, for all of these reasons, necessarily be indicative of future cash flows, the Company expects to continue to be able to generate substantial cash from sales of its products and services in future periods.

On April 14, 2006, the Company entered into a \$460 million five-year revolving credit agreement (the Credit Agreement), under which \$50 million was outstanding as of June 30, 2007. The agreement replaced a similar \$460 million revolving credit facility. The applicable interest rate for borrowings under the agreement is LIBOR plus a spread, based on the Company's leverage ratio at the time of borrowing. The agreement includes covenants that could limit the Company's ability to purchase Common Stock, pay dividends, or acquire other companies or dispose of its assets.

In March 2006, the Company issued \$180 million principal amount of 2.25% convertible notes. The notes are convertible upon the occurrence of specified events and at any time on or after February 15, 2013, into cash up to the principal amount of notes converted and shares of the Company's Class A common stock with respect to the remainder, if any, of the Company's conversion obligation at a conversion rate of 22.487 shares per \$1,000 principal amount of notes (equivalent to a conversion price of \$44.47 per share of Class A common stock).

In connection with the offering, the Company entered into convertible note hedge and warrant transactions with respect to its Class A common stock at a net cost of \$14,727,000. These transactions are intended to reduce the potential dilution upon conversion of the notes by providing the Company with the option, subject to certain exceptions, to acquire shares which offset the delivery of newly issued shares upon conversion of the notes.

Emerging Issues Task Force (EITF) Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, (EITF 00-19) provides guidance for distinguishing between permanent equity, temporary equity and assets and liabilities. The convertible feature of the notes, the convertible note hedge, and the warrant transactions each meet the requirements of EITF 00-19 to be accounted for as equity instruments. As such, the convertible feature of the notes has not been accounted for as a derivative (which would be marked to market each reporting period) and in the event the debt is converted, no gain or loss would be recognized as the cash payment of principal reduces the recorded liability and the issuance of common shares would be recorded in stockholders' equity.

In addition, the amount paid for the call option and the premium received for the warrant were recorded as additional paid-in capital in the accompanying consolidated balance sheet and are not accounted for as derivatives (which would be marked to market each reporting period). Incremental net shares for the convertible note feature and the warrant agreement will be included in future diluted earnings per share calculations for those periods in which the Company's average common stock price exceeds \$44.47 per share in the case of the Senior Notes and \$52.16 per share in the case of the warrants. The purchased call option is anti-dilutive and is excluded from the diluted earnings per share calculation.

In October 2005, the Company entered into a Note Agreement and Guaranty (the Prudential Agreement) with the Prudential Insurance Company of America, and certain other purchasers, in an aggregate principal amount of \$150,000,000. The notes bear interest at a rate of 5.34% and have a maturity date of October 25, 2017, with mandatory prepayments of \$50,000,000 on October 25, 2013 and October 25, 2015. At the noteholders election, certain prepayments may also be required in connection with certain asset dispositions or financings. The notes may not otherwise be prepaid without a premium. The Note Agreement contains customary terms, as well as affirmative covenants, negative covenants and events of default comparable to those in the Company's current principal revolving credit facility.

Reflecting, in each case, the effect of subsequent amendments to each agreement, the Company is required to maintain a leverage ratio of not greater than 3.50 to 1.00 under the Credit Agreement, and a leverage ratio of not greater than 3.00 to 1.00 (or 3.50 to 1.00 for a period of six fiscal quarters following a material acquisition, as defined) under the Prudential Agreement. The Company is also required to maintain minimum interest coverage of 3.00 to 1.00 under each agreement. As of June 30, 2007, the Company's leverage ratio under the agreement was

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2.09 to 1.00 and the interest coverage ratio was 9.78 to 1.00. Under the Credit Agreement, the Company may purchase its Common Stock or pay dividends to the extent its leverage ratio remains at or below 3.50 to 1.00; under the Prudential Agreement, such payments or purchases are permitted to the extent that the leverage ratio remains at or below 3.00 to 1.00.

For the six months ended June 30, 2007 and 2006, dividends declared were \$0.21 and \$0.19 per share, respectively. Dividends have been declared each quarter since the fourth quarter of 2001. Decisions with respect to whether a dividend will be paid, and the amount of the dividend, are made by the Board of Directors each quarter. To the extent the Board declares cash dividends in the future, the Company would expect to pay such dividends out of operating cash flow. Future cash dividends will be dependent on debt covenants and on the Board's assessment of the Company's ability to generate sufficient cash flows.

In August 2006, the Company announced that the Board of Directors authorized Management to purchase up to 2,000,000 additional shares of its Class A Common Stock. The Board's action authorized management to purchase shares from time to time, in the open market or otherwise, whenever it believes such purchase to be advantageous to the Company's shareholders, and it is otherwise legally permitted to do so. There have been no share purchases since the authorization by the Board of Directors.

As of June 30, 2007, the Company has restructuring accruals totaling \$7.5 million, substantially all of which is expected to be paid within one year.

#### **Outlook:**

In the Company's last three earnings releases, management has focused on progress toward its short-term objective of returning to second-quarter 2006 profit levels by the fourth quarter of 2007, excluding the expenses associated with the cost-reduction and performance improvement initiatives. Management has now taken, or announced plans to take, what it believes to be the remaining steps necessary to achieve that short term objective. As a result, management is increasingly confident that, barring any additional instability in the PMC market, the Company will return in the fourth quarter of 2007, to the profit levels that it had been experiencing just before last year's price disruptions in the European PMC market.

The Company has been focusing on three factors to drive the improvement in profits: cost reduction and performance improvement, gradual recovery of PMC revenue, and continued growth in the emerging businesses.

Since the first-quarter 2007 earnings release, the Company has made the most significant progress on the cost-reduction, performance improvement front: the European PMC business successfully started operations at its new central administrative services center; the Company announced the closure of three PMC manufacturing facilities and one Albany Door Systems facility; and the Company switched over its first business unit (Albany Engineered Composites) to SAP.

Previously, management estimated that the combined annualized savings from cost-reduction and performance improvement activities initiated since the third quarter of 2006 would be at least \$0.45 per share by the end of 2007. Management now estimates that, with the added impact from the actions announced since the first-quarter 2007 earnings release, total annualized savings from all initiatives taken or announced since the third quarter of 2006 will be at least \$0.50 per share by the end of 2007, growing to at least \$1.00 per share by the end of 2008. The costs savings will principally be in cost of goods sold.

The second quarter of 2007 also saw continued stability in PMC revenues. While sales were 3% lower than they were in the same quarter of 2006, they were 6% higher than the low point in the third quarter of 2006. Second-quarter 2007 orders in Western Europe were 16% higher than they were in the same period of 2006, as gains in order volume continued to offset lower average prices. Moreover, several important multi-year contracts were successfully completed in both Europe and North America, which further reduce the likelihood of a return to the instability of last year. To be sure, the risk that competitors will respond to the Company's growing market strength with additional price cuts is ever present, and the consolidation of the paper industry in Europe and North America, particularly in Canada, continues. But the Company enters the third quarter of 2007 with confidence that the strategy of maintaining a steady price premium, based on the benefits delivered to customers, is the right one, both for the short-term return to second-quarter 2006 profit levels, and for the longer-term objective of steady profit growth in PMC.

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The third factor that the Company has been focusing on is continued growth in the emerging businesses. Compared to the second quarter of 2006, segment sales in the Doors business grew by 13%, and Applied Technologies grew by 20%. Despite the top-line growth, the lack of profits in the Doors and Albany Engineered Composites (AEC) businesses contributed to the Company's lower-than-expected earnings in the second quarter of 2007. AEC lost \$1.8 million, or \$0.05 per share, but had been expected to break even. The reason for the loss is that, at the very time that AEC was staffing up to meet a strong order backlog and an accelerating stream of new business opportunities, shipments to three key customers were substantially lower than expected because of delays in their production schedules. Management expects a sharp increase in sales as those shipments begin to flow in the third quarter of 2007, and expects the business to be profitable in the second half of the year.

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As for Albany Door Systems, despite sales of \$33.3 million in the second quarter of 2007, the business only broke even. The units within this segment have been engaged in a business-wide set of process-improvement activities, but these clearly have progressed at too slow a pace, and costs of operation, particularly in Europe, are simply too high. The Company took steps in the second quarter of 2007 to reduce costs, most notably through the announced shutdown of manufacturing operations in Sweden, and management expects that, by the fourth quarter of this year, operating margins will return to their customary levels.

During the second quarter of 2007, the Company acquired the assets and business of R-Bac Industries. Since its inception in 2004, R-Bac has been by far the fastest growing company in the North American high-performance door market. Its product line complements Albany's; and the combined businesses make Albany Door Systems the largest supplier of high performance doors in North America, with the most complete product line. R-Bac will be fully integrated into Albany's North American Doors operations by the end of the year. The market strength in North America of Albany/R-Bac along with a strong worldwide order backlog and continued expansion of the after-market business in Europe, suggest that the short-term growth potential of this business should exceed the Company's previous estimate of a 5 to 7 percent compound annual growth rate.

In sum, the Company remains on trend toward its target of a return to second-quarter 2006 levels of profitability by the fourth quarter of 2007.

On the cost-reduction front, management believes that the actions taken or announced to date, will lead to the significantly lower costs needed to recover profits lost due to the recent disruption in the European PMC market.

In the PMC marketplace, while the underlying risks associated with competitive behavior and paper industry consolidation remain real, management believes that the revenue outlook is considerably more stable than it was a year ago, and that the Company's market position is even stronger.

And in the emerging businesses, while a lack of profitability in two of the Company's critical businesses contributed to lower-than-expected overall results in the second quarter of 2007, strong orders in both businesses and lower costs in the Doors business should bring higher sales and better profitability in the second half of the year.

Looking beyond the short-term targets, the actions taken since the third quarter of 2006 augur well for the Company's long-term, cash-and-grow strategy. A significantly lower cost base and recovering revenues in PMC, a strong PMC product pipeline, continued progress in the Company's Asian expansion, and accelerating growth in AEC and Doors, are all reasons for optimism about the long-term viability of the Company's strategy of growing profits in PMC, while growing profitably in the emerging businesses.

### **Non-GAAP Measures**

This Form 10-Q contains certain items that may be considered non-GAAP financial measures. Such measures are provided because management believes that, when presented together with the GAAP items to which they relate, they can provide additional useful information to investors regarding the registrant's financial condition, results of operations and cash flows.

The effect of changes in currency translation rates is calculated by converting amounts reported in local currencies into U.S. dollars at the exchange rate of a prior period. That amount is then compared to the U.S. dollar amount reported in the current period.

### **Recent Accounting Pronouncements**

In February 2006, the FASB issued FAS No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB statements No. 133 and 140 (FAS No. 155). This Standard resolves and clarifies the accounting and reporting for certain financial instruments, including hybrid

financial instruments with embedded derivatives, interest-only strips, and securitized financial instruments. FAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company's adoption of this Standard on January 1, 2007 did not have a material effect on its financial statements.

In March 2006, the FASB issued FAS No. 156, *Accounting for Servicing of Financial Assets*, an amendment of FAS No. 140. This Standard amends the accounting treatment with respect to separately recognized servicing assets and servicing liabilities, and is effective for fiscal years beginning after September 15, 2006. The Company's adoption of this Standard on January 1, 2007 did not have a material effect on its financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an Interpretation of FAS No. 109 (FIN 48). This interpretation clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognizing, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company's adoption of this interpretation on January 1, 2007 resulted in an increase in liabilities and a decrease in retained earnings of \$2,491,000.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements* (FAS No. 157). FAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the Standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. The Company does not expect the adoption of FAS No. 157 to have a material effect on its financial statements.

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (FAS No. 159). FAS No. 159 provides companies with a choice to measure certain financial assets and liabilities at fair value that are not currently required to be measured at fair value (the Fair Value Option). Election of the Fair Value Option is made on an instrument-by-instrument basis and is irrevocable. At the adoption date, unrealized gains and losses on financial assets and liabilities for which the Fair Value Option has been elected would be reported as a cumulative adjustment to beginning retained earnings. The Fair Value Option for certain financial assets and liabilities requires that unrealized gains and losses, due to changes in their fair value, be reported in earnings at each subsequent reporting date. FAS No. 159 is effective as of January 1, 2008. The Company does not expect the adoption of FAS No. 159 to have a material effect on its financial statements.

### **Critical Accounting Policies and Assumptions**

The following should be read in conjunction with the Consolidated Financial Statements and Notes thereto.

#### **Critical Accounting Policies and Assumptions**

The Company's discussion and analysis of its financial condition and results of operations are based on the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

The Company records sales when persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed, and collectibility is reasonably assured. The timing of revenue recognition is dependent upon the contractual arrangement between the Company and its customers. These arrangements, which may include provisions for transfer of title and guarantees of workmanship, are specific to each customer. Sales contracts in the Albany Door Systems segment may include product and installation services. For these sales, the Company applies the provisions of EITF 00-21, *Revenue Arrangements with Multiple Deliverables*. The Company's contracts that include product and installation services generally do not qualify as separate units of accounting and, accordingly, revenue for the entire contract value is recognized upon completion of installation services. The Company limits the concentration of credit risk in receivables by closely monitoring credit and collection policies. The Company records allowances for sales returns as a deduction in the computation of net sales. Such provisions are recorded on the basis of written communication with customers and/or historical experience.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Goodwill and other long-lived assets are reviewed for impairment whenever events such as significant changes in the business climate, plant closures, changes in product offerings, or other circumstances indicate that the carrying

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amount may not be recoverable. The Company performs a test for goodwill impairment at least annually. The determination of whether these assets are impaired involves significant judgments based on short and long-term projections of future performance. Changes in strategy and/or market conditions may result in adjustments to recorded asset balances.

The Company has investments in other companies that are accounted for under either the cost method or equity method of accounting. Investments accounted for under the equity method are included in Investments in associated companies. The Company performs regular reviews of the financial condition of the investees to determine if its investment is impaired. If the financial condition of the investees were to no longer support their valuations, the Company would record an impairment provision.

The Company has pension and postretirement benefit costs and liabilities that are developed from actuarial valuations. Inherent in these valuations are key assumptions, including discount rates and expected return on plan assets, which are updated on an annual basis. The Company is required to consider current market conditions, including changes in interest rates, in making these assumptions. Changes in the related pension and postretirement benefit costs or credits may occur in the future due to changes in the assumptions. The amount of annual pension plan funding and annual expense is subject to many variables, including the investment return on pension plan assets and interest rates. Assumptions used for determining pension plan liabilities and expenses are evaluated and updated at least annually. The largest benefit plans are the U.S. pension plan and the U.S. postretirement benefits plan, which account for 43% and 23% of the total company benefit obligations. Discount rate assumptions are based on the population of plan participants and a mixture of high-quality fixed income investments for which the average maturity approximates the average remaining service period of plan participants. The largest portion of pension plan assets (48% for the U.S. plan and 72% for non-U.S. plans) was invested in equities. The assumption for expected return on plan assets is based on historical and expected returns on various categories of plan assets. The U.S. plan accounts for 66% of the total consolidated pension plan assets. The actual return on assets in the U.S. pension plan for 2006 was 97% of the total assumed return. For the U.S. pension plan, 2006 pension expense was determined using the 1983 Group Annuity Mortality table. The benefit obligation as of September 30, 2006 was calculated using the RP-2000 Combined Healthy Mortality Table projected to 2015 using Scale AA with phase-out and without collar adjustment. Weakness in investment returns and low interest rates, or deviations in results from other assumptions, could result in the Company making equal or greater pension plan contributions in future years, as compared to 2006. Including anticipated contributions for all pension plans, the Company estimates that contributions will amount to approximately \$18.6 million. Actual contributions for 2006 totaled \$29.9 million. The Company adopted the provisions of FAS No. 158 in the fourth quarter of 2006, resulting in an increase of \$23.7 million in noncurrent deferred tax assets, a decrease of \$5.6 million in intangible assets, an increase of \$59.6 million in pension liabilities, and an increase of \$41.5 million in accumulated other comprehensive losses.

The Company records deferred income tax assets and liabilities for the tax consequences of differences between financial statement and tax bases of existing assets and liabilities. A tax valuation allowance is established, as needed, to reduce net deferred tax assets to the amount expected to be realized. In the event it becomes more likely than not that some or all of the deferred tax asset allowances will not be needed, the valuation allowance will be adjusted.

The Company has contingent liabilities for litigation, claims and assessments that result from the ordinary course of business. These matters are more fully described in Notes to the Consolidated Financial Statements.

#### **Forward-looking statements**

This quarterly report and the documents incorporated or deemed to be incorporated by reference in this quarterly report contain statements concerning our future results and performance and other matters that are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). The words believe, expect, anticipate, intend, plan, project, may, will and variations of such words or similar expressions are intended, but are not the exclusive means, to identify forward-looking statements. Because forward-looking statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by the forward-looking statements.

There are a number of risks, uncertainties and other important factors that could cause actual results to differ materially from the forward-looking statements, including, but not limited to: changes in conditions in the industry in which the Company's Paper Machine Clothing segment competes or in the papermaking industry in general could change; failure to remain competitive in the industry in which the Company's Paper Machine Clothing segment

competes; material and petroleum-related costs could increase more or faster than anticipated; failure to receive, or a delay in receiving, the benefits from the Company's capital expenditures and investments; the strategies described in this report to address certain business or operational matters could fail to be effective, or their effectiveness could be delayed; other risks and uncertainties detailed from time to time in the Company's filings with the SEC.

Further information concerning important factors that could cause actual events or results to be materially different from the forward-looking statements can be found in "Industry Trends" and "Challenges, Risks and Opportunities" sections of this quarterly report, as well as in the "Risk Factors," section of the Company's most recent Annual Report on Form 10-K. Although the Company believes the expectations reflected in the Company's forward-looking statements are based upon reasonable assumptions, it is not possible to foresee or identify all factors that could have a material and negative impact on future performance. The forward-looking statements included or incorporated by reference in this quarterly report are made on the basis of management's assumptions and analyses, as of the time the statements are made, in light of their experience and perception of historical conditions, expected future developments and other factors believed to be appropriate under the circumstances.

Except as otherwise required by the federal securities laws, the Company disclaims any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained or incorporated by reference in this report to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

For discussion of the Company's exposure to market risk, refer to "Quantitative and Qualitative Disclosures About Market Risk" under Item 7A of form 10-K, which is included as an exhibit to this Form 10-Q.

### **Item 4. Controls and Procedures**

- (a) Disclosure controls and procedures.

The principal executive officers and principal financial officer, based on their evaluation of disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that the Company's disclosure controls and procedures are effective for ensuring that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures, include, without limitation, controls and procedures designed to ensure that information required to be disclosed in filed or submitted reports is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer as appropriate, to allow timely decisions regarding required disclosure.

- (b) Changes in internal control over financial reporting.

There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. LEGAL PROCEEDINGS**

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Albany International Corp. ( Albany ) is a defendant in suits brought in various courts in the United States by plaintiffs who allege that they have suffered personal injury as a result of exposure to asbestos-containing products previously manufactured by Albany. Albany produced asbestos-containing paper machine clothing synthetic dryer fabrics marketed during the period from 1967 to 1976 and used in certain paper mills. Such fabrics generally had a useful life of three to twelve months.

Albany was defending against 18,813 claims as of July 27, 2007. This compares with 19,120 claims as of April 27, 2007, 19,388 such claims as of February 16, 2007, 19,416 claims as of December 31, 2006, 19,283 claims as of October 27, 2006, 24,451 claims as of December 31, 2005, 29,411 claims as of December 31, 2004, 28,838 claims as of December 31, 2003, 22,593 claims as of December 31, 2002, 7,347 claims as of December 31, 2001, 1,997 claims as of December 31, 2000, and 2,276 claims as of December 31, 1999. These suits allege a variety of lung and other diseases based on alleged exposure to products previously manufactured by Albany.

Albany anticipates that additional claims will be filed against it and related companies in the future, but is unable to predict the number and timing of such future claims. These suits typically involve claims against from twenty to more than two hundred defendants, and the complaints usually fail to identify the plaintiffs work history or the nature of the plaintiffs alleged exposure to Albany s products. Pleadings and discovery responses in those cases in which work histories have been provided indicate claimants with paper mill exposure in less than 10% of total claims reported, and only a portion of those claimants have alleged time spent in a paper mill to which Albany is believed to have supplied asbestos-containing products.

As of July 27, 2007, approximately 12,612 of the claims pending against Albany are pending in Mississippi. Of these, approximately 12,031 are in federal court, at the multidistrict litigation panel ( MDL ), either through removal or original jurisdiction. (In addition to the 12,031 Mississippi claims pending against the Company at the MDL, there are approximately 850 claims pending against the Company at the MDL removed from various United States District Courts in other states.)

The MDL s past practice was to place all nonmalignant claims on an inactive docket until such time as the plaintiff developed a malignant disease. The MDL would also administratively dismiss, without prejudice, the claims of plaintiffs resulting from mass-screenings who had not otherwise demonstrated that they suffered from an asbestos-related disease. Because the court continued to exercise jurisdiction over these claims, it would allow the claims to be reinstated following the diagnosis of an asbestos-related disease. Any such administratively dismissed claims are included in the total number of pending claims reported.

The MDL has now issued a new order addressing the cases on its inactive docket. That order, signed on May 31, 2007, requires each plaintiff to provide detailed information regarding, among other things, alleged asbestos-related medical diagnoses. Contrary to expectations described in other reports, the order does not require plaintiffs to produce information about alleged exposure. The first set of plaintiffs are required to submit their filings with the Court by August 1, 2007, with deadlines for additional sets of plaintiffs monthly thereafter until December 1, 2007, by which time all plaintiffs are required to be compliant. The order states that the Court may dismiss the claims of any plaintiff who fails to comply.

Because the order of the MDL does not require the submission of alleged exposure information, the Company cannot reasonably expect many dismissals to follow the initial filings. After these filings, the MDL will begin conducting settlement conferences, at which plaintiffs will be required to submit short position statements setting forth exposure information. The Company does not expect the MDL to begin the process of scheduling the settlement conference for several months. Consequently, the Company believes that the effects of the new order will not be fully realized for some time.

Based on past experience, communications from certain plaintiffs counsel, and the advice of the Company s Mississippi counsel, the Company expects the percentage of Mississippi claimants able to demonstrate time spent in a paper mill to which Albany supplied asbestos-containing products during a period in which Albany s asbestos-containing products were in use to be considerably lower than the total number of pending claims. However, due to the large number of inactive claims pending in the MDL and the lack of alleged exposure information, the Company does not believe a meaningful estimate can be made regarding the range of possible loss with respect to these remaining claims.

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It is the position of Albany and the other paper machine clothing defendants that there was insufficient exposure to asbestos from any paper machine clothing products to cause asbestos-related injury to any plaintiff. Furthermore, asbestos contained in Albany s synthetic products was encapsulated in a resin-coated yarn woven into the interior of the fabric, further reducing the likelihood of fiber release. While the Company believes it has meritorious defenses to these claims, it has settled certain of these cases for amounts it considers reasonable given the facts and circumstances of each case. The Company s insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of July 27, 2007, the Company had resolved, by means of settlement or dismissal, 21,563 claims. The total cost of resolving all claims was \$6,706,000. Of this amount, \$6,671,000, or 99%, was paid by the Company s insurance carrier. The Company has approximately \$130 million in confirmed insurance coverage that should be available with respect to current and future asbestos claims, as well as additional



insurance coverage that it should be able to access.

#### **Brandon Drying Fabrics, Inc.**

Brandon Drying Fabrics, Inc. ( Brandon ), a subsidiary of Geschmay Corp., which is a subsidiary of the Company, is also a separate defendant in many of the asbestos cases in which Albany is named as a defendant. Brandon was defending against 9,023 claims as of July 27, 2007. This compares with 9,089 claims as of April 27, 2007, 9,189 claims as of February 16, 2007, 9,114 such claims as of December 31, 2006, 8,992 claims as of October 27, 2006, 9,566 claims as of December 31, 2005, 9,985 claims as of December 31, 2004, 10,242 claims as of December 31, 2003, 11,802 claims as of December 31, 2002, 8,759 claims as of December 31, 2001, 3,598 claims as of December 31, 2000, and 1,887 claims as of December 31, 1999. The Company acquired Geschmay Corp., formerly known as Wangner Systems Corporation, in 1999. Brandon is a wholly-owned subsidiary of Geschmay Corp. In 1978, Brandon acquired certain assets from Abney Mills ( Abney ), a South Carolina textile manufacturer. Among the assets acquired by Brandon from Abney were assets of Abney's wholly-owned subsidiary, Brandon Sales, Inc. which had sold, among other things, dryer fabrics containing asbestos made by its parent, Abney. It is believed that Abney ceased production of asbestos-containing fabrics prior to the 1978 transaction. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. Under the terms of the Assets Purchase Agreement between Brandon and Abney, Abney agreed to indemnify, defend, and hold Brandon harmless from any actions or claims on account of products manufactured by Abney and its related corporations prior to the date of the sale, whether or not the product was sold subsequent to the date of the sale. It appears that Abney has since been dissolved. Nevertheless, a representative of Abney has been notified of the pendency of these actions and demand has been made that it assume the defense of these actions. Because Brandon did not manufacture asbestos-containing products, and because it does not believe that it was the legal successor to, or otherwise responsible for obligations of Abney with respect to products manufactured by Abney, it believes it has strong defenses to the claims that have been asserted against it. In some instances, plaintiffs have voluntarily dismissed claims against it, while in others it has entered into what it considers to be reasonable settlements. As of July 27, 2007, Brandon has resolved, by means of settlement or dismissal, 8,530 claims for a total of \$152,499. Brandon's insurance carriers initially agreed to pay 88.2% of the total indemnification and defense costs related to these proceedings, subject to the standard reservation of rights. The remaining 11.8% of the costs had been borne directly by Brandon. During 2004, Brandon's insurance carriers agreed to cover 100% of indemnification and defense costs, subject to policy limits and the standard reservation of rights, and to reimburse Brandon for all indemnity and defense costs paid directly by Brandon related to these proceedings.

#### **Mount Vernon**

In some of these asbestos cases, the Company is named both as a direct defendant and as the successor in interest to Mount Vernon Mills ( Mount Vernon ). The Company acquired certain assets from Mount Vernon in 1993. Certain plaintiffs allege injury caused by asbestos-containing products alleged to have been sold by Mount Vernon many years prior to this acquisition. Mount Vernon is contractually obligated to indemnify the Company against any liability arising out of such products. The Company denies any liability for products sold by Mount Vernon prior to the acquisition of the Mount Vernon assets. Pursuant to its contractual indemnification obligations, Mount Vernon has assumed the defense of these claims. On this basis, the Company has successfully moved for dismissal in a number of actions.

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While the Company does not believe, based on currently available information and for the reasons stated above, that a meaningful estimate of a range of possible loss can be made with respect to such claims, based on its understanding of the insurance policies available, how settlement amounts have been allocated to various policies,

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its recent settlement experience, the absence of any judgments against the Company or Brandon, the ratio of paper mill claims to total claims filed, and the defenses available, the Company currently does not anticipate any material liability relating to the resolution of the aforementioned pending proceedings in excess of existing insurance limits. Consequently, the Company currently does not anticipate, based on currently available information, that the ultimate resolution of the aforementioned proceedings will have a material adverse effect on the financial position, results of operations or cash flows of the Company. Although the Company cannot predict the number and timing of future claims, based on the foregoing factors and the trends in claims against it to date, the Company does not anticipate that additional claims likely to be filed against it in the future will have a material adverse effect on its financial position, results of operations, or cash flows. The Company is aware that litigation is inherently uncertain, especially when the outcome is dependent primarily on determinations of factual matters to be made by juries. The Company is also aware that numerous other defendants in asbestos cases, as well as others who claim to have knowledge and expertise on the subject, have found it difficult to anticipate the outcome of asbestos litigation, the volume of future asbestos claims, and the anticipated settlement values of those claims. For these reasons, there can be no assurance that the foregoing conclusions will not change.

**Item 1A. Risk Factors**

There have been no material changes in risks since December 31, 2006. For discussion of risk factors, refer to Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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

Management made no share purchases during the first and second quarters of 2007. Management remains authorized by the Board of Directors to purchase up to 2,000,000 shares of its Class A Common Stock.

**Item 3. Defaults Upon Senior Securities**

None

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

None

**Item 5. Other Information**

None

**Item 6. Exhibits**

**Exhibit No. Description**

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|-------|---|
| 31.1  | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act.  |
| 31.2  | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act.  |
| 32.1  | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) |
| 99.1. | Quantitative and qualitative disclosures about market risks as reported at December 31, 2006.   |

**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.

ALBANY INTERNATIONAL CORP.  
(Registrant)

Date: August 7, 2007

By

/s/ Michael C. Nahl  
Michael C. Nahl  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)