

ALBANY INTERNATIONAL CORP /DE/  
Form 10-Q  
May 09, 2007  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended: March 31, 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.)

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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 []

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

Yes [] No []

The registrant had 26,092,660 shares of Class A Common Stock and 3,236,098 shares of Class B Common Stock outstanding as of March 31, 2007.

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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>March 31, |           |
|---|---------------------------------|-----------|
|   | 2007                            | 2006      |
| Net sales   | \$257,738                       | \$251,223 |
| Cost of goods sold                                  | 159,352                         | 147,247   |
| Gross profit  | 98,386                          | 103,976   |
| Selling, technical, general and research expenses   | 82,327                          | 74,562    |
| Operating income                                    | 16,059                          | 29,414    |
| Interest expense, net                               | 3,302                           | 1,879     |
| Other (income)/expense, net                         | (30)                            | 909       |
| Income before income taxes                          | 12,787                          | 26,626    |
| Income tax expense                                  | 3,197                           | 7,988     |
| Income before associated companies                  | 9,590                           | 18,638    |
| Equity in (losses)/earnings of associated companies | (285)                           | 177       |
| Net income  | 9,305                           | 18,815    |
| Earnings per share:                                 |                                 |           |
| Basic   | \$0.32                          | \$0.60    |
| Diluted   | \$0.31                          | \$0.59    |

Shares used in computing earnings per share:

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|                     |        |        |
|---------------------|--------|--------|
| Basic               | 29,265 | 31,419 |
| Diluted             | 29,672 | 31,919 |
| Dividends per share | \$0.10 | \$0.09 |

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)       |                      |
|--|-------------------|----------------------|
|  | March 31,<br>2007 | December 31,<br>2006 |
| <b>ASSETS</b>  |                   |                      |
| Cash and cash equivalents  | \$56,426          | \$68,237             |
| Accounts receivable, net   | 205,616           | 209,907              |
| Inventories  | 238,894           | 224,210              |
| Deferred taxes   | 16,488            | 16,290               |
| Prepaid expenses   | 13,122            | 10,552               |
| Total current assets   | 530,546           | 529,196              |
| Property, plant and equipment, net   | 407,588           | 397,521              |
| Investments in associated companies  | 6,321             | 6,634                |
| Intangibles  | 8,937             | 9,343                |
| Goodwill   | 174,797           | 172,890              |
| Deferred taxes   | 112,286           | 112,280              |
| Cash surrender value of life insurance policies  | 42,099            | 41,197               |
| Other assets   | 41,105            | 37,486               |
| Total assets   | \$1,323,679       | \$1,306,547          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                   |                      |
| Notes and loans payable  | \$21,488          | \$12,510             |
| Accounts payable   | 44,414            | 50,214               |
| Accrued liabilities  | 114,329           | 101,995              |
| Current maturities of long-term debt   | 11,171            | 11,167               |
| Income taxes payable and deferred  | 1,686             | 20,099               |
| Total current liabilities  | 193,088           | 195,985              |
| Long-term debt   | 345,859           | 354,587              |
| Other noncurrent liabilities   | 220,088           | 219,774              |
| Deferred taxes and other credits   | 53,771            | 37,076               |
| Total liabilities  | 812,806           | 807,422              |
| Commitments and Contingencies  | -                 | -                    |
| <b>SHAREHOLDERS' EQUITY</b>  |                   |                      |
| Preferred stock, par value \$5.00 per share;<br>authorized 2,000,000 shares; none issued   | -                 | -                    |
| Class A Common Stock, par value \$.001 per share;<br>authorized 100,000,000 shares; issued<br>34,633,542 in 2007 and 34,518,870 in 2006. | 35                | 35                   |
| Class B Common Stock, par value \$.001 per share;<br>authorized 25,000,000 shares; issued and<br>outstanding 3,236,098 in 2007 and 2006  | 3                 | 3                    |
| Additional paid in capital   | 320,010           | 316,164              |
| Retained earnings  | 545,484           | 541,602              |

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|  |             |             |
|--|-------------|-------------|
| Accumulated items of other comprehensive income:                           |             |             |
| Translation adjustments  | (13,831)    | (18,348)    |
| Pension liability adjustment   | (81,568)    | (81,071)    |
|  | 770,133     | 758,385     |
| Less treasury stock (Class A), at cost (8,540,882 shares in 2007 and 2006) | 259,260     | 259,260     |
| Total shareholders' equity   | 510,873     | 499,125     |
| Total liabilities and shareholders' equity                                 | \$1,323,679 | \$1,306,547 |

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

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ALBANY INTERNATIONAL CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2007                            | 2006      |
| <b>OPERATING ACTIVITIES</b>   |                                 |           |
| Net income  | \$9,305                         | \$18,815  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |           |
| Equity in earnings of associated companies  | 285                             | (177)     |
| Depreciation  | 14,187                          | 13,174    |
| Amortization  | 1,131                           | 778       |
| Provision for deferred income taxes, other credits and long-term liabilities      | 915                             | 893       |
| Provision for write-off of equipment  | 66                              | 95        |
| Increase in cash surrender value of life insurance                                | (902)                           | (854)     |
| Unrealized currency transaction gains and losses                                  | 169                             | 1,721     |
| Shares contributed to ESOP  | 1,961                           | 3,145     |
| Stock option expense  | 200                             | 386       |
| Tax benefit of options exercised  | (145)                           | (226)     |
| Issuance of shares under long-term incentive plan                                 | 937                             | -         |
| Changes in operating assets and liabilities, net of business acquisition:         |                                 |           |
| Accounts receivable   | 5,185                           | (3,312)   |
| Note receivable   | -                               | (336)     |
| Inventories   | (13,641)                        | (14,711)  |
| Prepaid expenses  | (2,446)                         | (1,786)   |
| Accounts payable  | (6,041)                         | 4,895     |
| Accrued liabilities   | 11,809                          | 5,331     |
| Income taxes payable  | (4,727)                         | (290)     |
| Other, net  | (899)                           | (849)     |
| Net cash provided by operating activities   | 17,349                          | 26,692    |
| <b>INVESTING ACTIVITIES</b>   |                                 |           |
| Purchases of property, plant and equipment  | (23,206)                        | (19,764)  |
| Purchased software  | (2,683)                         | (85)      |
| Acquisitions, net of cash acquired  | -                               | (6,232)   |
| Net cash (used in) investing activities   | (25,889)                        | (26,081)  |
| <b>FINANCING ACTIVITIES</b>   |                                 |           |
| Proceeds from borrowings  | 10,532                          | 186,875   |
| Principal payments on debt  | (10,437)                        | (9,105)   |
| Purchase of treasury shares   | -                               | (101,104) |

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|   |          |           |
|---|----------|-----------|
| Purchase of call options on common stock            | -        | (47,688)  |
| Sale of common stock warrants                       | -        | 32,961    |
| Proceeds from options exercised                     | 603      | 869       |
| Tax benefit of options exercised                    | 145      | 226       |
| Debt issuance costs                                 | -        | (4,704)   |
| Dividends paid                                      | (2,919)  | (2,910)   |
| Net cash (used in)/provided by financing activities | (2,076)  | 55,420    |
| Effect of exchange rate changes on cash flows       | (1,195)  | 962       |
| (Decrease)/increase in cash and cash equivalents    | (11,811) | 56,993    |
| Cash and cash equivalents at beginning of year      | 68,237   | 72,771    |
| Cash and cash equivalents at end of period          | \$56,426 | \$129,764 |

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.

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**2. Inventories**

Inventories consist of the following:

March 31

December 31,

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|                           |           |           |
|---------------------------|-----------|-----------|
| (in thousands)            | 2007      | 2006      |
| Finished goods            | \$125,042 | \$120,158 |
| Work in process           | 62,323    | 59,738    |
| Raw material and supplies | 51,529    | 44,314    |
| Total inventories         | \$238,894 | \$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.

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### 3. Goodwill and other Intangible Assets

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 2006, 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.

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

| (in thousands)                        | Balance at<br>December 31, 2006 | Amortization | Currency<br>translation | Other<br>Changes | Balance at<br>March 31, 2007 |
|---------------------------------------|---------------------------------|--------------|-------------------------|------------------|------------------------------|
| <b>Amortized intangible assets:</b>   |                                 |              |                         |                  |                              |
| Trade names                           | \$2,339                         | (\$145)      | \$3                     | -                | \$2,197                      |
| Patents                               | 2,450                           | (114)        | 2                       | -                | 2,338                        |
| Customer contracts                    | 4,202                           | (145)        | -                       | -                | 4,057                        |
| Technology                            | 352                             | (7)          | -                       | -                | 345                          |
| Total amortized intangible assets     | \$9,343                         | (\$411)      | \$5                     | -                | \$8,937                      |
| <b>Unamortized intangible assets:</b> |                                 |              |                         |                  |                              |
| Goodwill                              | \$172,890                       | -            | \$2,045                 | (\$138)          | \$174,797                    |

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The \$138,000 change in goodwill relates to an adjustment made to deferred tax liabilities that were recorded in 2006 in connection with the acquisition of Texas Composite Inc. (TCI).

As of March 31, 2007, goodwill included \$121,933,000 in the Paper Machine Clothing segment, \$22,871,000 in the Applied Technologies segment, and \$29,993,000 in the Albany Door Systems segment.

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

| Year | Annual amortization<br>(in thousands) |
|------|---------------------------------------|
| 2007 | \$1,876                               |
| 2008 | 1,876                                 |
| 2009 | 1,716                                 |
| 2010 | 1,399                                 |
| 2011 | 447                                   |
|      | \$7,314                               |

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

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

| (in thousands)              | Three Months Ended<br>March 31,<br>2007 | 2006    |
|-----------------------------|---|---------|
| Currency transactions       | (\$493)                                 | (\$763) |
| Debt costs                  | 387                                     | 481     |
| Securitization program      | -                                       | 792     |
| Other miscellaneous expense | 76                                      | 399     |
| Total                       | (\$30)                                  | \$909   |



## 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:

| (in thousands, except market price data)   | Three Months Ended |          |
|--|--------------------|----------|
|  | March 31<br>2007   | 2006     |
| Net income available to common shareholders                                      | \$9,305            | \$18,815 |
| <b>Weighted average number of shares:</b>  |                    |          |
| Weighted average number of shares used in calculating basic earnings per share   | 29,265             | 31,419   |
| <b>Effect of dilutive stock-based compensation plans:</b>                        |                    |          |
| Stock options  | 369                | 451      |
| Long-term incentive plan   | 38                 | 49       |
| Weighted average number of shares used in calculating diluted earnings per share | 29,672             | 31,919   |
| Average market price of common stock used for calculation of dilutive shares     | \$33.88            | \$37.05  |
| <b>Earnings per share:</b>   |                    |          |
| Basic  | \$0.32             | \$0.60   |
| Diluted  | \$0.31             | \$0.59   |

There were no option shares that were excluded from the computation of diluted earnings per share in any of the periods presented. As of March 31, 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: Treasury<br>Shares | Net shares<br>Outstanding |
|-------------------|-------------------|-------------------|--------------------------|---------------------------|
| December 31, 2006 | 34,518,870        | 3,236,098         | (8,540,882)              | 29,214,086                |

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March 31, 2007                      34,633,542                      3,236,098                      (8,540,882)                      29,328,758

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**6. Comprehensive Income**

Comprehensive income consists of the following:

| (in thousands)                               | Three Months Ended<br>March 31,<br>2007 | 2006     |
|--|---|----------|
| Net income                                   | \$9,305                                 | \$18,815 |
| Other comprehensive income, before tax:      |   |          |
| Foreign currency translation adjustments     | 4,517                                   | 6,717    |
| Amortization of pension liability adjustment | (497)                                   | -        |
| Other comprehensive income, net of tax       | 4,020                                   | 6,717    |
| Comprehensive income                         | \$13,325                                | \$25,532 |

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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 capital | Retained<br>earnings | Accumulated items<br>of other<br>comprehensive<br>income | Treasury stock | Total Shareholders<br>Equity |
|------------------------------------|----------------------------|----------------------------|-------------------------------|----------------------|--|----------------|------------------------------|
| December 31, 2006                  | \$35                       | \$3                        | \$316,164                     | \$541,602            | (\$99,419)   | (\$259,260)    | \$499,125                    |
| Net income                         |                            |                            |                               | 9,305                |  |                | 9,305                        |
| Shares contributed to ESOP         |                            |                            | 1,961                         |                      |  |                | 1,961                        |
| Proceeds from options<br>exercised |                            |                            | 603                           |                      |  |                | 603                          |
| Dividends declared                 |                            |                            |                               | (2,932)              |  |                | (2,932)                      |

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|  |      |     |           |           |            |             |           |
|--|------|-----|-----------|-----------|------------|-------------|-----------|
| Stock option expense   |      |     | 200       |           |            |             | 200       |
| Tax benefit of options exercised                             |      |     | 145       |           |            |             | 145       |
| 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                 |      |     |           |           | (497)      |             | (497)     |
| Cumulative translation adjustment/other                      |      |     |           |           | 4,517      |             | 4,517     |
| March 31, 2007   | \$35 | \$3 | \$320,010 | \$545,484 | (\$95,399) | (\$259,260) | \$510,873 |

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## 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 |           |
|---|--------------------|-----------|
|   | March 31, 2007     | 2006      |
| <b>Net Sales</b>                          |                    |           |
| Paper Machine Clothing                    | \$182,306          | \$183,896 |
| Applied Technologies                      | 40,938             | 37,842    |
| Albany Door Systems                       | 34,494             | 29,485    |
| Consolidated total                        | \$257,738          | \$251,223 |
| <b>Operating Income</b>                   |                    |           |
| Paper Machine Clothing                    | \$27,077           | \$39,335  |
| Applied Technologies                      | 4,321              | 5,575     |
| Albany Door Systems                       | 1,733              | 1,774     |
| Research expense                          | (5,011)            | (6,003)   |
| Unallocated expenses                      | (12,061)           | (11,267)  |
| Operating income before reconciling items | 16,059             | 29,414    |
| <b>Reconciling items:</b>                 |                    |           |
| Interest expense, net                     | (3,302)            | (1,879)   |
| Other income/(expense), net               | 30                 | (909)     |
| Consolidated income before income taxes   | \$12,787           | \$26,626  |

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. Operating income for 2006 has been reclassified to conform to the current year presentation and, accordingly, operating income in the PMC, Applied Technologies, and Albany Door Systems segments was reduced by \$1,452,000, \$573,000, and \$511,000, respectively, while Research expense was reduced by \$2,536,000.

For the three months ended March 31, 2007, the Company had expenses of \$7,609,000 associated with cost reduction and \$1,596,000 associated with performance improvement initiatives. In the operating income table above, \$6,845,000 of that total is included in the PMC segment, and \$2,360,000 is included in Unallocated expenses. Expenses for cost reduction initiatives principally relate to the Company's initiative to centralize administrative functions in the Europe Paper Machine Clothing business and include \$5,938,000 of termination benefits and \$1,671,000 for professional fees.

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There were no material changes in the total assets of the reportable segments during the three months ended March 31, 2007.

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## 9. Income Taxes

The effective tax rate was 25 percent for the first quarter of 2007, as compared to 30 percent 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 (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 is 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 quarter of 2007, the Company recognized additional tax liabilities related to uncertain tax positions in the consolidated balance sheet of \$838,000 of which \$306,000, if recognized, would favorably impact the effective tax rate. Additionally, the company recorded \$289,000 in potential interest and penalties on existing tax reserves in the consolidated statements of income.

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 \$3,865,000 as of January 1, 2007 and March 31, 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.

The Company is currently 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 next twelve months.

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## 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 19,120 claims as of April 27, 2007. This compares with 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 April 27, 2007, approximately 12,709 of the claims pending against Albany are pending in Mississippi. Of these, approximately 12,042 are in federal court, at the multidistrict litigation panel ( MDL ), either through removal or original jurisdiction. (In addition to the 12,042 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 current practice is to place all nonmalignant claims on an inactive docket until such time as the plaintiff develops a malignant disease; in addition, the MDL has administratively dismissed, without prejudice, the claims of plaintiffs resulting from mass-screenings who had not otherwise demonstrated that they suffer from an asbestos-related disease. Because the court continues to exercise jurisdiction over these claims, and will allow the claims to be reinstated following the diagnosis of an asbestos-related disease, we do not reflect them as reducing the total number of pending claims. The MDL is currently evaluating proposed orders that would require each plaintiff to provide detailed information regarding alleged asbestos exposure and medical diagnoses. While new procedures have not yet been adopted by the court, if they were, the Company could expect to be dismissed from the claims of all plaintiffs who can not establish both an asbestos-related disease and exposure to one of the Company s asbestos-containing products. Alternatively, in cases where a plaintiff does establish an asbestos-related disease and work history in a paper mill, the Company will be expected to engage in good faith settlement negotiations or to defend that claim at trial when remanded back to Mississippi. The Company does not expect the MDL to complete its evaluation of the current procedures for many weeks, and further expects that the effect of such changes, if adopted, would not be fully realized for an additional 12 months.

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.

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However, due to the large number of inactive claims pending in the MDL, 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 April 27, 2007, the Company had resolved, by means of settlement or dismissal, 21,231 claims. The total cost of resolving all claims was \$6,691,000. Of this amount, \$6,656,000, 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 9,089 claims as of April 27, 2007. This compares with 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 April 27, 2007, Brandon has resolved, by means of settlement or dismissal, 8,463 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.

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**Mount Vernon**

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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, 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.

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### 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 March 31, 2007 and 2006 are, as follows:

| (in thousands)                 | Pension Plans |         | Other Benefits |         |
|--------------------------------|---------------|---------|----------------|---------|
|                                | 2007          | 2006    | 2007           | 2006    |
| Service cost                   | \$1,898       | \$1,761 | \$713          | \$752   |
| Interest cost                  | 5,269         | 4,471   | 1,592          | 1,553   |
| Expected return on plan assets | (5,390)       | (4,405) | -              | -       |
| Amortization:                  |               |         |                |         |
| Transition obligation          | 8             | 27      | -              | -       |
| Prior service cost/(credit)    | 226           | 237     | (1,241)        | (1,138) |
| Net actuarial loss             | 1,365         | 1,361   | 1,191          | 1,203   |
| Net periodic benefit costs     | \$3,376       | \$3,452 | \$2,255        | \$2,370 |

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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.

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### 12. Long Term Debt

Long term debt consists of the following:

| (in thousands)  | March 31,<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 5.84%  | 15,000            | 23,000               |
| Various notes and mortgages relative to operations principally outside the United States, at an average rate of 5.57% in 2007 and 5.81% in 2006 due in varying amounts through 2021 | 1,189             | 1,822                |
| Industrial revenue financings at an average interest rate of 7.09% in 2007 and 7.06% in 2006, due in varying amounts through 2009   | 10,841            | 10,932               |
| Long term debt  | 357,030           | 365,754              |
| Less: current portion   | (11,171)          | (11,167)             |
| Long term debt, net of current portion  | \$345,859         | \$354,587            |

The weighted average rate for all debt was 3.79% as of March 31, 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 \$15 million was outstanding as of March 31, 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.



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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 an initial conversion rate of 22.462 shares per \$1,000 principal amount of notes (equivalent to an initial conversion price of \$44.52 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 \$14.7 million. 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 \$44.52 per share in the case of the Senior Notes and \$52.25 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 March 31, 2007, the Company's leverage ratio under the agreement was 1.73 to 1.00 and the interest coverage ratio was 11.30 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.

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### 13. Recent Accounting Pronouncements

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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 \$2,500,000.

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.

### **14. Subsequent events**

On May 4, 2007, the Company announced a plan to cease production at its plant in Järvenpää, Finland. The planned closure reflects similar efforts by the Company over the last several years to match capacity to the global demand for paper machine clothing, as the global paper industry has continued to consolidate and eliminate capacity. Implementation and timing of the planned reduction is subject to local legal requirements and works council notifications and consultations. The Company expects to incur cash charges of from \$1 to \$2 million for equipment relocation, and additional non-cash charges for equipment write-downs and other non-cash items. Given local legal requirements, the Company cannot determine the amount of expense to be incurred for severance and termination payments until the conclusion of the works council consultation process. As a result, the Company is not yet able to estimate total charges to be incurred in connection with this planned action. The estimated charges, and related cash expenditures, are expected to be incurred during the remainder of 2007.

On May 7, 2007, the Company announced a plan to cease manufacturing operations at its Albany Door Systems operation in Halmstad, Sweden. As with the planned closure in Finland, the implementation and timing of this plan is subject to local legal requirements and works council and trade union notifications and consultations. Given local legal requirements, the Company cannot determine the amount of expense to be incurred for severance and termination payments until the conclusion of the works council consultation process. The Company expects to incur cash charges of less than \$1 million for equipment relocation, fees and other cash charges. The Company does not expect to incur any significant non-cash charges for equipment write-downs and other non-cash items. While the Company is not yet able to estimate total charges to be incurred in connection with this plan, any such charges, and related cash expenditures, are currently expected to be incurred during the remainder of 2007.

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**Item 2. Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

**For the Three Month Period Ended March 31, 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 competencies in advanced textiles and materials to other industries including insulation for personal outerwear and home furnishings (PrimaLoft®); specialty materials and composite structures for aircraft and other applications (Albany Engineered Composites); specialty filtration products for wet and dry applications (Albany Filtration Technologies); fabrics, wires, and belting products for the nonwovens and pulp industries, and industrial process belts for tannery, textile, and corrugator applications (Albany Engineered Fabrics). 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 manufactures, sells, and services high-speed, high-performance industrial doors. The business grew from an internal invention applying the company's coated fabric technology to produce a rolling fabric door. Albany's Rapid Roll® doors are produced and sold in Europe, North America, and the Pacific and there are more than 100,000 installations worldwide. 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.

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## Trends and Challenges

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 quarter 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.

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The Company's strategy for dealing with trends and challenges 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. As a result, the Company's focus has sharpened, leaving it better able to bring 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. The principal challenges and opportunities in this segment involve managing this 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.

#### **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.

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

*Total Company three months ended March 31, 2006*

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Net sales were \$257.7 million for the three months ended March 31, 2007 as compared to \$251.2 million for the three months ended March 31, 2006. Changes in currency translation rates had the effect of increasing net sales by \$8.9 million. Excluding the effect of changes in currency translation rates, net sales decreased 0.9 percent as compared to the same period last year.

The following table presents 2007 and 2006 net sales by segment and the effect of changes in currency translation rates:

| (in thousands)         | Three months ended<br>March 31, |           | Percent<br>change | Increase due to<br>changes in currency<br>translation rates | Percent change<br>Excluding currency<br>rate effect |
|------------------------|---------------------------------|-----------|-------------------|---|---|
|                        | 2007                            | 2006      |                   |   |   |
| Paper Machine Clothing | \$182,306                       | \$183,893 | -0.9%             | \$5,271   | -3.7%   |
| Applied Technologies   | 40,938                          | 37,843    | 8.2%              | 1,226   | 4.9%  |
| Albany Door Systems    | 34,494                          | 29,487    | 17.0%             | 2,394   | 8.9%  |
| Consolidated total     | \$257,738                       | \$251,223 | 2.6%              | \$8,891   | -0.9%   |

Gross profit was 38.2 percent of net sales in the first quarter of 2007, compared to 41.4 percent in the first quarter of 2006 and 35.2 percent in the fourth quarter of 2006. In comparison to the first quarter of 2006, the decrease was principally due to the impact of lower PMC sales. In comparison to the fourth quarter of 2006, the increase in gross profit percentage reflects operating efficiency improvements.

Selling, technical, general, and research (STG&R) expenses were \$82.3 million in the first quarter of 2007, compared to \$74.6 million for the same period of 2006. The increase included \$2.9 million related to the effect of changes in currency translation rates and \$9.2 million (\$0.24 per share) of charges related to cost reduction (\$0.19 per share) and process improvement initiatives (\$0.05 per share) that were previously announced.

Operating income was \$16.1 million in the first quarter of 2007, compared to \$29.4 million in the first quarter of 2006, reflecting a lower gross profit percentage and the 2007 charges related to cost reduction and process improvement initiatives.

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. Operating income for 2006 has been reclassified to conform to the current year presentation and, accordingly, operating income in the PMC, Applied Technologies, and Albany Door Systems segments was reduced by \$1,452,000, \$573,000, and \$511,000, respectively, while Research expense was reduced by \$2,536,000.

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| (in thousands)          | Three Months Ended<br>March 31, |          |
|-------------------------|---------------------------------|----------|
|                         | 2007                            | 2006     |
| <b>Operating Income</b> |                                 |          |
| Paper Machine Clothing  | \$27,077                        | \$39,335 |
| Applied Technologies    | 4,321                           | 5,575    |
| Albany Door Systems     | 1,733                           | 1,774    |

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|   |          |          |
|---|----------|----------|
| Research expense                          | (5,011)  | (6,003)  |
| Unallocated expenses                      | (12,061) | (11,267) |
| Operating income before reconciling items | 16,059   | 29,414   |
| <b>Reconciling items:</b>                 |          |          |
| Interest expense, net                     | (3,302)  | (1,879)  |
| Other income/(expense), net               | 30       | (909)    |
| Consolidated income before income taxes   | \$12,787 | \$26,626 |

For the three months ended March 31, 2007, the Company had expenses of \$7,609,000 associated with cost reduction and \$1,596,000 associated with performance improvement initiatives. In the operating income table above, \$6,845,000 of that total is included in the PMC segment, and \$2,360,000 is included in Unallocated expenses. Expenses for cost reduction initiatives principally relate to the Company's initiative to centralize administrative functions in the Europe Paper Machine Clothing business and include \$5,938,000 of termination benefits and \$1,671,000 for professional fees.

Research expense decreased \$1.0 million as compared to the first quarter of 2006, principally due to lower professional fees related to intellectual property. Unallocated expenses, which consist primarily of corporate headquarters expenses, increased \$0.8 million compared to the first quarter of 2006. The net increase included expenses of \$2.6 million associated cost reduction and performance improvement initiatives, which was partially offset by lower wages and costs related to incentive programs.

Interest expense, net, was \$3.3 million for the first quarter of 2007, compared to \$1.9 million for the same period of 2006. The increase is due principally to interest on the convertible bond that originated in March 2006.

Other income/expense, net, was \$30,000 of income for the first quarter of 2007, compared to \$0.9 million of expense for the same period of 2006. The decrease is principally due to the termination of the accounts receivable securitization program in the third quarter of 2006, as costs related to this program were \$0.8 million for the first quarter of 2006.

The first-quarter effective income tax rate was 25 percent in 2007, compared to 30 percent in 2006. The lower rate in 2007 is attributable to changes in the amount and mix of geographical income. Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation Number 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB statement No. 109. The effect of adopting this Interpretation was an increase in liabilities and a decrease in retained earnings of \$2.5 million.

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*Paper Machine Clothing Segment three months ended March 31, 2007*

First-quarter net sales of PMC decreased 0.9 percent compared to the same period last year. Excluding the effect of changes in currency translation rates, net sales for the quarter decreased 3.7 percent. The decline in net sales compared to Q1 2006 resulted principally from lower sales in Europe.

In Western Europe, with volume increases more than offsetting lower average prices, revenue rose 3.9 percent over the fourth quarter of 2006, which in turn had been 8.6 percent higher than the third quarter of 2006 low point. Orders in Western Europe were also strong. Revenue in the Americas grew compared to the fourth quarter of 2006, and orders remained firm. Pacific Corridor sales were soft in the first quarter of 2007,

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but orders were strong and the Company continues to make good progress toward the completion of its plant expansion in Korea and the new plant in China.

Gross profit as a percentage of net sales for the Paper Machine Clothing segment was 41.8 percent for the first quarter of 2007 compared to 44.4 percent for the same period of 2006. The decrease was principally due to the impact of lower prices in the European market. Operating income decreased from \$39.3 million for the first quarter of 2006, to \$27.1 million, after \$6.7 million of expenses related to cost reduction and performance improvement initiatives.

### *Applied Technologies Segment three months ended March 31, 2007*

First-quarter net sales in the Applied Technologies segment increased 8.2 percent compared to the same period of 2006 and increased 4.9 percent excluding the effect of changes in currency translation rates.

Compared to the first quarter of 2006 and excluding currency translation effects, Albany Engineered Composites sales grew 30.2 percent, Albany Filtration Technologies by 9.4 percent, and PrimaLoft by 7.9 percent. Orders in each of these businesses were strong. The one drag on growth in the emerging businesses in the first quarter of 2007 was Engineered Fabrics, which accounts for roughly half of the revenue in the Applied Technologies segment. Compared to the first quarter of 2006, Engineered Fabrics revenue declined by 3.2 percent, excluding the effect of changes in currency translation rates. Orders in the first quarter of 2007 were also slow, but management does not believe this slowdown in Engineered Fabrics is due to any structural or competitive factors, and management does expect a rebound later in the year.

Gross profit as a percentage of net sales was 30.6 percent for the first quarter of 2007 compared to 33.9 percent for the same period of 2006. The decrease was due to a lower gross profit percentage on sales in Albany Engineered Composites (due to ongoing ramp-up of manufacturing) and Albany Engineered Fabrics (due to lower sales volume). Operating income decreased to \$4.3 million compared to \$5.6 million for the first quarter of 2006, principally due to the lower gross profit percentage.

### *Albany Door Systems Segment three months ended March 31, 2007*

Led by strong new product and after-market sales in Europe and Asia, Door System net sales increased 17.0 percent compared to the same period last year and increased 8.9 percent excluding the effect of changes in currency translation rates. The order backlog at March 31, 2007 was strong, compared to the same time in 2006, and reflects the impact of new product introductions.

Gross profit as a percentage of net sales was 33.5 percent for the first quarter of 2007 compared to 36.1 percent for the same period of 2006. The decrease was due to higher costs of materials. Operating income decreased from \$1.8 million for the first quarter of 2006 to \$1.7 million for the first quarter of 2007.



The Company finances its business activities primarily with cash generated from operations and borrowings, primarily under \$180 million of convertible bonds issued in March 2006, \$150 million of 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 \$17.3 million in comparison with \$26.7 million in the first quarter of 2006. Capital spending during the first quarter of 2007 was \$23.2 million, and the Company remains on track with its previously announced capital spending plans, which call for \$160 to \$180 million of spending in 2007. Depreciation and amortization were \$14.2 million and \$1.1 million, respectively, for the first quarter of 2007, and are expected to be approximately \$60 million and \$4 million, respectively, for the full year.

The first-quarter effective income tax rate was 25 percent in 2007, compared to 30 percent in 2006. The lower rate in 2007 is attributable to changes in the amount and mix of geographical income.

Under "Trends and Challenges", 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 \$15 million was outstanding as of March 31, 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 an initial conversion rate of 22.462 shares per \$1,000 principal amount of notes (equivalent to an initial conversion price of \$44.52 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 \$14.7 million. 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 \$44.52 per share in the case of the Senior Notes and \$52.25 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 March 31, 2007, the Company's leverage ratio under the agreement was 1.73 to 1.00 and the interest coverage ratio was 11.30 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 three months ended March 31, 2007 and 2006, dividends declared were \$0.10 and \$0.09 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.

#### **Outlook:**

In its earnings release for the third quarter of 2006, management outlined its short-term objective of returning by the fourth quarter of 2007, to the profitability levels of the second quarter of 2006, excluding the effects of cost reduction and process improvement initiatives. In its earnings release after the fourth quarter of 2006, management reported that the operating results and market conditions experienced in the fourth quarter suggested that the Company was indeed on trend toward meeting that objective. The first quarter of 2007 provided further evidence that the Company remains on trend.

The trend toward gradually improving profitability is shaped by three distinct components: recovery in Paper Machine Clothing revenue from the third quarter of 2006 bottom, company-wide cost reduction and process improvement initiatives, and continued growth of the emerging

businesses. In the first quarter of 2007, the Company made good progress on each of these three fronts.

Management remains cautious in its outlook for PMC revenue. On the positive side, orders are strong, especially in Europe and Asia, and several new products are beginning to have an impact in the market. But management's view of these positive indicators is tempered by the knowledge that its customer base in PMC continues to consolidate in both the Americas and Europe, and as evidenced by European market conditions in 2006, the PMC industry remains highly competitive.

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The Company has been undertaking three sets of cost-reduction initiatives: reduction of administrative costs, consolidation of manufacturing capacity, and restructuring of global procurement practices. In the first quarter of 2007, net income was reduced by \$0.19 per share for costs associated with these initiatives. The Company incurred charges of \$0.35 per share for costs associated with these initiatives over the last three quarters. Consistent with earlier estimates, management still expects total annualized savings from these initiatives to reach \$0.45 to \$0.50 per share by year's end.

In April 2007, the Company announced that it expects to take additional charges in the second and third quarters that should lead to additional savings in 2008 and beyond.

On May 4, 2007, the Company announced a plan to cease production at its plant in Järvenpää, Finland. The planned closure reflects similar efforts by the Company over the last several years to match capacity to the global demand for paper machine clothing, as the global paper industry has continued to consolidate and eliminate capacity. Implementation and timing of the planned reduction is subject to local legal requirements and works council notifications and consultations. The Company expects to incur cash charges of from \$1 to \$2 million for equipment relocation, and additional non-cash charges for equipment write-downs and other non-cash items. Given local legal requirements, the Company cannot determine the amount of expense to be incurred for severance and termination payments until the conclusion of the works council consultation process. As a result, the Company is not yet able to estimate total charges to be incurred in connection with this planned action. The estimated charges, and related cash expenditures, are expected to be incurred during the remainder of 2007.

On May 7, 2007, the Company announced a plan to cease manufacturing operations at its Albany Door Systems operation in Halmstad, Sweden. As with the planned closure in Finland, the implementation and timing of this plan is subject to local legal requirements and works council and trade union notifications and consultations. Given local legal requirements, the Company cannot determine the amount of expense to be incurred for severance and termination payments until the conclusion of the works council consultation process. The Company expects to incur cash charges of less than \$1 million for equipment relocation, fees and other cash charges. The Company does not expect to incur any significant non-cash charges for equipment write-downs and other non-cash items. While the Company is not yet able to estimate total charges to be incurred in connection with this plan, any such charges, and related cash expenditures, are currently expected to be incurred during the remainder of 2007.

In addition to expenses associated with these and other cost-reduction activities, the Company expects to incur costs for other initiatives for which there will be some obvious future benefits, but for which it is not possible to quantify an earnings per share benefit. Costs associated with these initiatives reduced net income by \$0.05 in the first quarter of 2007. Ongoing expenses associated with these initiatives are estimated as follows:

The Company's China Press Fabric manufacturing facility, which is under construction, and which is on budget and on schedule for start up in the first quarter of 2008, is expected to result in non-capitalizable expenses of approximately \$0.8 million in the second quarter of 2007, \$0.9 million in the third quarter, and \$1.2 million in the fourth quarter.

Expenses in connection with the Company's conversion to its new SAP global information system reduced pretax profits in the first quarter of 2007 by \$1.3 million, and are expected to reduce pretax profits in the second quarter, third quarter and fourth quarter of 2007 by \$1.5 million, \$1.1 million and \$3.9 million, respectively.

Regarding the third component of management's profit improvement plan (continued growth in the emerging businesses), management continues to be especially encouraged by developments in the Composites business, and the Company is making steady progress in its efforts to build the manufacturing and engineering base required to sustain rapid and profitable growth. Management is also encouraged by its exploration of ways to accelerate growth of the Door Systems business, and by the sales and orders growth in the Filtration business, which is being driven by the

requirement for environmental control in the power generation market in China.

In sum, management thinks the Company is still on track toward the short-term target of returning, by year's end, to the operating income levels of the second quarter of 2006. Management remains bullish in the long term about the Albany cash and grow business model and cautiously optimistic about the short term. The optimism stems from growing competitive strength in PMC, progress in cost-cutting and process improvement initiatives, and continued growth in the emerging businesses; while management's caution stems from the recognition that those underlying conditions that hit the top line in PMC in the third quarter of 2006 are still in place.

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### **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 \$2,500,000.

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

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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 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.

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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.

#### **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

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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 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.

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## **PART II OTHER INFORMATION**

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

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 19,120 claims as of April 27, 2007. This compares with 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 April 27, 2007, approximately 12,709 of the claims pending against Albany are pending in Mississippi. Of these, approximately 12,042 are in federal court, at the multidistrict litigation panel (MDL), either through removal or original jurisdiction. (In addition to the 12,042 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 current practice is to place all nonmalignant claims on an inactive docket until such time as the plaintiff develops a malignant disease; in addition, the MDL has administratively dismissed, without prejudice, the claims of plaintiffs resulting from mass-screenings who had not otherwise demonstrated that they suffer from an asbestos-related disease. Because the court continues to exercise jurisdiction over these claims, and will allow the claims to be reinstated following the diagnosis of an asbestos-related disease, we do not reflect them as reducing the total number of pending claims. The MDL is currently evaluating proposed orders that would require each plaintiff to provide detailed information regarding alleged asbestos exposure and medical diagnoses. While new procedures have not yet been adopted by the court, if they were, the Company could expect to be dismissed from the claims of all plaintiffs who can not establish both an asbestos-related disease and



exposure to one of the Company's asbestos-containing products. Alternatively, in cases where a plaintiff does establish an asbestos-related disease and work history in a paper mill, the Company will be expected to engage in good faith settlement negotiations or to defend that claim at trial when remanded back to Mississippi. The Company does not expect the MDL to complete its evaluation of the current procedures for many weeks, and further expects that the effect of such changes, if adopted, would not be fully realized for an additional 12 months.

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, 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 April 27, 2007, the Company had resolved, by means of settlement or dismissal, 21,231 claims. The total cost of resolving all claims was \$6,691,000. Of this amount, \$6,656,000, 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 9,089 claims as of April 27, 2007. This compares with 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 April 27, 2007, Brandon has resolved, by means of settlement or dismissal, 8,463 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, 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.

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**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 quarter 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

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

At the annual meeting of shareholders held April 13, 2007, the only item subject to a vote of security holders was the election of ten directors.

In the vote for the election of ten members of the Board of Directors of the Company, the number of votes cast for, and the number of votes withheld from, each of the nominees were as follows:

| <u>Nominee</u>           | <u>Number of Votes For</u> |                | <u>Number of Votes Withheld</u> |                |
|--------------------------|----------------------------|----------------|---------------------------------|----------------|
|                          | <u>Class A</u>             | <u>Class B</u> | <u>Class A</u>                  | <u>Class B</u> |
| Frank R. Schmeler        | 17,301,994                 | 32,358,900     | 7,035,913                       | -              |
| Joseph G. Morone         | 16,748,734                 | 32,358,900     | 7,589,173                       | -              |
| Thomas R. Beecher, Jr.   | 13,127,867                 | 32,358,900     | 11,210,040                      | -              |
| Christine L. Standish    | 11,575,948                 | 32,358,900     | 12,761,959                      | -              |
| Erland E. Kailbourne     | 21,201,661                 | 32,358,900     | 3,136,246                       | -              |
| John C. Standish         | 16,681,072                 | 32,358,900     | 7,656,835                       | -              |
| Juhani Pakkala           | 22,051,255                 | 32,358,900     | 2,286,652                       | -              |
| Paula H. J. Cholmondeley | 20,480,335                 | 32,358,900     | 3,857,572                       | -              |
| John F. Cassidy, Jr.     | 22,749,882                 | 32,358,900     | 1,588,025                       | -              |
| Edgar G. Hotard          | 22,749,686                 | 32,358,900     | 1,588,221                       | -              |

**Item 5. Other Information**

None

**Item 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 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: May 8, 2007

By /s/ Michael C. Nahl

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