

ALBANY INTERNATIONAL CORP /DE/  
Form 10-Q  
August 07, 2014

**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: June 30, 2014

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: 1-10026

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.)

216 Airport Drive, Rochester, New Hampshire 03867  
(Address of principal executive offices) (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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [  ] No [  ]

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

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

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

The registrant had 28.6 million shares of Class A Common Stock and 3.2 million shares of Class B Common Stock outstanding as of July 23, 2014.

**ALBANY INTERNATIONAL CORP.**

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## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

| Three Months Ended<br>June 30, |           |   | Six Months Ended<br>June 30, |           |
|--------------------------------|-----------|---|------------------------------|-----------|
| 2014                           | 2013      |   | 2014                         | 2013      |
| \$193,518                      | \$197,974 | Net sales   | \$373,825                    | \$384,628 |
| 118,175                        | 120,541   | Cost of goods sold  | 223,673                      | 234,426   |
| 75,343                         | 77,433    | Gross profit  | 150,152                      | 150,202   |
| 40,012                         | 41,994    | Selling, general, and administrative expenses                     | 79,169                       | 78,547    |
| 14,397                         | 14,631    | Technical, product engineering, and research expenses             | 28,266                       | 27,693    |
| 1,957                          | 24,321    | Restructuring and other, net                                      | 3,139                        | 24,957    |
| 18,977                         | (3,513)   | Operating income  | 39,578                       | 19,005    |
| 2,717                          | 3,547     | Interest expense, net   | 5,635                        | 7,572     |
| (2,133)                        | 2,211     | Other (income)/expenses, net                                      | (2,600)                      | 2,945     |
| 18,393                         | (9,271)   | Income before income taxes  | 36,543                       | 8,488     |
| 7,216                          | (2,243)   | Income tax expense  | 14,673                       | 4,005     |
| 11,177                         | (7,028)   | Income from continuing operations                                 | 21,870                       | 4,483     |
| -                              | (575)     | Loss from operations of discontinued business                     | -                            | (575)     |
| -                              | (224)     | Income tax benefit on discontinued operations                     | -                            | (224)     |
| -                              | (351)     | Loss from discontinued operations                                 | -                            | (351)     |
| 11,177                         | (7,379)   | Net income/(loss)   | 21,870                       | 4,132     |
| (42)                           | -         | Net income attributable to the noncontrolling interest            | 30                           | -         |
| \$11,219                       | (\$7,379) | Net income/(loss) attributable to the Company                     | \$21,840                     | \$4,132   |
|                                |           | Earnings per share attributable to Company shareholders - Basic   |                              |           |
| \$0.35                         | (\$0.22)  | Income/(loss) from continuing operations                          | \$0.69                       | \$0.14    |
| 0.00                           | (0.01)    | Discontinued operations   | 0.00                         | (0.01)    |
| \$0.35                         | (\$0.23)  | Net income/(loss) attributable to the Company                     | \$0.69                       | \$0.13    |
|                                |           | Earnings per share attributable to Company shareholders - Diluted |                              |           |
| \$0.35                         | (\$0.22)  | Income/(loss) from continuing operations                          | \$0.68                       | \$0.14    |
| 0.00                           | (0.01)    | Discontinued operations   | 0.00                         | (0.01)    |
| \$0.35                         | (\$0.23)  | Net income/(loss) attributable to the Company                     | \$0.68                       | \$0.13    |

| Shares of the Company used in computing earnings per share: |        |                     |        |        |
|---|--------|---------------------|--------|--------|
| 31,832  | 31,628 | Basic               | 31,809 | 31,562 |
| 31,935  | 31,628 | Diluted             | 31,913 | 31,687 |
| \$0.16  | \$0.15 | Dividends per share | \$0.31 | \$0.29 |

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

## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

| Three Months Ended |           |  | Six Months Ended |           |
|--------------------|-----------|--|------------------|-----------|
| June 30,           |           |  | June 30,         |           |
| 2014               | 2013      |  | 2014             | 2013      |
| \$11,177           | (\$7,379) | Net income/(loss)  | \$21,870         | \$4,132   |
|                    |           | Other comprehensive income, before tax:                          |                  |           |
| 3,289              | (2,647)   | Foreign currency translation adjustments                         | (1,940)          | (13,269)  |
|                    |           | Amortization of pension liability adjustment:                    |                  |           |
| -                  | 17        | Transition obligation  | -                | 34        |
| (1,108)            | (909)     | Prior service (credit)/cost                                      | (2,217)          | (1,817)   |
| 1,355              | 1,664     | Net actuarial loss   | 2,683            | 3,328     |
| 473                | 454       | Payments related to interest rate swaps included in earnings     | 951              | 910       |
| (955)              | 1,960     | Derivative valuation adjustment                                  | (1,315)          | 1,961     |
|                    |           | Income taxes related to items of other comprehensive income:     |                  |           |
| (98)               | (271)     | Amortization of pension liability adjustment                     | (186)            | (541)     |
| (184)              | (177)     | Payments related to interest rate swaps included in earnings     | (371)            | (354)     |
| 372                | (764)     | Derivative valuation adjustment                                  | 513              | (765)     |
| 14,321             | (8,052)   | Comprehensive income/(loss)                                      | 19,988           | (6,381)   |
| -                  | -         | Comprehensive income attributable to the noncontrolling interest | -                | -         |
| \$14,321           | (\$8,052) | Comprehensive income/(loss) attributable to the Company          | \$19,988         | (\$6,381) |

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

## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

|  | June 30,<br>2014 | December<br>31,<br>2013 |
|--|------------------|-------------------------|
| <b>ASSETS</b>  |                  |                         |
| Cash and cash equivalents  | \$206,836        | \$222,666               |
| Accounts receivable, net   | 148,473          | 163,547                 |
| Inventories  | 123,889          | 112,739                 |
| Deferred income taxes  | 13,900           | 13,873                  |
| Prepaid expenses and other current assets  | 10,120           | 9,659                   |
| Total current assets   | 503,218          | 522,484                 |
| Property, plant and equipment, net   | 414,758          | 418,830                 |
| Intangibles  | 501              | 616                     |
| Goodwill   | 78,635           | 78,890                  |
| Income taxes receivable and deferred   | 111,942          | 119,612                 |
| Other assets   | 29,709           | 26,456                  |
| Total assets   | \$1,138,763      | \$1,166,888             |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                  |                         |
| Notes and loans payable  | \$692            | \$625                   |
| Accounts payable   | 35,698           | 36,397                  |
| Accrued liabilities  | 100,006          | 112,331                 |
| Current maturities of long-term debt   | 1,265            | 3,764                   |
| Income taxes payable and deferred  | 4,378            | 5,391                   |
| Total current liabilities  | 142,039          | 158,508                 |
| Long-term debt   | 283,104          | 300,111                 |
| Other noncurrent liabilities   | 100,940          | 106,014                 |
| Deferred taxes and other credits   | 53,302           | 54,476                  |
| Total liabilities  | 579,385          | 619,109                 |
| <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 |                  |                         |

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|  |             |             |
|--|-------------|-------------|
| 37,064,939 in 2014 and 36,997,277 in 2013  | 37          | 37          |
| Class B Common Stock, par value \$.001 per share;<br>authorized 25,000,000 shares; issued and<br>outstanding 3,235,048 in 2014 and 3,235,048 in 2013 | 3           | 3           |
| Additional paid in capital   | 418,117     | 416,728     |
| Retained earnings  | 446,570     | 434,598     |
| Accumulated items of other comprehensive income:   |             |             |
| Translation adjustments  | (1,976 )    | (138 )      |
| Pension and postretirement liability adjustments   | (48,205 )   | (48,383 )   |
| Derivative valuation adjustment  | (1,199 )    | (977 )      |
| Treasury stock (Class A), at cost 8,459,498 shares<br>in 2014 and 8,463,635 in 2013  | (257,481 )  | (257,571 )  |
| Total Company shareholders' equity   | 555,866     | 544,297     |
| Noncontrolling interest  | 3,512       | 3,482       |
| Total equity   | 559,378     | 547,779     |
| Total liabilities and shareholders' equity   | \$1,138,763 | \$1,166,888 |

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



## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED STATEMENTS OF CASH FLOW

(in thousands)

(unaudited)

| Three Months Ended<br>June 30, |           |  | Six Months Ended<br>June 30, |          |
|--------------------------------|-----------|--|------------------------------|----------|
| 2014                           | 2013      |  | 2014                         | 2013     |
|                                |           | <b>OPERATING ACTIVITIES</b>  |                              |          |
| \$11,177                       | (\$7,379) | Net income/(loss)  | \$21,870                     | \$4,132  |
|                                |           | Adjustments to reconcile net income to net cash provided by operating activities:                  |                              |          |
| 14,276                         | 14,427    | Depreciation   | 28,383                       | 28,638   |
| 1,821                          | 1,654     | Amortization   | 3,622                        | 3,317    |
| 2,946                          | (7,864)   | Change in long-term liabilities, deferred taxes and other credits                                  | 2,732                        | (3,991)  |
| 728                            | 21        | Provision for write-off of property, plant and equipment   | 729                          | 65       |
| (961)                          | -         | Gain on disposition or involuntary conversion of assets  | (961)                        | (3,763)  |
| (106)                          | (172)     | Excess tax benefit of options exercised  | (145)                        | (524)    |
| 405                            | (476)     | Compensation and benefits paid or payable in Class A Common Stock                                  | 947                          | (1,174)  |
|                                |           | Changes in operating assets and liabilities that provide/(use) cash, net of business divestitures: |                              |          |
| 3,333                          | (4,515)   | Accounts receivable  | 14,297                       | (6,238)  |
| (1,963)                        | 2,458     | Inventories  | (10,959)                     | (530)    |
| 1,762                          | 1,544     | Prepaid expenses and other current assets  | (386)                        | (2,033)  |
| (7)                            | 28        | Income taxes prepaid and receivable  | 14                           | 180      |
| 555                            | (1,139)   | Accounts payable   | (739)                        | (592)    |
| 170                            | 29,912    | Accrued liabilities  | (12,679)                     | 20,929   |
| 651                            | 441       | Income taxes payable   | (1,059)                      | (4,877)  |
| (2,098)                        | (793)     | Other, net   | (4,129)                      | (1,231)  |
| 32,689                         | 28,147    | Net cash provided by operating activities  | 41,537                       | 32,308   |
|                                |           | <b>INVESTING ACTIVITIES</b>  |                              |          |
| (12,799)                       | (14,620)  | Purchases of property, plant and equipment   | (27,402)                     | (27,808) |
| (21)                           | (555)     | Purchased software   | (315)                        | (648)    |
| 961                            | -         | Proceeds from sale or involuntary conversion of assets   | 961                          | 6,268    |

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|                      |           |  |           |           |
|----------------------|-----------|--|-----------|-----------|
| (11,859)             | (15,175)  | Net cash used in investing activities                        | (26,756)  | (22,188)  |
| FINANCING ACTIVITIES |           |  |           |           |
| 235                  | 5,037     | Proceeds from borrowings                                     | 4,670     | 51,905    |
| (17,593)             | (18,476)  | Principal payments on debt                                   | (24,109)  | (50,659)  |
| 261                  | 1,004     | Proceeds from options exercised                              | 387       | 2,968     |
| 106                  | 172       | Excess tax benefit of options exercised                      | 145       | 524       |
| -                    | (76)      | Debt acquisition costs                                       | -         | (1,639)   |
| (4,774)              | (4,423)   | Dividends paid   | (9,539)   | (4,423)   |
| (21,765)             | (16,762)  | Net cash used in financing activities                        | (28,446)  | (1,324)   |
| (608)                | 1,278     | Effect of exchange rate changes on cash and cash equivalents | (2,165)   | (2,193)   |
| (1,543)              | (2,512)   | (Decrease)/increase in cash and cash equivalents             | (15,830)  | 6,603     |
| 208,379              | 199,833   | Cash and cash equivalents at beginning of period             | 222,666   | 190,718   |
| \$206,836            | \$197,321 | Cash and cash equivalents at end of period                   | \$206,836 | \$197,321 |

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

ALBANY INTERNATIONAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

***1. Basis of Presentation***

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of only normal recurring adjustments and elimination of intercompany transactions necessary for a fair presentation of results for such periods. Albany International Corp. (“Albany”) consolidates the financial results of its subsidiaries for all periods presented. The results for any interim period are not necessarily indicative of results for the full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with “Risk Factors,” “Legal Proceedings,” “Management’s Discussion and Analysis of Financial Condition and Results of Operation,” “Quantitative and Qualitative Disclosures about Market Risk” and the Consolidated Financial Statements and Notes thereto included in Items 1A, 3, 7, 7A and 8, respectively, of the Albany International Corp. Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

The preparation of financial statements in accordance with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the amounts reported in Albany International Corp.’s Consolidated Financial Statements and accompanying Notes. Actual results could differ materially from those estimates.

***2. Noncontrolling Interest***

Effective October 31, 2013, Safran S.A. (Safran) acquired a 10 percent equity interest in a new Albany subsidiary, Albany Safran Composites, LLC (ASC). Under the terms of the transaction agreements, ASC is the exclusive supplier to Safran of advanced 3D-woven composite parts for use in aircraft and rocket engines, thrust reversers and nacelles, and aircraft landing and braking systems (the “Safran Applications”). AEC may develop and supply parts other than advanced 3D-woven composite parts for all aerospace applications, as well as advanced 3D-woven composite parts for any aerospace applications that are not Safran Applications (such as airframe applications) and any non-aerospace applications.

The agreement provides Safran an option to purchase Albany’s remaining 90 percent interest upon the occurrence of certain bankruptcy or performance default events, or if Albany’s Engineered Composites business is sold to a direct competitor of Safran. The purchase price is based initially on the same valuation of ASC used to determine Safran’s 10% equity interest, and increases over time as LEAP production increases.

In accordance with the operating agreement, Albany received a \$28 million preferred holding in ASC which includes a preferred return based on the Company’s revolving credit agreement. The common shares of ASC are owned 90 percent by Albany and 10 percent by Safran.

The table below presents a reconciliation of income attributable to the noncontrolling interest and noncontrolling equity:

| (in thousands, except percentages)  | <b>Six months ended</b> |            |
|---|-------------------------|------------|
|   | <b>June 30, 2014</b>    |            |
| Net income of ASC   | <b>\$801</b>            |            |
| Less: Return attributable to the Company's preferred holding                  |                         | <b>501</b> |
| Net income of ASC available for common ownership                              |                         | <b>300</b> |
| Ownership percentage of noncontrolling shareholder                            | <b>10%</b>              |            |
| Net income attributable to noncontrolling interest                            | <b>\$30</b>             |            |
| <br>  |                         |            |
| Noncontrolling interest as of December 31, 2013                               | <b>\$3,482</b>          |            |
| Net income attributable to noncontrolling interest                            |                         | <b>30</b>  |
| Changes in other comprehensive income attributable to noncontrolling interest |                         | <b>-</b>   |
| Noncontrolling interest as of June 30, 2014                                   | <b>\$3,512</b>          |            |

### ***3. Reportable Segments***

Effective January 1, 2014, Albany International Corp. (the "Company") changed its business segment reporting by recasting, for all prior periods, certain expenses previously identified as Research and Unallocated expenses to existing segments. The Company has two reportable segments: Machine Clothing (MC) and Albany Engineered Composites (AEC), and had Research and Unallocated expenses that were not allocated to these segments. Substantially all research and development expenses are now included in segment operating expenses. Prior to this change, Unallocated expenses included long-term incentive compensation for all Company employees. To the extent such programs are related to MC and AEC employees, such expenses are now included in segment operating expenses. Additionally, the amounts previously referred to as "Unallocated expenses," is now referred to as "Corporate expenses." These changes are being made to be consistent with how the chief operating decision-maker assesses Company performance. On April 10, 2014, we filed a Form 8-K to show the effect of these changes on previously reported results and, accordingly, the 2013 segment results in this report reflect the effect of this change.

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

| (in thousands)                                   | Three months ended      |           | Six months ended        |           |
|--|-------------------------|-----------|-------------------------|-----------|
|  | June 30,<br><b>2014</b> | 2013      | June 30,<br><b>2014</b> | 2013      |
| <b>Net sales</b>                                 |                         |           |                         |           |
| Machine Clothing                                 | <b>\$172,809</b>        | \$177,536 | <b>\$336,897</b>        | \$344,946 |
| Albany Engineered Composites                     | <b>20,709</b>           | 20,438    | <b>36,928</b>           | 39,682    |
| Consolidated total                               | <b>\$193,518</b>        | \$197,974 | <b>\$373,825</b>        | \$384,628 |
| <b>Operating income/(loss)</b>                   |                         |           |                         |           |
| Machine Clothing                                 | <b>\$33,879</b>         | \$14,821  | <b>\$70,022</b>         | \$52,377  |
| Albany Engineered Composites                     | <b>(3,545)</b>          | (4,678)   | <b>(7,021)</b>          | (9,081)   |
| Corporate expenses                               | <b>(11,357)</b>         | (13,656)  | <b>(23,423)</b>         | (24,291)  |
| Operating income/(loss) before reconciling items | <b>18,977</b>           | (3,513)   | <b>39,578</b>           | 19,005    |
| Reconciling items:                               |                         |           |                         |           |
| Interest income                                  | <b>(356)</b>            | (300)     | <b>(552)</b>            | (600)     |
| Interest expense                                 | <b>3,073</b>            | 3,847     | <b>6,187</b>            | 8,172     |
| Other expense/ (income), net                     | <b>(2,133)</b>          | 2,211     | <b>(2,600)</b>          | 2,945     |
| Income/(loss) before income taxes                | <b>\$18,393</b>         | (\$9,271) | <b>\$36,543</b>         | \$8,488   |

The table below presents restructuring costs by reportable segment (also see Note 5):

| (in thousands)               | Three months ended      |          | Six months ended        |          |
|------------------------------|-------------------------|----------|-------------------------|----------|
|                              | June 30,<br><b>2014</b> | 2013     | June 30,<br><b>2014</b> | 2013     |
| <b>Restructuring expense</b> |                         |          |                         |          |
| Machine Clothing             | <b>\$1,297</b>          | \$24,230 | <b>\$2,159</b>          | \$24,423 |
| Albany Engineered Composites | <b>660</b>              | 91       | <b>980</b>              | 534      |
| Consolidated total           | <b>\$1,957</b>          | \$24,321 | <b>\$3,139</b>          | \$24,957 |

Machine Clothing restructuring expense was principally related to the reduction in manufacturing capacity at the production facilities in France. Restructuring expenses in the Albany Engineered Composites operations were principally related to organizational changes and exiting certain aerospace programs.

There were no material changes in the total assets of the reportable segments during this period.

#### **4. Pensions and Other Postretirement Benefit Plans**

##### *Pension Plans*

The Company has defined benefit pension plans covering certain U.S. and non-U.S. employees. The U.S. qualified defined benefit pension plan has been closed to new participants since October 1998 and, as of February 2009, benefits accrued under this plan were frozen. As a result of the freeze, employees covered by the pension plan will receive, at retirement, benefits already accrued

through February 2009, but no new benefits accrue after that date. Benefit accruals under the U.S. Supplemental Executive Retirement Plan ("SERP") were similarly frozen. The eligibility, benefit formulas, and contribution requirements for plans outside of the U.S. vary by location.

#### *Other Postretirement Benefits*

In addition to providing pension benefits, the Company provides various medical, dental, and life insurance benefits for certain retired United States employees. U.S. employees hired prior to 2005 may become eligible for these benefits if they reach normal retirement age while working for the Company. Benefits provided under this plan are subject to change. Retirees share in the cost of these benefits. Effective January 2005, any new employees who wish to be covered under this plan will be responsible for the full cost of such benefits. In September 2008, we changed the cost sharing arrangement under this program such that increases in health care costs are the responsibility of plan participants. In August 2013, we reduced the life insurance benefit for retirees and eliminated the benefit for active employees.

The Company also provides certain postretirement life insurance benefits to retired employees in Canada. The Company accrues the cost of providing postretirement benefits during the active service period of the employees. The Company currently funds the plan as claims are paid.

The composition of the net periodic benefit plan cost for the six months ended June 30, 2014 and 2013 was as follows:

| (in thousands)                              | Pension plans  |         | Other postretirement benefits |         |
|---|----------------|---------|-------------------------------|---------|
|   | 2014           | 2013    | 2014                          | 2013    |
| Components of net periodic benefit cost:    |                |         |                               |         |
| Service cost                                | <b>\$1,683</b> | \$1,684 | <b>\$157</b>                  | \$571   |
| Interest cost                               | <b>4,815</b>   | 4,000   | <b>1,371</b>                  | 1,604   |
| Expected return on assets                   | <b>(4,846)</b> | (4,068) | -                             | -       |
| Amortization of prior service cost/(credit) | <b>27</b>      | 17      | <b>(2,244)</b>                | (1,834) |
| Amortization of transition obligation       | -              | 34      | -                             | -       |
| Amortization of net actuarial loss          | <b>1,229</b>   | 1,571   | <b>1,454</b>                  | 1,757   |
| Curtailment                                 | <b>(710)</b>   | -       | -                             | -       |
| Net periodic benefit cost                   | <b>\$2,198</b> | \$3,238 | <b>\$738</b>                  | \$2,098 |

#### **5. Restructuring**

During the second quarter of 2013, the Company commenced a program to restructure operations at the Company's Machine Clothing production facilities in France. The restructuring, when completed, will have reduced employment by approximately 200 positions at these locations. As of June 30, 2014, approximately 190 positions had been eliminated.

Under the terms of the restructuring plan, the Company provides training, outplacement and other benefits, the costs of which are recorded as restructuring when they are incurred. The Company recorded a curtailment gain of \$0.2 million in the second quarter of 2014 and \$0.7 million for the first six months of 2014 related to the elimination of pension accruals, which reduced net restructuring expense as reflected in the table below. Such curtailment gains are recorded as employees terminate employment and, accordingly, we expect to record additional gains during 2014. Remaining costs for this program are expected to be between \$1 and \$3 million, most of which we expect to be incurred in 2014.

Restructuring expenses in the Albany Engineered Composites operations were principally related to organizational changes and exiting certain aerospace programs.

The following table summarizes charges reported in the Statements of Income under “Restructuring and other, net”:

|                              | Three months ended |          | Six months ended |          |
|------------------------------|--------------------|----------|------------------|----------|
|                              | June 30,           |          | June 30,         |          |
| (in thousands)               | 2014               | 2013     | 2014             | 2013     |
| Machine Clothing             | \$1,297            | \$24,230 | \$2,159          | \$24,423 |
| Albany Engineered Composites | 660                | 91       | 980              | 534      |
| Total                        | \$1,957            | \$24,321 | \$3,139          | \$24,957 |

|                              | Six months ended June 30, 2014 | Total restructuring costs incurred | Termination and other costs | Impairment of plant and equipment | Benefit plan curtailment/settlement |
|------------------------------|--------------------------------|------------------------------------|-----------------------------|-----------------------------------|-------------------------------------|
| (in thousands)               |                                |                                    |                             |                                   |                                     |
| Machine Clothing             |                                | \$2,159                            | \$2,869                     | \$-                               | (\$710)                             |
| Albany Engineered Composites |                                | 980                                | 320                         | 660                               | -                                   |
| Total                        |                                | \$3,139                            | \$3,189                     | \$660                             | (\$710)                             |

|                              | Six months ended June 30, 2013 | Total restructuring costs incurred | Termination and other costs | Impairment of plant and equipment | Benefit plan curtailment/settlement |
|------------------------------|--------------------------------|------------------------------------|-----------------------------|-----------------------------------|-------------------------------------|
| (in thousands)               |                                |                                    |                             |                                   |                                     |
| Machine Clothing             |                                | \$24,423                           | \$24,587                    | \$-                               | (\$164)                             |
| Albany Engineered Composites |                                | 534                                | 446                         | 88                                | -                                   |
| Total                        |                                | \$24,957                           | \$25,033                    | \$88                              | (\$164)                             |

We expect that substantially all Accrued liabilities for restructuring will be paid within one year. The table below presents year-to-date changes in restructuring liabilities for 2014 and 2013 all of which related to termination costs:

|                   | December 31, 2013             |         | Currency Payments translation/other |         | June 30, 2014 |
|-------------------|-------------------------------|---------|-------------------------------------|---------|---------------|
| (in thousands)    | Restructuring charges accrued |         |                                     |         |               |
| Termination costs | \$9,656                       | \$3,189 | (\$8,675)                           | (\$144) | \$4,026       |
| Total             | \$9,656                       | \$3,189 | (\$8,675)                           | (\$144) | \$4,026       |

|                   | December 31, 2012             |          | Currency Payments translation/other |         | June 30, 2013 |
|-------------------|-------------------------------|----------|-------------------------------------|---------|---------------|
| (in thousands)    | Restructuring charges accrued |          |                                     |         |               |
| Termination costs | \$4,947                       | \$24,869 | (\$2,576)                           | (\$269) | \$26,971      |
| Total             | \$4,947                       | \$24,869 | (\$2,576)                           | (\$269) | \$26,971      |



**6. Other (Income)/Expenses, net**

The components of Other (income)/expenses, net, are:

| (in thousands)                                    | Three months ended |         | Six months ended |              |    |
|---|--------------------|---------|------------------|--------------|----|
|   | 2014               | 2013    | 2014             | 2013         |    |
| Currency transactions                             | <b>(\$1,397)</b>   | \$1,894 | <b>(\$1,903)</b> | \$1,903      |    |
| Bank fees and amortization of debt issuance costs | <b>285</b>         | 377     | <b>597</b>       | 998          |    |
| Gain on insurance recovery                        | <b>(961)</b> -     |         | <b>(961)</b> -   |              |    |
| Other   | <b>(60)</b>        |         | <b>(60)</b>      | <b>(333)</b> | 44 |
| Total   | <b>(\$2,133)</b>   | \$2,211 | <b>(\$2,600)</b> | \$2,945      |    |

In July 2013, the Company's manufacturing facility in Germany was damaged by severe weather. At that time, the Company expensed the remaining book value of the damaged property, but that value was minimal. In the second quarter of 2014, we recorded a gain equal to proceeds received.

**7. Income Taxes**

The following table presents components of income tax expense/(benefit) for the three and six months ending June 30, 2014 and 2013:

| (in thousands)   | Three months ended June 30, |           | Six months ended June 30, |         |
|--|-----------------------------|-----------|---------------------------|---------|
|  | 2014                        | 2013      | 2014                      | 2013    |
| Income tax based on income from continuing operations, at estimated tax rates of 36.5% and 39.0%, respectively | <b>\$6,368</b>              | (\$3,616) | <b>\$12,999</b>           | \$3,310 |
| Provision for change in estimated tax rates  | <b>278</b>                  | 888       | -                         | -       |
| Income tax before discrete items   | <b>6,646</b>                | (2,728)   | <b>12,999</b>             | 3,310   |
| Discrete tax expense/(benefit):  |                             |           |                           |         |
| Provision for/adjustment to beginning of year valuation allowances   | <b>437</b>                  | -         | <b>437</b>                | -       |
| Provision for/resolution of tax audits and contingencies, net  | <b>99</b>                   | 425       | <b>979</b>                | 425     |
| Adjustments to prior period tax liabilities  | <b>30</b>                   | (126)     | <b>254</b>                | 84      |
| Repatriation of non-U.S. prior years' earnings   | -                           | 186       | -                         | 186     |
| Other discrete tax adjustments, net  | <b>4</b>                    | -         | <b>4</b>                  | -       |
| Total income tax expense/(benefit)   | <b>\$7,216</b>              | (\$2,243) | <b>\$14,673</b>           | \$4,005 |

The second quarter estimated effective tax rate on continuing operations was 36.5 percent in 2014, as compared to 39.0 percent for the same period in 2013. The change in the estimated effective tax rate was primarily attributable to the amount and distribution of income and loss among the countries in which we operate.

At June 30, 2014 the Company reported a deferred tax liability of \$0.3 million on \$3.6 million of prior year non-U.S. earnings that have been targeted for future repatriation to the U.S. The Company records the residual U.S. and foreign taxes on certain amounts of current foreign earnings that have been targeted for repatriation to the U.S. As a result, such amounts are not considered to be permanently reinvested, and the Company accrued for the residual taxes on these earnings to the extent they cannot be repatriated in a tax-free manner.

We conduct business globally and, as a result, the Company or one or more of our subsidiaries files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business we are subject to examination by taxing authorities throughout the world, including major jurisdictions such as the United States, Brazil, Canada, China, France, Germany, Italy, Mexico, and Switzerland. The open tax years in these jurisdictions range from 2000 to 2013. We are currently under audit in the U.S. and in other non-U.S. tax jurisdictions, including but not limited to Canada, Germany and Italy.

It is reasonably possible that over the next twelve months the amount of the liability on uncertain tax positions may change within a range of a net increase of \$0 million to a net decrease of \$9.8 million, from the reevaluation of uncertain tax positions arising in examinations, in appeals, or in the courts, or from the closure of tax statutes. Not included in the range is \$24.0 million of tax benefits in Germany related to a 1999 reorganization that have been challenged by the German tax authorities in the course of an audit, of which \$18.4 million would have a direct impact on our Statements of Income if resolved unfavorably. In 2008 the German Federal Tax Court (FTC) denied tax benefits to other taxpayers in a case involving German tax laws relevant to our reorganization. One of these cases involved a non-German party, and in the ruling in that case, the FTC acknowledged that the German law in question may be violative of European Union (EU) principles and referred the issue to the European Court of Justice (ECJ) for its determination on this issue. In September 2009, the ECJ issued an opinion in this case that is generally favorable to the other taxpayer and referred the case back to the FTC for further consideration. In May 2010 the FTC released its decision, in which it resolved certain tax issues that may be relevant to our audit and remanded the case to a lower court for further development. In 2012, the lower court decided in favor of the taxpayer and the government appealed the findings to the FTC. On July 2, 2014, The FTC conducted a hearing in the aforementioned case involving the other taxpayer and a decision is expected later in the year. Although we were required to pay tax and interest of approximately \$16.3 million to the German tax authorities in order to continue to pursue the position, when taking into consideration the ECJ decision, the May 2010 FTC decision and the lower court decision, we believe that it is more likely than not that the relevant German law is violative of EU principles and, accordingly, we have not accrued tax expense on this matter. As we continue to monitor developments and consider the outcome of the July 2, 2014 hearing, it may become necessary for us to accrue tax expense and related interest.

**8. Earnings Per Share**

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

| (in thousands, except market price data)       | Three months ended |           | Six months ended |         |
|--|--------------------|-----------|------------------|---------|
|  | June 30, 2014      | 2013      | June 30, 2014    | 2013    |
| Net income/ (loss) attributable to the Company | <b>\$11,219</b>    | (\$7,379) | <b>\$21,840</b>  | \$4,132 |

**Weighted average number of shares:**

|   |               |        |               |        |
|---|---------------|--------|---------------|--------|
| Weighted average number of shares used in calculating basic net income/(loss) per share | <b>31,832</b> | 31,628 | <b>31,809</b> | 31,562 |
|---|---------------|--------|---------------|--------|

**Effect of dilutive stock-based compensation plans:**

|               |            |   |            |     |
|---------------|------------|---|------------|-----|
| Stock options | <b>103</b> | - | <b>104</b> | 125 |
|---------------|------------|---|------------|-----|

|  |               |        |               |        |
|--|---------------|--------|---------------|--------|
| Weighted average number of shares used in calculating diluted net income per share | <b>31,935</b> | 31,628 | <b>31,913</b> | 31,687 |
|--|---------------|--------|---------------|--------|

|  |                |         |                |         |
|--|----------------|---------|----------------|---------|
| Average market price of common stock used for calculation of dilutive shares | <b>\$36.23</b> | \$30.59 | <b>\$35.97</b> | \$28.53 |
|--|----------------|---------|----------------|---------|

**Net income/(loss) per share:**

|       |               |          |               |        |
|-------|---------------|----------|---------------|--------|
| Basic | <b>\$0.35</b> | (\$0.23) | <b>\$0.69</b> | \$0.13 |
|-------|---------------|----------|---------------|--------|

|         |               |          |               |        |
|---------|---------------|----------|---------------|--------|
| Diluted | <b>\$0.35</b> | (\$0.23) | <b>\$0.68</b> | \$0.13 |
|---------|---------------|----------|---------------|--------|

As a result of a net loss in the second quarter of 2013, the potential dilutive effect of stock-based compensation plans was not included in the computation of the diluted earnings per share because to do so would have been antidilutive.

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

|                | Class A Shares | Class B Shares | Less: Treasury Shares | Net shares Outstanding |
|----------------|----------------|----------------|-----------------------|------------------------|
| June 30, 2014  | 37,064,939     | 3,235,048      | (8,459,498)           | 31,840,489             |
| March 31, 2014 | 37,050,389     | 3,235,048      | (8,463,635)           | 31,821,802             |
| June 30, 2013  | 36,875,127     | 3,236,098      | (8,463,635)           | 31,647,590             |

**9. Accumulated Other Comprehensive Income**

The table below presents changes in the components of Accumulated Other Comprehensive Income for the period December 31, 2013 to June 30, 2014:

| (in thousands)  | Translation<br>adjustments | Pension and<br>postretirement<br>liability<br>adjustments | Derivative<br>valuation<br>adjustment | Total Other<br>Comprehensive<br>Income |
|---|----------------------------|---|---------------------------------------|--|
| <b>Balance, December 31, 2013</b>   | <b>(\$138)</b>             | <b>(\$48,383)</b>   | <b>(\$977)</b>                        | <b>(\$49,498)</b>                      |
| Other comprehensive income before reclassifications   | (1,838)                    | (102)   | (802)                                 | (2,742)                                |
| Interest expense related to swaps reclassified to the Statements of Income, net of tax            | -                          | -   | 580                                   | 580                                    |
| Pension and postretirement liability adjustments reclassified to Statements of Income, net of tax | -                          | 280   | -                                     | 280                                    |
| Net current period other comprehensive income   | (1,838)                    | 178   | (222)                                 | (1,882)                                |
| <b>Balance, June 30, 2014</b>   | <b>(\$1,976)</b>           | <b>(\$48,205)</b>   | <b>(\$1,199)</b>                      | <b>(\$51,380)</b>                      |

The components of our Accumulated Other Comprehensive Income that are reclassified to the Statements of Income relate to our pension and postretirement plans and interest rate swaps. The table below presents the amounts reclassified, and the line items of the Statements of Income that were affected:

| Expense/(income)(in thousands)   | Three months<br>ended<br>June 30,<br><b>2014</b> |         | Six months<br>ended<br>June 30,<br><b>2014</b> |           |
|--|--|---------|--|-----------|
|  | 2013   | 2013    | 2013   | 2013      |
| <b>Pretax Derivative valuation reclassified from Accumulated Other Comprehensive Income:</b>                   |  |         |  |           |
| Payments made on interest rate swaps included in earnings  | <b>\$473</b>                                     | \$454   | <b>\$951</b>                                   | \$910     |
| Income tax effect  | <b>(184)</b>                                     | (177)   | <b>(371)</b>                                   | (354)     |
| Effect on net income due to items reclassified from Accumulated Other Comprehensive Income                     | <b>\$289</b>                                     | \$277   | <b>\$580</b>                                   | \$556     |
| <b>Pretax pension and postretirement liabilities reclassified from Accumulated Other Comprehensive Income:</b> |  |         |  |           |
| Amortization of prior service cost/(credit)  | <b>(\$1,108)</b>                                 | (\$909) | <b>(\$2,217)</b>                               | (\$1,817) |
| Amortization of transition obligation  | -  | 17      | -  | 34        |
| Amortization of net actuarial loss   | <b>1,355</b>                                     | 1,664   | <b>2,683</b>                                   | 3,328     |
| Total pretax amount reclassified (a)   | <b>247</b>                                       | 772     | <b>466</b>                                     | 1,545     |
| Income tax effect  | <b>(98)</b>                                      | (271)   | <b>(186)</b>                                   | (541)     |
| Effect on net income due to items reclassified from Accumulated Other Comprehensive Income                     | <b>\$149</b>                                     | \$501   | <b>\$280</b>                                   | \$1,004   |

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see Note 4).



**10. Accounts Receivable**

Accounts receivable includes trade receivables and revenue in excess of progress billings on long-term contracts in the Albany Engineered Composites business. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company determines the allowance based on historical write-off experience, customer-specific facts and economic conditions. 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.

The components of Accounts receivable are summarized below:

| (in thousands)                         | <b>June 30, 2014</b> | December 31, 2013 |
|--|----------------------|-------------------|
| Trade accounts receivable              | <b>\$147,304</b>     | \$154,296         |
| Revenue in excess of progress billings | <b>11,046</b>        | 20,525            |
| Less: allowance for doubtful accounts  | <b>(9,877)</b>       | (11,274)          |
| Total Accounts Receivable              | <b>\$148,473</b>     | \$163,547         |

**11. Inventories**

Inventories are stated at the lower of cost or market, and are valued at average cost, net of reserves. The Company maintains reserves for possible impairment in the value of inventories. Such reserves can be specific to certain inventory, or general based on judgments about the overall condition of the inventory. General reserves are established based on percentage write-downs applied to aged inventories, or for inventories that are slow-moving. If actual results differ from estimates, additional inventory write-downs may be necessary. These general reserves for aged inventory are relieved through income only when the inventory is sold.

As of June 30, 2014 and December 31, 2013, inventories consisted of the following:

| (in thousands)    | <b>June 30, 2014</b> | December 31, 2013 |
|-------------------|----------------------|-------------------|
| Raw materials     | <b>\$29,322</b>      | \$25,754          |
| Work in process   | <b>50,132</b>        | 45,998            |
| Finished goods    | <b>44,435</b>        | 40,987            |
| Total inventories | <b>\$123,889</b>     | \$112,739         |

During the second quarter of 2014, the Company identified an error in the value of Machine Clothing inventories reported in prior periods. Included in cost of goods sold for the second quarter is a charge of \$1.6 million to correct the errors by reducing inventories to their proper carrying values. The error relates to intercompany transfers of inventory and originated when the Company transitioned to a new ERP system in the Americas in 2008 and Europe in 2011.

**12. Goodwill and Other Intangible Assets**

Goodwill and intangible assets with indefinite useful lives are not amortized, but are tested for impairment at least annually. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination. Our reporting units are consistent with our operating segments.



Determining the fair value of a reporting unit requires the use of significant estimates and assumptions, including revenue growth rates, operating margins, discount rates, and future market conditions, among others. 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.

To determine fair value, we utilize two market-based approaches and an income approach. Under the market-based approaches, we utilize information regarding the Company as well as publicly available industry information to determine earnings multiples and sales multiples. Under the income approach, we determine fair value based on estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn.

The entire balance of goodwill on our books is attributable to the Machine Clothing business. In the second quarter of 2014, the Company applied the qualitative assessment approach in performing its annual evaluation of goodwill and concluded that no impairment provision was required. In addition, there were no amounts at risk due to the large spread between the fair and carrying values.

We are continuing to amortize certain patents, trade names, customer contracts and technology assets that have finite lives. The changes in intangible assets and goodwill from December 31, 2013 to June 30, 2014, were as follows:

| (in thousands)                    | <b>Balance at<br/>December 31, 2013</b> | <b>Amortization</b> | <b>Currency<br/>Translation</b> | <b>Balance at<br/>June 30, 2014</b> |
|-----------------------------------|---|---------------------|---------------------------------|-------------------------------------|
| Amortized intangible assets:      |   |                     |                                 |                                     |
| AEC trade names                   | \$33                                    | (\$2)               | \$-                             | \$31                                |
| AEC customer contracts            | 404                                     | (101)               | -                               | 303                                 |
| AEC technology                    | 179                                     | (12)                | -                               | 167                                 |
| Total amortized intangible assets | \$616                                   | (\$115)             | \$-                             | \$501                               |
| Unamortized intangible assets:    |   |                     |                                 |                                     |
| Goodwill                          | \$78,890                                | \$-                 | (\$255)                         | \$78,635                            |

Estimated amortization expense of intangibles for the years ending December 31, 2014 through 2018, is as follows:

| <b>Annual amortization</b> |                       |
|----------------------------|-----------------------|
| <b>Year</b>                | <b>(in thousands)</b> |
| 2014                       | \$231                 |
| 2015                       | 231                   |
| 2016                       | 29                    |
| 2017                       | 29                    |
| 2018                       | 29                    |



**13. Financial Instruments**

Long-term debt, principally to banks and bondholders, consists of:

| (in thousands, except interest rates)   | <b>June 30,<br/>2014</b> | December 31,<br>2013 |
|---|--------------------------|----------------------|
| Private placement with a fixed interest rate of 6.84%, due 2015 through 2017  | <b>\$100,000</b>         | \$100,000            |
| Credit agreement with borrowings outstanding at an end of period interest rate of 2.62% in 2014 and 2.53% in 2013 (including the effect of interest rate hedging transactions, as described below), due in 2018 | <b>183,000</b>           | 200,000              |
| Various notes and mortgages relative to operations principally outside the United States, at an average end of period rate of 3.13% in 2014 and 3.10% in 2013, due in varying amounts through 2021              | <b>1,369</b>             | 3,875                |
| Long-term debt  | <b>284,369</b>           | 303,875              |
| Less: current portion   | <b>(1,265)</b>           | (3,764)              |
| Long-term debt, net of current portion  | <b>\$283,104</b>         | \$300,111            |

A note agreement and guaranty (“Prudential Agreement”) was entered into in October 2005, and was amended and restated as of September 17, 2010 and March 26, 2013, with the Prudential Insurance Company of America, and certain other purchasers with interest at 6.84% and a maturity date of October 25, 2017. The remaining obligation under the Prudential Agreement has a mandatory payment of \$50 million due on October 25, 2015, and the final payment is due October 25, 2017. 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, under certain market conditions. The Prudential Agreement contains customary terms, as well as affirmative covenants, negative covenants, and events of default comparable to those in our current principal credit facility (as described below). For disclosure purposes, we are required to measure the fair value of outstanding debt on a recurring basis. As of June 30, 2014, the fair value of this debt was approximately \$113.7 million, which was measured using active market interest rates, and would be considered Level 2 for fair value measurement purposes.

On March 26, 2013, we entered into a \$330 million, unsecured Five-Year Revolving Credit Facility Agreement (“Credit Agreement”), under which \$183 million of borrowings were outstanding as of June 30, 2014. The Credit Agreement replaces the previous \$390 million five-year Credit Agreement made in 2010. The applicable interest rate for borrowings under the Credit Agreement, as well as under the former agreement, is LIBOR plus a spread, based on our leverage ratio at the time of borrowing. At the time of the last borrowing on June 23, 2014, the spread was 1.375%. The spread is based on a pricing grid, which ranges from 1.25% to 1.875%, based on our leverage ratio.

Our ability to borrow additional amounts under the Credit Agreement is conditional upon the absence of any defaults, as well as the absence of any material adverse change. Based on our maximum leverage ratio and our consolidated EBITDA (as defined in the Credit Agreement), and without modification to any other credit agreements, as of June 30, 2014, we would have been able to borrow an additional \$147 million under our agreement.

On July 16, 2010, we entered into interest rate hedging transactions that have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$105 million of the indebtedness drawn under the Credit Agreement at the rate of 2.04% until July 16, 2015. Under the terms of these transactions, we pay the fixed rate of 2.04% and the counterparties pay a floating rate based on the three-month LIBOR rate at each quarterly calculation date, which on April 16, 2014 was 0.23%. The net effect is to fix the effective interest rate on \$105 million of indebtedness at 2.04%, plus the applicable spread, until these swap agreements expire. On June 30, 2014, the all-in rate on the \$105 million of debt was 3.415%.

On May 20, 2013, we entered into interest rate hedging transactions for the period July 16, 2015 through March 16, 2018. These transactions have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$110 million of indebtedness drawn under the Credit Agreement at the rate of 1.414% during this period. Under the terms of these transactions, we pay the fixed rate of 1.414% and the counterparties pay a floating rate based on the one-month LIBOR rate at each monthly calculation date, which on June 30, 2014 was 0.1552%. The net effect is to fix the effective interest rate on \$110 million of indebtedness at 1.414%, plus the applicable spread, during the swap period.

These interest rate swaps are accounted for as a hedge of future cash flows, as further described in Note 14 of the Notes to Consolidated Financial Statements. No cash collateral was received or pledged in relation to the swap agreements.

Under the Credit Agreement and Prudential Agreement, we are currently required to maintain a leverage ratio (as defined in the agreements) of not greater than 3.50 to 1.00 and minimum interest coverage (as defined) of 3.00 to 1.00.

As of June 30, 2014, our leverage ratio was 1.56 to 1.00 and our interest coverage ratio was 10.64 to 1.00. We may purchase our Common Stock or pay dividends to the extent our leverage ratio remains at or below 3.50 to 1.00, and may make acquisitions with cash provided our leverage ratio would not exceed 3.50 to 1.00 after giving pro forma effect to the acquisition.

Indebtedness under each of the Prudential Agreement and the Credit Agreement is ranked equally in right of payment to all unsecured senior debt.

We were in compliance with all debt covenants as of June 30, 2014.

#### ***14. Fair-Value Measurements***

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Accounting principles establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Level 3 inputs are unobservable data points for the asset or liability, and include situations in which there is little, if any, market activity for the asset or liability. As of June 30, 2014 and December 31, 2013, we have no Level 3 financial assets or liabilities.

The following table presents the fair-value hierarchy for our Level 1 and Level 2 financial assets and liabilities measured at fair value on a recurring basis:

| (in thousands)                             | June 30, 2014                             |   | December 31, 2013                         |   |
|--|---|---|---|---|
|  | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) |
| <b>Fair Value</b>                          |   |   |   |   |
| <i>Assets:</i>                             |   |   |   |   |
| Cash equivalents                           | \$33,990                                  | \$-   | \$25,073                                  | \$-   |
| Prepaid expenses and other current assets: |   |   |   |   |
| Foreign currency instruments               | 273                                       | -   | -   | -   |
| <i>Other Assets:</i>                       |   |   |   |   |
| Common stock of foreign public company     | 817                                       | -   | 952                                       | -   |
| Interest rate swap                         | -   | 372   | (a) -                                     | 1,517 (c)                                     |
| <i>Liabilities:</i>                        |   |   |   |   |
| <i>Other noncurrent liabilities:</i>       |   |   |   |   |
| Interest rate swap                         | -   | (2,337)                                       | (b) -                                     | (3,119) (d)                                   |

(a) Net of \$4.5 million receivable floating leg and \$4.1 million liability fixed leg

(b) Net of \$0.4 million receivable floating leg and \$2.7 million liability fixed leg

(c) Net of \$5.6 million receivable floating leg and \$4.1 million liability fixed leg

(d) Net of \$0.7 million receivable floating leg and \$3.8 million liability fixed leg

During the six months ended June 30, 2014, there were no transfers between levels 1, 2, and 3.

Cash equivalents include short-term securities that are considered to be highly liquid and easily tradable. These securities are valued using inputs observable in active markets for identical securities.

The common stock of a foreign public company is traded in an active market exchange. The shares are measured at fair value using closing stock prices and are recorded in the Consolidated Balance Sheets as Other assets. The securities are classified as available for sale, and as a result any unrealized gain or loss is recorded in the Shareholders' Equity section of the Consolidated Balance Sheets rather than in the Consolidated Statements of Income. When the security is sold or impaired, gains and losses are reported on the Consolidated Statements of Income. Investments are considered to be impaired when a decline in fair value is judged to be other than temporary.

Foreign currency instruments are entered into periodically, and consist of foreign currency option contracts and forward contracts that are valued using quoted prices in active markets obtained from independent pricing sources. These instruments are measured using market foreign exchange prices and are recorded in the Consolidated Balance Sheets as Other current assets and Accounts payable, as applicable. Changes in fair value of these instruments are recorded as gains or losses within Other (income)/expenses, net. Gains totaled \$0.2 million for the six months ended June 30, 2014. There were no open contracts and no gains/(losses) for the six months ended June 30, 2013.

When exercised, the foreign currency instruments are net settled with the same financial institution that bought or sold them. For all positions, whether options or forward contracts, there is risk from the possible inability of the financial institution to meet the terms of the contracts and the risk of unfavorable changes in interest and currency rates, which may reduce the value of the instruments. We seek to control risk by evaluating the creditworthiness of counterparties and by monitoring the currency exchange and interest rate markets while reviewing the hedging risks and contracts to ensure compliance with our internal guidelines and policies.

We operate our business in many regions of the world, and currency rate movements can have a significant effect on operating results.

Changes in exchange rates can result in revaluation gains and losses that are recorded in Selling, General and Administrative expenses or Other (income)/expenses, net. Revaluation gains and losses occur when our business units have cash, intercompany (recorded in Other (income)/expenses, net or third-party trade receivable or payable balances (recorded in Selling, General and Administrative expenses) in a currency other than their local reporting (or functional) currency.

Operating results can also be affected by the translation of sales and costs, for each non-U.S. subsidiary, from the local functional currency to the U.S. dollar. The translation effect on the income statement is dependent on our net income or expense position in each non-U.S. currency in which we do business. A net income position exists when sales realized in a particular currency exceed expenses paid in that currency; a net expense position exists if the opposite is true.

The interest rate swaps are accounted for as hedges of future cash flows. The fair value of our interest rate swaps are derived from a discounted cash flow analysis based on the terms of the contract and the interest rate curve, and is included in Other assets and Other noncurrent liabilities in the Consolidated Balance Sheets. Unrealized gains and losses on the swaps will flow through the caption Derivative valuation adjustment in the Shareholders' equity section of the Consolidated Balance Sheets, to the extent that the hedges are highly effective. As of June 30, 2014, these interest rate swaps were determined to be 100% effective hedges of interest rate cash flow risk. Gains and losses related to the ineffective portion of the hedges will be recognized in the current period in earnings. Amounts accumulated in Other comprehensive income are reclassified as Interest expense, net when the related interest payments (that is, the hedged forecasted transactions) affect earnings. Interest expense related to the swaps totaled \$1.0 million and \$0.9 million for the six month periods ended June 30, 2014 and 2013, respectively.

Gains/ (losses) related to changes in fair value of derivative instruments that were recognized in Other (income)/expenses, net in the Statements of Income were as follows:

|   | Three<br>months<br>ended<br>June 30,<br><b>2014</b> | Six<br>months<br>ended<br>June 30,<br><b>2013</b> | Three<br>months<br>ended<br>June 30,<br><b>2014</b> | Six<br>months<br>ended<br>June 30,<br><b>2013</b> |
|---|---|---|---|---|
| (in thousands)                                    |   |   |   |   |
| Derivatives not designated as hedging instruments |   |   |   |   |
| Forward exchange options                          | \$80  | \$-   | \$154   | \$-   |

**15. Contingencies****Asbestos Litigation**

Albany International Corp. 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 that we previously manufactured. We 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.

We were defending 4,217 claims as of June 30, 2014.

The following table sets forth the number of claims filed, the number of claims settled, dismissed or otherwise resolved, and the aggregate settlement amount during the periods presented:

| <b>Year ended<br/>December 31,</b> | <b>Opening<br/>Number of<br/>Claims</b> | <b>Claims<br/>Dismissed,<br/>Settled, or<br/>Resolved</b> | <b>New Claims</b> | <b>Closing<br/>Number of<br/>Claims</b> | <b>Amounts Paid<br/>(thousands) to<br/>Settle or<br/>Resolve</b> |
|------------------------------------|---|---|-------------------|---|--|
| 2005                               | 29,411                                  | 6,257   | 1,297             | 24,451                                  | \$504  |
| 2006                               | 24,451                                  | 6,841   | 1,806             | 19,416                                  | 3,879  |
| 2007                               | 19,416                                  | 808   | 190               | 18,798                                  | 15   |
| 2008                               | 18,798                                  | 523   | 110               | 18,385                                  | 52   |
| 2009                               | 18,385                                  | 9,482   | 42                | 8,945                                   | 88   |
| 2010                               | 8,945                                   | 3,963   | 188               | 5,170                                   | 159  |
| 2011                               | 5,170                                   | 789   | 65                | 4,446                                   | 1,111  |
| 2012                               | 4,446                                   | 90  | 107               | 4,463                                   | 530  |
| 2013                               | 4,463                                   | 233   | 85                | 4,315                                   | 82   |
| <b>As of June 30, 2014</b>         | <b>4,315</b>                            | <b>149</b>  | <b>51</b>         | <b>4,217</b>                            | <b>\$433</b>   |

We anticipate that additional claims will be filed against the Company and related companies in the future, but are unable to predict the number and timing of such future claims.

Exposure and disease information sufficient to meaningfully estimate a range of possible loss of a particular claim is typically not available until late in the discovery process, and often not until a trial date is imminent and a settlement demand has been received. For these reasons, we do not believe a meaningful estimate can be made regarding the range of possible loss with respect to pending or future claims.

While we believe we have meritorious defenses to these claims, we have settled certain claims for amounts we consider reasonable given the facts and circumstances of each case. Our insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of June 30, 2014 we had resolved, by means of settlement or dismissal, 36,752 claims. The total cost of resolving all claims was \$9.2 million. Of this amount, almost 100% was paid by our insurance carrier. The Company's insurer has confirmed that although the coverage limits under two (of approximately 23) primary insurance policies have been exhausted, there still remains approximately \$3 million in coverage limits under other applicable primary policies, and \$140 million in coverage under excess umbrella coverage policies that should be available with respect to current and future asbestos claims.

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 7,732 claims as of June 30, 2014.

The following table sets forth the number of claims filed, the number of claims settled, dismissed or otherwise resolved, and the aggregate settlement amount during the periods presented:

| <b>Year ended<br/>December 31,</b> | <b>Opening<br/>Number of<br/>Claims</b> | <b>Claims<br/>Dismissed,<br/>Settled, or<br/>Resolved</b> | <b>New Claims</b> | <b>Closing<br/>Number of<br/>Claims</b> | <b>Amounts Paid<br/>(thousands) to<br/>Settle or<br/>Resolve</b> |
|------------------------------------|---|---|-------------------|---|--|
| 2005                               | 9,985                                   | 642   | 223               | 9,566                                   | \$-  |
| 2006                               | 9,566                                   | 1,182   | 730               | 9,114                                   | -  |
| 2007                               | 9,114                                   | 462   | 88                | 8,740                                   | -  |
| 2008                               | 8,740                                   | 86  | 10                | 8,664                                   | -  |
| 2009                               | 8,664                                   | 760   | 3                 | 7,907                                   | -  |
| 2010                               | 7,907                                   | 47  | 9                 | 7,869                                   | -  |
| 2011                               | 7,869                                   | 3   | 11                | 7,877                                   | -  |
| 2012                               | 7,877                                   | 12  | 2                 | 7,867                                   | -  |
| 2013                               | 7,867                                   | 55  | 3                 | 7,815                                   | -  |
| <b>As of June 30, 2014</b>         | <b>7,815</b>                            | <b>85</b>   | <b>2</b>          | <b>7,732</b>                            | <b>\$-</b>   |

We 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. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. 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. As of June 30, 2014, Brandon has resolved, by means of settlement or dismissal, 9,873 claims for a total of \$0.2 million. 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.

For the same reasons set forth above with respect to Albany’s claims, as well as the fact that no amounts have been paid to resolve any Brandon claims since 2001, we do not believe a meaningful estimate can be made regarding the range of possible loss with respect to these remaining claims.

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”). We 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. We deny 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, we have successfully moved for dismissal in a number of actions.

Although we do 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 our understanding of the insurance policies available, how settlement amounts have been allocated to various policies, our 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, we currently do not anticipate any material liability relating to the resolution of the aforementioned pending proceedings in excess of existing insurance limits.

Consequently, we currently do 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 we cannot predict the number and timing of future claims, based on the foregoing factors and the trends in claims against us to date, we do not anticipate that additional claims likely to be filed against us in the future will have a material adverse effect on our financial position, results of operations, or cash flows. We are aware that litigation is inherently uncertain, especially when the outcome is dependent primarily on determinations of factual matters to be made by juries.

### 16. Changes in Shareholders' Equity

The following table summarizes changes in Shareholders' Equity:

| (in thousands)   | Class A<br>Common<br>Stock | Class B<br>Common<br>Stock | Additional<br>paid<br>in capital | Retained<br>earnings | Accumulated<br>items of other<br>comprehensive<br>income | Treasury<br>stock  | Noncontrolling<br>Interest |
|--|----------------------------|----------------------------|----------------------------------|----------------------|--|--------------------|----------------------------|
| <b>December 31, 2013</b>   | <b>\$37</b>                | <b>\$3</b>                 | <b>\$416,728</b>                 | <b>\$434,598</b>     | <b>(\$49,498)</b>  | <b>(\$257,571)</b> | <b>\$3,482</b>             |
| Net income   | -                          | -                          | -                                | 21,840               | -  | -                  | 30                         |
| Dividends declared   | -                          | -                          | -                                | (9,868)              | -  | -                  | -                          |
| Compensation and benefits paid or payable<br>in Class A Common Stock | -                          | -                          | 798                              | -                    | -  | -                  | -                          |
| Options exercised  | -                          | -                          | 531                              | -                    | -  | -                  | -                          |
| Shares issued to Directors'  | -                          | -                          | 60                               | -                    | -  | 90                 | -                          |
| Cumulative translation adjustment                                    | -                          | -                          | -                                | -                    | (1,838)  | -                  | -                          |
| Change in pension liability adjustment                               | -                          | -                          | -                                | -                    | 178  | -                  | -                          |
| Change in derivative valuation adjustment                            | -                          | -                          | -                                | -                    | (222)  | -                  | -                          |
| <b>June 30, 2014</b>   | <b>\$37</b>                | <b>\$3</b>                 | <b>\$418,117</b>                 | <b>\$446,570</b>     | <b>(\$51,380)</b>  | <b>(\$257,481)</b> | <b>\$3,512</b>             |

### 17. Recent Accounting Pronouncements

In July 2013, amended accounting guidance was issued regarding the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. This guidance was adopted in the first quarter 2014 and had the effect of reducing noncurrent deferred tax assets and noncurrent deferred tax liabilities by \$7.1 million.

In April 2014, an accounting update was issued regarding which disposals qualify for reporting as discontinued operations. Additionally, new disclosures will apply for discontinued operations. This accounting update is to be applied prospectively to new disposals and new classifications of disposal groups as held for sale beginning in periods after December 15, 2014. We do not expect the adoption of this update to have a significant effect on our financial statements.

In June 2014, an accounting update was issued that replaces the existing revenue recognition framework regarding contracts with customers. This accounting update is effective for reporting periods beginning after December 15, 2016. We have not determined the impact of this update on our financial statements.

In June 2014, an accounting update was issued relating to accounting for share-based payments with a performance target that could be achieved after the requisite service period. The adoption of this accounting guidance will be effective for reporting periods beginning after December 15, 2015. We do not expect the adoption of this update to have a significant effect on our financial statements.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **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," "intend," "estimate," "anticipate," "project," "will," "and similar expressions identify forward-looking statements, which generally are not historical in nature.

Forward-looking statements are subject to certain risks and uncertainties (including, without limitation, those set forth in the Company's most recent Annual Report on Form 10-K or prior Quarterly Reports on Form 10-Q) that could cause actual results to differ materially from the Company's historical experience and our present expectations or projections.

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:

- Conditions in the industries in which our Machine Clothing segment competes, including the paper industry, along with general risks associated with economic downturns;
- Failure to remain competitive in the industries in which our Machine Clothing segment competes;
- Failure to have, achieve, or maintain anticipated profitable growth in our Engineered Composites segment; and
- Other risks and uncertainties detailed in this report.

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 "Business Environment and "Trends," "Liquidity," and "Legal Proceedings" sections of this quarterly report, as well as in the "Risk Factors," section of our most recent Annual Report on Form 10-K. Although we believe the expectations reflected in our 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 our 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, we disclaim 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 our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Management’s Discussion and Analysis (“MD&A”) is intended to help the reader understand the results of operations and financial condition of the Company. MD&A is provided as a supplement to, and should be read in conjunction with, our Consolidated Financial Statements and the accompanying Notes.

**Overview**

See Note 3, “Reportable Segments”, under Item 1, Financial Statements, for a discussion of recasting Research and Unallocated expenses to reportable segments.

Our reportable segments: Machine Clothing (MC) and Albany Engineered Composites (AEC), draw on many of the same advanced textiles and materials processing capabilities, and compete on the basis of proprietary, product-based advantage that is grounded in those core capabilities. As a result, technology and manufacturing advances in one tend to benefit the other.

MC is the Company’s long-established core business and primary generator of cash. While the paper and paperboard industry in our traditional geographic markets has suffered from well-documented overcapacity in publication grades, especially newsprint, the industry is still expected to grow on a global basis, driven by demand for packaging and tissue grades, as well as the expansion of paper consumption and production in Asia and South America. We feel we are now well-positioned in these markets, with high-quality, low-cost production in growth markets, substantially lower fixed costs in mature markets, and continued strength in new product development, field services, and manufacturing technology. Although we consider the market for Machine Clothing as having flat growth potential, the business has been a significant generator of cash, and we seek to maintain the cash-generating potential of this business by maintaining the low costs that we achieved through restructuring, and competing vigorously by using our differentiated products and services to reduce our customers’ total cost of operation and improve their paper quality.

We believe that AEC provides the greatest growth potential, both near and long term, for our Company. Our strategy is to grow organically by focusing our proprietary technology on high-value aerospace and defense applications that cannot be served effectively by conventional composites. AEC (including Albany Safran Composites, LLC (“ASC”), in which our customer SAFRAN Group owns a 10% noncontrolling interest) supplies a number of customers in the aerospace industry. AEC’s largest aerospace customer is the SAFRAN Group. Through ASC, AEC develops and sells composite aerospace components to SAFRAN, with the most significant program at present being the production of fan blades and other components for the LEAP engine. AEC (through ASC and otherwise) is also developing other new and potentially significant composite products for aerospace (engine and airframe) applications.

**Consolidated Results of Operations**

**Net sales**

The following table summarizes our net sales by business segment:

|                                    | Three months ended June 30, |           |          | Six months ended June 30, |           |          |
|------------------------------------|-----------------------------|-----------|----------|---------------------------|-----------|----------|
| (in thousands, except percentages) | 2014                        | 2013      | % Change | 2014                      | 2013      | % Change |
| Machine Clothing                   | \$172,809                   | \$177,536 | -2.7%    | \$336,897                 | \$344,946 | -2.3%    |

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|                              |                  |           |       |                  |           |       |
|------------------------------|------------------|-----------|-------|------------------|-----------|-------|
| Albany Engineered Composites | <b>20,709</b>    | 20,438    | 1.3%  | <b>36,928</b>    | 39,682    | -6.9% |
| Total                        | <b>\$193,518</b> | \$197,974 | -2.3% | <b>\$373,825</b> | \$384,628 | -2.8% |

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Net sales were affected by the following:

### *Three month comparison*

Changes in currency translation rates had the effect of increasing net sales by \$1.6 million during the second quarter of 2014 as compared to 2013.

The year-over-year decline in second-quarter MC sales was primarily attributable to North America; where sales were particularly strong in the second quarter of 2013. Sales in the rest of the world were at levels comparable to the second quarter 2013.

AEC sales rebounded to prior-year levels from the transitional effects of the change in LEAP invoicing terms discussed in the first quarter 2014.

- Excluding the effect of changes in currency translation rates:
- Total Company Net sales decreased 3.0% compared to the same period in 2013
- Net sales in MC decreased 3.6%
- Net sales in AEC increased 1.3%

### *Six month comparison*

Changes in currency translation rates had the effect of increasing net sales by \$2.4 million during 2014 as compared to 2013.

The year-over-year decline in the first six months MC sales was attributable to North America; where sales were particularly strong for the first six months of 2013. Sales in the rest of the world remained stable.

The decrease in AEC sales was principally due to the shift during the first quarter to larger scale LEAP part production, together with the related change in invoicing terms, resulting in a build-up of inventory and an associated temporary lag in sales.

- Excluding the effect of changes in currency translation rates:
- Total Company Net sales decreased 3.4% compared to the same period in 2013
- Net sales in MC decreased 3.0%
- Net sales in AEC decreased 6.9%

## **Gross Profit**

The following table summarizes gross profit by business segment:

|                                    | Three months ended<br>June 30, |          | Six months ended<br>June 30, |           |
|------------------------------------|--------------------------------|----------|------------------------------|-----------|
| (in thousands, except percentages) | <b>2014</b>                    | 2013     | <b>2014</b>                  | 2013      |
| Machine Clothing                   | <b>\$73,339</b>                | \$77,797 | <b>\$147,209</b>             | \$151,786 |
| Albany Engineered Composites       | <b>2,358</b>                   | 667      | <b>3,651</b>                 | 481       |
| Corporate expenses                 | <b>(354)</b>                   | (1,031)  | <b>(708)</b>                 | (2,065)   |
| Total                              | <b>\$75,343</b>                | \$77,433 | <b>\$150,152</b>             | \$150,202 |
| % of Net sales                     | <b>38.9%</b>                   | 39.1%    | <b>40.2%</b>                 | 39.1%     |

***Three month comparison***

The decrease in gross profit, compared to the same period in 2013, was principally due to the net effect of the following:

During the second quarter of 2014, the Company identified an error in the value of Machine Clothing inventories reported in prior periods. Included in cost of goods sold for the second quarter is a charge of \$1.6 million to correct the error by reducing inventories to their proper carrying values. The error relates to intercompany transfers of inventory and originated when the Company transitioned to a new ERP system in the Americas in 2008 and Europe in 2011.

Gross profit margins in MC decreased from 43.8 percent to 42.4 percent principally due to the \$1.6 million charge for the inventory valuation correction in 2014.

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AEC gross margin for the second quarter of 2014 was 11.4 percent compared to 3.3 percent in 2013 due to improvements in profitability of programs at the Company's Boerne, Texas facility.

Corporate expenses decreased \$0.7 million for the second quarter of 2014 primarily due to a change made during the third quarter of 2013 that reduced the U.S. postretirement life insurance benefit for retirees and eliminated the benefit for active employees.

***Six month comparison***

The decrease in gross profit during 2014 was principally due to the net effect of the following:

- A \$3.5 million decrease due to lower sales in MC.

- A charge of \$1.6 million to correct MC inventory values, as described above.

- A \$3.4 million increase due to higher gross profit margin in AEC due to improvements in profitability of programs at the Company's Boerne, Texas facility.

- Corporate expenses decreased \$1.4 million for the first six months of 2014 primarily due to a change made during the third quarter of 2013 that reduced the U.S. postretirement life insurance benefit for retirees and eliminated the benefit for active employees.

**Selling, Technical, General, and Research (STG&R)**

The following table summarizes STG&R by business segment:

| (in thousands)               | Three months ended |          | Six months ended |           |
|------------------------------|--------------------|----------|------------------|-----------|
|                              | June 30, 2014      | 2013     | June 30, 2014    | 2013      |
| Machine Clothing             | <b>\$38,162</b>    | \$38,745 | <b>\$75,027</b>  | \$74,985  |
| Albany Engineered Composites | <b>5,244</b>       | 5,255    | <b>9,693</b>     | 9,028     |
| Corporate expenses           | <b>11,003</b>      | 12,625   | <b>22,715</b>    | 22,227    |
| Total                        | <b>\$54,409</b>    | \$56,625 | <b>\$107,435</b> | \$106,240 |
| % of Net sales               | <b>28.1%</b>       | 28.6%    | <b>28.7%</b>     | 27.6%     |

***Three month comparison***

STG&R expenses decreased \$2.2 million, compared to the same period in 2013, principally due to the net effect of the following:

- Revaluation of nonfunctional currency assets and liabilities resulted in losses of \$0.4 million during the second quarter of 2014 and gains of \$0.5 million in the comparable quarter of 2013.

- Corporate expenses in the second quarter of 2013 included \$1.0 million of increased legal expenses and accrual adjustments for the Company's self-insured medical program.

·Currency translation increased STG&R expenses by \$0.2 million.

**Six month comparison**

STG&R expenses increased \$1.2 million, compared to the same period in 2013, principally due to the net effect of the following:

- Revaluation of nonfunctional currency assets and liabilities resulted in losses of \$0.6 million during the first six months of 2014 and gains of \$1.2 million in comparable period of 2013.
- A gain on the sale of former manufacturing facility in Australia reduced 2013 expenses by \$3.8 million.
- Corporate expenses for the first six months of 2013 included \$1.7 million of increased legal expenses and accrual adjustments for the Company's self-insured medical program.
- Currency translation decreased STG&R expense by \$0.3 million.

**Research and Development**

The following table summarizes expenses associated with internally funded research and development by business segment:

| (in thousands)               | Three months ended |         | Six months ended |          |
|------------------------------|--------------------|---------|------------------|----------|
|                              | June 30, 2014      | 2013    | June 30, 2014    | 2013     |
| Machine Clothing             | \$5,185            | \$4,815 | \$10,022         | \$9,201  |
| Albany Engineered Composites | 2,267              | 2,507   | 4,586            | 4,447    |
| Corporate expenses           | 199                | 351     | 391              | 1,016    |
| Total                        | \$7,651            | \$7,673 | \$14,999         | \$14,664 |

**Restructuring Expense**

In addition to the items discussed above affecting gross profit and STG&R, operating income was affected by restructuring costs of \$2.0 million in the second quarter of 2014 and \$24.3 million in the second quarter of 2013.

The following table summarizes restructuring expense by business segment:

|  | Three months ended | Six months ended |
|--|--------------------|------------------|
|  | June 30,           | June 30,         |
|  |                    |                  |

| (in thousands)               | <b>2014</b>    | 2013     | <b>2014</b>    | 2013     |
|------------------------------|----------------|----------|----------------|----------|
| Machine Clothing             | <b>\$1,297</b> | \$24,230 | <b>\$2,159</b> | \$24,423 |
| Albany Engineered Composites | <b>660</b>     | 91       | <b>980</b>     | 534      |
| Total                        | <b>\$1,957</b> | \$24,321 | <b>\$3,139</b> | \$24,957 |

Machine Clothing restructuring expense was principally related to the reduction in manufacturing capacity at production facilities in France. Restructuring expenses in the Albany Engineered Composites operations were principally related to organizational changes and exiting certain aerospace programs.

During the second quarter of 2013, the Company commenced a program to restructure operations at the Company's Machine Clothing production facilities in France. The restructuring, when completed, will have reduced employment by approximately 200 positions at these locations. As of June 30, 2014, approximately 190 positions had been eliminated. Accordingly, the Company is now realizing substantially all of the expected \$10 million of annual cost savings, which principally impacts the cost of goods sold line in the Statements of Income.

Under the terms of the restructuring plan, the Company provides training, outplacement and other benefits, the costs of which are recorded as restructuring when they are incurred. The Company recorded a curtailment gain of \$0.2 million in the second quarter of 2014 and \$0.7 million for the first six months of 2014 related to the elimination of pension accruals, which reduced net restructuring expense as reflected in the table above. Such curtailment gains are recorded as employees terminate employment and, accordingly, we expect to record additional gains during 2014. Remaining costs for this program are expected to be between \$1 and \$3 million, most of which we expect to be incurred in 2014.



For more information on our restructuring charges, see Note 5 to the Consolidated Financial Statements in Item 1, which is incorporated herein by reference.

### Operating Income/(loss)

The following table summarizes operating income/(loss) by business segment:

| (in thousands)               | Three months ended<br>June 30, |           | Six months ended<br>June 30, |          |
|------------------------------|--------------------------------|-----------|------------------------------|----------|
|                              | <b>2014</b>                    | 2013      | <b>2014</b>                  | 2013     |
| Machine Clothing             | <b>\$33,879</b>                | \$14,821  | <b>\$70,022</b>              | \$52,377 |
| Albany Engineered Composites | <b>(3,545)</b>                 | (4,678)   | <b>(7,021)</b>               | (9,081)  |
| Corporate expenses           | <b>(11,357)</b>                | (13,656)  | <b>(23,423)</b>              | (24,291) |
| Total                        | <b>\$18,977</b>                | (\$3,513) | <b>\$39,578</b>              | \$19,005 |

### Other Earnings Items

#### Interest Expense, net

Second quarter Interest expense, net, decreased \$0.8 million principally due to lower average interest rates that resulted from using the revolving credit facility for the first \$50 million payment under the Prudential Agreement. For more information on borrowings and interest rates, see Note 13 to the Consolidated Financial Statements in Item 1, which is incorporated herein by reference.

#### Other (Income)/Expenses, net

Other (income)/expenses, net included the following:

##### *Three month comparison*

Foreign currency revaluations of intercompany balances resulted in gains of \$1.4 million during the second quarter of 2014 and losses of \$1.9 million in the second quarter 2013 income.

In July 2013, the Company's MC manufacturing facility in Germany was damaged by severe weather. At that time, the Company expensed the remaining book value of the damaged property, but that value was minimal. In the second quarter of 2014, we recorded a gain of \$1.0 million, which was equal to the proceeds received.

##### *Six month comparison*

Foreign currency revaluations of intercompany balances resulted in gains of \$1.9 million for the first six months of 2014 and \$1.9 million loss for the comparable period of 2013.

Bank fees and amortization of debt issuance costs were \$0.6 million in the first six months of 2014 and \$1.0 million for the comparable period of 2013.

The insurance recovery gain described above resulted in income of \$1.0 million for the first six months of 2014.

### **Income Tax**

The Company has operations which constitute a taxable presence in 19 countries outside of the United States. All of these countries except one had income tax rates that were lower than the United States federal tax rate of 35% during the periods reported. The jurisdictional location of earnings is a significant component of our effective tax rate each year, and therefore, on our overall income tax expense.

***Three month comparison***

The Company's effective tax rate for the second quarters of 2014 and 2013 was 41.4% and 24.2%, respectively. The tax rate is affected by recurring items, such as the income tax rate in the U.S. and in non-U.S. jurisdictions, and the mix of income earned in those jurisdictions. The rate is also affected by U.S. tax costs on foreign earnings that have been or will be repatriated to the U.S., and discrete items that may occur in any given year but are not consistent from year to year.

Significant items that impacted the tax rate in the second quarter of 2014 included the following (percentages reflect the effect of each item as a percentage of income excluding insurance recovery gain and before income taxes):

- A discrete charge of \$0.4 million (2.5%) for a change to the beginning of year valuation allowance.
- A \$0.4 million (2.4%) net tax expense related to other discrete items and the effect of a change in the estimated tax rate for the year.
- A \$0.3 million (0.7%) tax charge related to other discrete items.
- The income tax rate on continuing operations, excluding discrete items, was 36.5%.

Significant items that impacted the second quarter of 2013 tax rate included the following:

- A \$1.4 million (14.8%) net charge related to discrete items and the effect of a change in the estimated tax rate for the year.
- The income tax rate on continuing operations, excluding discrete items, was 39.0%.

***Six month comparison***

The Company's effective tax rate for the first six-month periods of 2014 and 2013 were 41.2% and 47.2%, respectively. The tax rate is affected by recurring items, such as the income tax rate in the U.S. and in non-U.S. jurisdictions and the mix of income earned in those jurisdictions. The tax rate is also affected by U.S. tax costs on foreign earnings that have been or will be repatriated to the U.S., and discrete items that may occur in any given year but are not consistent from year to year.

Significant items that impacted the 2014 tax rate included the following (percentages reflect the effect of each item as a percentage of income excluding the insurance recovery gain and before income taxes):

- A \$1.0 million (2.8%) discrete income tax expense related to provisions for and settlements of income tax audits.
- Discrete tax expense for a change to the beginning of year valuation allowance in the amount of \$0.4 million (1.2%).
- The income tax rate on continuing operations, excluding discrete items, was 36.5%.

Significant items that impacted the 2013 tax rate included the following:

- A \$0.7 million (8.2%) net tax expense related to discrete items.
- The income tax rate on continuing operations, excluding discrete items, was 39.0%.

## Segment Results of Operations

## Machine Clothing Segment

## Business Environment and Trends

MC is our primary business segment and accounted for nearly 90% of our consolidated revenues during the first six months of 2014. Machine clothing is purchased primarily by manufacturers of paper and paperboard.

According to RISI, Inc., global production of paper and paperboard is expected to grow at an annual rate of approximately 2% over the next five years, driven primarily by secular demand increases in Asia and South America, with stabilization in the mature markets of Europe and North America.

Shifting demand for paper, across different paper grades as well as across geographical regions, continues to drive the elimination of papermaking capacity in areas with significant established capacity, primarily in the mature markets of Europe and North America. At the same time, the newest, most efficient machines are being installed in areas of growing demand, including Asia and South America generally, as well as tissue and towel paper grades in all regions. Recent technological advances in Paper Machine Clothing, while contributing to the papermaking efficiency of customers, have lengthened the useful life of many of our products and had an adverse impact on overall paper machine clothing demand. These factors help to explain why Paper Machine Clothing revenue growth grows at a lesser rate than growth in paper production.

The Company's manufacturing and product platforms position us well to meet these shifting demands across product grades and geographic regions. Our strategy for meeting these challenges continues to be to grow share in all markets, with new products and technology, and to maintain our manufacturing footprint to align with global demand, while we offset the effects of inflation through continuous productivity improvement.

We have incurred significant restructuring charges in recent periods as we reduced Paper Machine Clothing manufacturing capacity in the United States, Canada, Germany, Finland, France, the Netherlands, Sweden, and Australia.

## Review of Operations

|                                    | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|------------------------------------|--------------------------------|-----------|------------------------------|-----------|
| (in thousands, except percentages) | <b>2014</b>                    | 2013      | <b>2014</b>                  | 2013      |
| Net sales                          | <b>\$172,809</b>               | \$177,536 | <b>\$336,897</b>             | \$344,946 |
| Gross profit                       | <b>73,339</b>                  | 77,797    | <b>147,209</b>               | 151,786   |
| % of net sales                     | <b>42.4%</b>                   | 43.8%     | <b>43.7%</b>                 | 44.0%     |
| Operating income                   | <b>33,879</b>                  | 14,821    | <b>70,022</b>                | 52,377    |

Net Sales

Net sales were affected by the following:

***Three month comparison***

- Changes in currency translation rates had the effect of increasing 2014 sales by \$1.6 million. Excluding the effect of changes in currency translation rates, sales decreased 3.5% compared to the same period in 2013.
- The year-over-year decline in second-quarter MC sales was primarily attributable to North America; where sales were particularly strong in the second quarter of 2013. Sales in the rest of the world remained stable and were at levels comparable to the second quarter 2013.

***Six month comparison***

- Changes in currency translation rates had the effect of increasing 2014 sales by \$2.4 million. The year-over-year decline in the first six months MC sales was primarily attributable to North America; where sales were particularly strong for the first six months of 2013. Sales in the rest of the world remained stable. Excluding the effect of changes in currency translation rates, sales decreased 3.0% compared to the same period in 2013.

## **Gross Profit**

### ***Three month comparison***

The decrease in gross profit was principally due to the net effect of the following:

- A \$2.5 million decrease due to lower gross margin, including a charge of \$1.6 million for the inventory valuation error noted above.
- A \$2.1 million decrease due to lower sales.

### ***Six month comparison***

The decrease in gross profit was principally due to the net effect of the following:

- A \$3.5 million decrease due to lower sales.
- A \$1.1 million decrease due to lower gross margin, including the charge for of the inventory valuation error noted above.

## **Operating Income/(loss)**

The increase in operating income was principally due to the net effect of the following:

### ***Three month comparison***

- Restructuring charges of \$1.3 million in the second quarter 2014, compared to \$24.2 million in 2013.
- Revaluation of nonfunctional currency assets and liabilities resulted in second quarter losses of \$0.4 million in 2014, compared to gains of \$0.5 million in 2013.

### ***Six month comparison***

- Restructuring charges of \$2.2 million in the first six months of 2014, compared to \$24.4 million in 2013.
- Revaluation of nonfunctional currency assets and liabilities resulted in losses of \$0.5 million for the first six months of 2014, compared to \$1.2 million of gains in 2013.

## **Albany Engineered Composites Segment**

### **Business Environment and Trends**

The Albany Engineered Composites segment (AEC), including Albany Safran Composites, LLC (ASC), in which our customer SAFRAN Group owns a 10 percent noncontrolling interest, provides custom-designed advanced composite structures based on proprietary technology to customers in the aerospace and defense industries. AEC's largest current development program relates to the LEAP engine being developed by CFM International. Under this program, AEC, through ASC, is developing a family of composite parts, including fan blades, to be incorporated into the LEAP engine. In 2013, approximately 10 percent of this segment's sales were related to U.S. government contracts or programs.

## Review of Operations

|                                    | Three months<br>ended<br>June 30, |          | Six months<br>ended<br>June 30, |          |
|------------------------------------|-----------------------------------|----------|---------------------------------|----------|
| (in thousands, except percentages) | <b>2014</b>                       | 2013     | <b>2014</b>                     | 2013     |
| Net sales                          | <b>\$20,709</b>                   | \$20,438 | <b>\$36,928</b>                 | \$39,682 |
| Gross profit                       | <b>2,358</b>                      | 667      | <b>3,651</b>                    | 481      |
| % of net sales                     | <b>11.4%</b>                      | 3.3%     | <b>9.9%</b>                     | 1.2%     |
| Operating income/(loss)            | <b>(3,545)</b>                    | (4,678)  | <b>(7,021)</b>                  | (9,081)  |

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**Net Sales*****Three and six month comparisons***

AEC sales rebounded from the transitional effects of the change in LEAP invoicing terms discussed in the first quarter 2014.

Sales for the first six months of 2014 were lower than 2013 due to the shift during the first quarter to larger scale LEAP part production, together with the related change in invoicing terms, resulting in a build-up of inventory and an associated temporary lag in sales.

**Gross Profit*****Three and six month comparisons***

The increase in gross profit included the following:

AEC gross margin was higher in 2014 principally due to improvements in profitability of programs at the Company's Boerne, Texas facility.

**Long-term contracts**

In the accounting for long-term fixed price contracts, we estimate the profit margin expected at the completion of the contract and recognize a pro-rata share of that profit during the course of the contract using a cost-to-cost or units of delivery approach. Changes in estimated contract profitability will affect revenue and gross profit when the change occurs, which could have a significant favorable or unfavorable effect on revenue and gross profit in any reporting period. The table below provides a summary of long-term contracts that were in process at the end of each period.

| (in thousands)                             | June 30,        |          |
|--|-----------------|----------|
|  | <b>2014</b>     | 2013     |
| Total value of contracts in process        | <b>\$28,474</b> | \$36,893 |
| Revenue recognized to date                 | <b>16,004</b>   | 28,378   |
| Revenue to be recognized in future periods | <b>12,470</b>   | 8,515    |

**Operating Income/(loss)*****Three and six month comparisons***

Operating income improved in 2014 principally due to the increase in gross profit as described above.



## Liquidity and Capital Resources

### Cash Flow Summary

| (in thousands)   | Six months ended |           |
|--|------------------|-----------|
|  | 2014             | 2013      |
| Net income   | \$21,870         | \$4,132   |
| Depreciation and amortization                                      | 32,005           | 31,955    |
| Changes in working capital   | (15,640)         | 5,608     |
| Gain on involuntary conversion or disposition of assets            | (961)            | (3,763)   |
| Changes in long-term liabilities, deferred taxes and other credits | 2,732            | (3,991)   |
| Other operating items  | 1,531            | (1,633)   |
| Net cash provided by/(used in) operating activities                | 41,537           | 32,308    |
| Net cash provided by/(used in) investing activities                | (26,756)         | (22,188)  |
| Net cash (used in)/provided by financing activities                | (28,446)         | (1,324)   |
| Effect of exchange rate changes on cash flows                      | (2,165)          | (2,193)   |
| (Decrease)/increase in cash and cash equivalents                   | (15,830)         | 6,603     |
| Cash and cash equivalents at beginning of year                     | 222,666          | 190,718   |
| Cash and cash equivalents at end of period                         | \$206,836        | \$197,321 |

### Operating activities

Cash provided by operating activities was \$41.5 million for the first six months of 2014, compared to \$32.3 million in the same period last year. The 2014 increase in cash flow was principally due to a decrease in Accounts receivable that resulted from strong cash receipts in the Engineered Composites business. Cash paid for income taxes was \$9.3 million and \$14.6 million for the first six months of 2014 and 2013, respectively. Cash paid for restructuring was \$8.7 million and \$2.6 million for the first six months of 2014 and 2013, respectively.

At June 30, 2014, we had \$206.8 million of cash and cash equivalents, of which \$177.9 million was held by subsidiaries outside of the United States. As disclosed in Note 7 contained in Item 1, "Notes to Consolidated Financial Statements", we determined that all but \$3.6 million of this amount (which represents the amount of prior year cumulative earnings expected to be repatriated to the United States at some point in the future) is intended to be utilized by these non-U.S. operations for an indefinite period of time. Our current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations or satisfy debt obligations in the United States. In the event that such funds were to be needed to fund operations in the U.S., and if associated accruals for U.S. tax have not already been provided, we would be required to accrue and pay additional U.S. taxes to repatriate these funds.

### Investing Activities

Capital spending for equipment and software was \$27.7 million for the first six months of 2014, including \$12.6 million for AEC. The Company expects full-year capital expenditure spending of \$60 to \$70 million. During the first quarter of 2013, the Company completed the sale of its production facility in Gosford, Australia, resulting in net proceeds of about \$6.3 million.



## Financing Activities

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. The dividend declared in the fourth quarter of 2012 was also paid during that quarter which resulted in two dividend payments during the fourth quarter of 2012, and no cash payments for dividends during the first quarter of 2013. To the extent the Board declares cash dividends in the future, we expect to pay such dividends out of operating cash flows. Future cash dividends will also depend on debt covenants and on the Board's assessment of our ability to generate sufficient cash flows.

## Capital Resources

We finance our business activities primarily with cash generated from operations and borrowings, largely through our revolving credit agreement as discussed below. Our 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. Substantially all of our cash balance at June 30, 2014 was held by non-U.S. subsidiaries. Based on cash on hand and credit facilities, we anticipate that the Company has sufficient capital resources to operate for the foreseeable future. We were in compliance with all debt covenants as of June 30, 2014.

On March 26, 2013, we entered into a \$330 million, unsecured Five-Year Revolving Credit Facility Agreement ("Credit Agreement"), under which \$183 million of borrowings were outstanding as of June 30, 2014. The applicable interest rate for borrowings under the Credit Agreement is LIBOR plus a spread, based on our leverage ratio at the time of borrowing. At the time of the last borrowing on June 23, 2014, the spread was 1.375%. The spread is based on a pricing grid, which ranges from 1.25% to 1.875%, based on our leverage ratio.

On July 16, 2010, we entered into interest rate hedging transactions that have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$105 million of the indebtedness drawn under the Credit Agreement at the rate of 2.04% until July 16, 2015. Under the terms of these transactions, we pay the fixed rate of 2.04% and the counterparties pay a floating rate based on the three-month LIBOR rate at each quarterly calculation date, which on April 16, 2014 was 0.23%. The net effect is to fix the effective interest rate on \$105 million of indebtedness at 2.04%, plus the applicable spread, until these swap agreements expire. On June 30, 2014, the all-in rate on the \$105 million of debt was 3.415%.

On May 20, 2013, we entered into interest rate hedging transactions for the period July 16, 2015 through March 16, 2018. These transactions have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$110 million of indebtedness drawn under the Credit Agreement at the rate of 1.414% during this period. Under the terms of these transactions, we pay the fixed rate of 1.414% and the counterparties pay a floating rate based on the one-month LIBOR rate at each monthly calculation date, which on June 30, 2014 was 0.1552%. The net effect is to fix the effective interest rate on \$110 million of indebtedness at 1.414%, plus the applicable spread, during the swap period.

As of June 30, 2014, our leverage ratio was 1.56 to 1.00 and our interest coverage ratio was 10.64 to 1.00. We may purchase our Common Stock or pay dividends to the extent our leverage ratio remains at or below 3.50 to 1.00, and may make acquisitions with cash provided our leverage ratio would not exceed 3.50 to 1.00 after giving pro forma effect to the acquisition.

These interest rate swaps are accounted for as hedges of future cash flows. For more information on our interest rate swaps, see Note 13 to the Consolidated Financial Statements in Item 1, which is incorporated herein by reference.

### **Off-Balance Sheet Arrangements**

As of June 30, 2014, we have no off-balance sheet arrangements required to be disclosed pursuant to Item 303(a)(4) of Regulation S-K.

### **Recent Accounting Pronouncements**

The information set forth under Note 17 contained in Item 1, "Notes to Consolidated Financial Statements" which is incorporated herein by reference.

### **Non-GAAP Measures**

This Form 10-Q contains certain items, such as earnings before interest, taxes, depreciation and amortization (EBITDA), Adjusted EBITDA, sales excluding currency effects, income tax rate exclusive of income tax adjustments, net debt, net income attributable to the Company, excluding adjustments (on an absolute and per-share basis), and certain income and expense items on a per-share basis that could be considered non-GAAP financial measures. Such items are provided because management believes that, when presented together with the GAAP items to which they relate, they provide additional useful information to investors regarding the Company's operational performance. Presenting increases or decreases in sales, after currency effects are excluded, can give management and investors insight into underlying sales trends. An understanding of the impact in a particular period of specific restructuring costs, or other gains and losses, on operating income or EBITDA can give management and investors additional insight into performance, especially when compared to periods in which such items had a greater or lesser effect, or no effect. All non-GAAP financial measures in this report relate to the Company's continuing operations.

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. The Company calculates Income tax adjustments by adding discrete tax items to the effect of a change in tax rate for the reporting period. The Company calculates its income tax rate, exclusive of income tax adjustments, by removing income tax adjustments from total Income tax expense, then dividing that result by Income before income taxes. The Company calculates EBITDA by removing the following from Net income: Interest expense net, Income tax expense, Depreciation and amortization, and Income or loss from Discontinued Operations. Adjusted EBITDA is calculated by adding EBITDA, costs associated with restructuring and pension settlement charges, adding or subtracting revaluation losses or gains, subtracting building sale and insurance-recovery gains, and subtracting Income attributable to the noncontrolling interest in ASC. The Company believes that EBITDA and Adjusted EBITDA provide useful information to investors because they provide an indication of the strength and performance of the Company's ongoing business operations, including its ability to fund discretionary spending such as capital expenditures and strategic investments, as well as its ability to incur and service debt. While depreciation and amortization are operating costs under GAAP, they are non-cash expenses equal to current period allocation of costs associated with capital and other long-lived investments made in prior periods. While restructuring expenses, foreign currency revaluation losses or gains, pension settlement charges, and building sale and insurance-recovery gains have an impact on the Company's net income, removing them from EBITDA can provide, in the opinion of the Company, a better measure of operating performance. EBITDA is also a calculation commonly used by investors and analysts to evaluate and compare the periodic and future operating performance and value of companies. EBITDA, as defined by the Company, may not be similar to EBITDA measures of other companies. Such EBITDA measures may not be considered measurements under GAAP, and should be considered in addition to, but not as substitutes for, the information contained in the Company's Statements of Income.



The following tables show the calculation of EBITDA and Adjusted EBITDA:

Three months ended June 30, 2014

| (in thousands)   | Machine<br>Clothing | AEC       | Corporate<br>expenses<br>and other | Total<br>Company |
|--|---------------------|-----------|------------------------------------|------------------|
| Net income   | \$33,879            | (\$3,545) | (\$19,157)                         | \$11,177         |
| Interest expense, net                                      | -                   | -         | 2,717                              | 2,717            |
| Income tax expense   | -                   | -         | 7,216                              | 7,216            |
| Depreciation and amortization                              | 11,554              | 2,453     | 2,090                              | 16,097           |
| EBITDA   | 45,433              | (1,092)   | (7,134)                            | 37,207           |
| Restructuring and other, net                               | 1,297               | 660       | -                                  | 1,957            |
| Foreign currency revaluation losses/(gains)                | 350                 | 61        | (1,395)                            | (984)            |
| Gain on insurance recovery                                 | -                   | -         | (961)                              | (961)            |
| Pretax loss attributable to noncontrolling interest in ASC | -                   | 45        | -                                  | 45               |
| Adjusted EBITDA  | \$47,080            | (\$326)   | (\$9,490)                          | \$37,264         |

Six months ended June 30, 2014

| (in thousands)   | Machine<br>Clothing | AEC       | Corporate<br>expenses<br>and other | Total<br>Company |
|--|---------------------|-----------|------------------------------------|------------------|
| Net income   | \$70,022            | (\$7,021) | (\$41,131)                         | \$21,870         |
| Interest expense, net  | -                   | -         | 5,635                              | 5,635            |
| Income tax expense   | -                   | -         | 14,673                             | 14,673           |
| Depreciation and amortization                                | 23,009              | 4,775     | 4,221                              | 32,005           |
| EBITDA   | 93,031              | (2,246)   | (16,602)                           | 74,183           |
| Restructuring and other, net                                 | 2,159               | 980       | -                                  | 3,139            |
| Foreign currency revaluation losses/(gains)                  | 502                 | 99        | (1,901)                            | (1,300)          |
| Gain on insurance recovery                                   | -                   | -         | (961)                              | (961)            |
| Pretax income attributable to noncontrolling interest in ASC | -                   | (13)      | -                                  | (13)             |
| Adjusted EBITDA  | \$95,692            | (\$1,180) | (\$19,464)                         | \$75,048         |

Three months ended June 30, 2013

| (in thousands)                              | Machine<br>Clothing | AEC       | Corporate<br>expenses<br>and other | Total<br>Company |
|---|---------------------|-----------|------------------------------------|------------------|
| Net income/(loss)                           | \$14,821            | (\$4,678) | (\$17,522)                         | (\$7,379)        |
| Loss from discontinued operations           | -                   | -         | 351                                | 351              |
| Interest expense, net                       | -                   | -         | 3,547                              | 3,547            |
| Income tax benefit                          | -                   | -         | (2,243)                            | (2,243)          |
| Depreciation and amortization               | 11,809              | 2,064     | 2,208                              | 16,081           |
| EBITDA                                      | 26,630              | (2,614)   | (13,659)                           | 10,357           |
| Restructuring and other, net                | 24,230              | 91        | -                                  | 24,321           |
| Foreign currency revaluation losses/(gains) | (452)               | -         | 1,896                              | 1,444            |
| Adjusted EBITDA                             | \$50,408            | (\$2,523) | (\$11,763)                         | \$36,122         |

Six months ended June 30, 2013

| (in thousands)                                | Machine<br>Clothing | AEC       | Corporate<br>expenses<br>and other | Total<br>Company |
|---|---------------------|-----------|------------------------------------|------------------|
| Net income                                    | \$52,377            | (\$9,081) | (\$39,164)                         | \$4,132          |
| Loss from discontinued operations             | -                   | -         | 351                                | 351              |
| Interest expense, net                         | -                   | -         | 7,572                              | 7,572            |
| Income tax expense                            | -                   | -         | 4,005                              | 4,005            |
| Depreciation and amortization                 | 23,679              | 3,795     | 4,481                              | 31,955           |
| EBITDA  | 76,056              | (5,286)   | (22,755)                           | 48,015           |
| Restructuring and other, net                  | 24,423              | 534       | -                                  | 24,957           |
| Foreign currency revaluation losses/(gains)   | (1,195)             | -         | 1,907                              | 712              |
| Gain on sale of former manufacturing facility | -                   | -         | (3,763)                            | (3,763)          |
| Adjusted EBITDA                               | \$99,284            | (\$4,752) | (\$24,611)                         | \$69,921         |

We disclose certain income and expense items on a per-share basis. We believe that such disclosures provide important insight into the underlying quarterly earnings and are financial performance metrics commonly used by investors. We calculate the per-share amount for items included in continuing operations by using the effective tax rate utilized in that reporting period, and the weighted average number of shares outstanding for each period.

The following tables show the earnings per share effect of certain income and expense items:

| Three months ended June 30, 2014<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|---------------------|
| Restructuring and other, net   | \$1,957            | \$714         | \$1,243             | \$0.04              |
| Foreign currency revaluation gains   | 984                | 359           | 625                 | 0.02                |
| Gain on insurance recovery   | 961                | -             | 961                 | 0.03                |
| Net discrete income tax charges  | -                  | 569           | 569                 | 0.02                |
| Unfavorable effect of change in income tax rate                              | -                  | 278           | 278                 | 0.01                |
| Adjustment to correct MC inventory value                                     | 1,577              | 576           | 1,001               | 0.03                |

| Six months ended June 30, 2014<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|---------------------|
| Restructuring and other, net   | \$3,139            | \$1,128       | \$2,011             | \$0.06              |
| Foreign currency revaluation gains   | 1,300              | 469           | 831                 | 0.03                |
| Gain on insurance recovery   | 961                | -             | 961                 | 0.03                |
| Net discrete income tax charges  | -                  | 1,673         | 1,673               | 0.05                |
| Adjustment to correct MC inventory value                                   | 1,577              | 576           | 1,001               | 0.03                |

| Three months ended June 30, 2013<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|---------------------|
| Restructuring and other, net   | \$24,321           | \$9,485       | \$14,836            | \$0.47              |
| Foreign currency revaluation losses  | 1,444              | 563           | 881                 | 0.03                |
| Unfavorable effect of change in income tax rate                              | -                  | 888           | 888                 | 0.03                |

|                                 |   |     |     |      |
|---------------------------------|---|-----|-----|------|
| Net discrete income tax charges | - | 485 | 485 | 0.02 |
|---------------------------------|---|-----|-----|------|

| Six months ended June 30, 2013<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|---------------------|
| Restructuring and other, net   | \$24,957           | \$9,701       | \$15,256            | \$0.48              |
| Foreign currency revaluation losses  | 712                | 314           | 398                 | 0.01                |
| Gain on sale of former manufacturing facility                              | 3,763              | 1,279         | 2,484               | 0.08                |
| Net discrete income tax charges  | -                  | 695           | 695                 | 0.03                |



The following table contains the calculation of net income per share attributable to the Company, excluding adjustments:

|   | Three months ended |          | Six months ended |        |
|---|--------------------|----------|------------------|--------|
|   | June 30, 2014      | 2013     | June 30, 2014    | 2013   |
| Per share amounts (Basic)                                     |                    |          |                  |        |
| Net income attributable to the Company                        | <b>\$0.35</b>      | (\$0.23) | <b>\$0.69</b>    | \$0.13 |
| Adjustments:  |                    |          |                  |        |
| Loss on discontinued operations                               | -                  | 0.01     | -                | 0.01   |
| Restructuring and other, net                                  | <b>0.04</b>        | 0.47     | <b>0.06</b>      | 0.48   |
| Discrete tax charges and effect of change in income tax rate  | <b>0.03</b>        | 0.05     | <b>0.05</b>      | 0.03   |
| Foreign currency revaluation gains                            | <b>(0.02)</b>      | 0.03     | <b>(0.03)</b>    | 0.01   |
| Gain on insurance recovery                                    | <b>(0.03)</b>      | -        | <b>(0.03)</b>    | -      |
| Gain on sale of former manufacturing facility                 | -                  | -        | -                | (0.08) |
| Net income attributable to the Company, excluding adjustments | <b>\$0.37</b>      | \$0.33   | <b>\$0.74</b>    | \$0.58 |

The following table contains the calculation of net debt:

| (in thousands)                       | June 30, March 31, December 31, December 31, |                 |                 |                  |
|--------------------------------------|--|-----------------|-----------------|------------------|
|                                      | 2014   | 2014            | 2013            | 2012             |
| Notes and loans payable              | \$692  | \$797           | \$625           | \$586            |
| Current maturities of long-term debt | 1,265  | 2,514           | 3,764           | 83,276           |
| Long-term debt                       | 283,104                                      | 299,108         | 300,111         | 235,877          |
| <b>Total debt</b>                    | <b>285,061</b>                               | <b>302,419</b>  | <b>304,500</b>  | <b>319,739</b>   |
| Cash                                 | 206,836                                      | 208,379         | 222,666         | 190,718          |
| <b>Net debt</b>                      | <b>\$78,225</b>                              | <b>\$94,040</b> | <b>\$81,834</b> | <b>\$129,021</b> |

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

For discussion of our exposure to market risk, refer to “Quantitative and Qualitative Disclosures About Market Risk”, which is included as an exhibit to this Form 10-Q.

### Item 4. Controls and Procedures

#### a) Disclosure controls and procedures.

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

(b) Changes in internal control over financial reporting.

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

## **PART II – OTHER INFORMATION**

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

The information set forth above under Note 15 in Item 1, “Notes to Consolidated Financial Statements” is incorporated herein by reference.

### **Item 1A. Risk Factors .**

There have been no material changes in risks since December 31, 2013. For discussion of risk factors, refer to Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013.

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

We made no share purchases during the second quarter of 2014. We remain authorized by the Board of Directors to purchase up to 2 million shares of our Class A Common Stock.

### **Item 3. Defaults Upon Senior Securities**

None.

### **Item 4. Mine Safety Disclosures**

Not Applicable.

### **Item 5. Other Information**

None.

### **Item 6. Exhibits**

Exhibit No. Description

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 June 30, 2014.

The following financial information from the Registrant's Quarterly Report on Form 10-Q for the quarter

101 ended June 30, 2014, formatted in eXtensible Business Reporting Language (XBRL), filed herewith:

(i) Consolidated Statements of Income for the three and six months ended June 30, 2014 and 2013.

(ii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2014 and 2013.

(iii) Consolidated Balance Sheets at June 30, 2014 and December 31, 2013.

(iv) Consolidated Statements of Cash Flows for the three and six months ended June 30, 2014 and 2013.

(v) Notes to Consolidated Financial Statements.

As provided in Rule 406T of Regulation S-T, this information shall not be deemed "filed" for purposes of Sections 11 and 12 of the Securities Act and Section 18 of the Securities Exchange Act or otherwise subject to liability under those sections.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ALBANY INTERNATIONAL CORP .

(Registrant)

Date: August 7, 2014

By /s/ John B. Cozzolino

John B. Cozzolino

Chief Financial Officer and Treasurer

(Principal Financial Officer)