

XERIUM TECHNOLOGIES INC
Form 10-Q/A
August 23, 2007
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended March 31, 2007**

or

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Transition Period from _____ to _____**

Commission File Number 001-32498

Xerium Technologies, Inc.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

42-1558674
(I.R.S. Employer
Identification No.)

14101 Capital Boulevard
Youngsville, North Carolina 27596
(Address of principal executive offices)

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

(919) 556-7235

Registrant's telephone number (including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares of the registrant's common stock, \$0.01 par value, outstanding as of May 7, 2007 was 43,434,325.

Table of Contents

EXPLANATORY NOTE

Xerium Technologies, Inc. is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2007, originally filed on May 9, 2007 (the Original Filing), to amend and restate the consolidated balance sheet as of March 31, 2007 and the consolidated statements of operations and cash flows for each of the three month periods ended March 31, 2007 and 2006. The restatement is discussed in Note 2 to the unaudited condensed consolidated financial statements.

Subsequent to the Original Filing, an error in accounting for our interest rate swap agreements was identified. We entered into floating-to-fixed interest rate swaps in June 2005. We had accounted for these interest rate swaps as hedging instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities-an amendment of FASB Statement No. 133 and SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities. The fair value of these interest rate swap agreements was adjusted quarterly with the changes recorded as deferred gains or losses in the Company's consolidated balance sheet with the offset recorded in accumulated other comprehensive loss, net of tax. In August 2007, we determined that the swaps do not qualify for hedge accounting because we inappropriately applied the short cut method to evaluate these interest rate swaps for hedge accounting purposes from the date of inception. Accordingly, we are required to recognize the change in the fair value of these interest rate swap derivatives as a component of earnings for the periods commencing in June 2005. The restatement has no effect on cash flows from operating, investing or financing activities or on our debt covenant calculations.

All of the sections of Part I to this Form 10-Q/A have been revised to reflect the restatement. For the convenience of the reader, this Amendment No. 1 includes, in their entirety, those items in the Original Filing not being amended and restated. Except to the extent relating to the restatement of our financial statements and other financial information described above, the financial statements and other disclosure in this Form 10-Q/A do not reflect any events that have occurred after the Original Filing. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the Securities and Exchange Commission subsequent to the filing of the Original Filing.

New certifications of the principal executive officer and principal financial officer are included as exhibits to this Amendment No. 1 on Form 10-Q/A.

Table of Contents

TABLE OF CONTENTS

	Page
<u>Part I. Financial Information</u>	
<u>Item 1. Condensed Consolidated Financial Statements</u>	4-20
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21-38
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	38
<u>Item 4. Controls and Procedures</u>	39-40
<u>Part II. Other Information</u>	
<u>Item 1. Legal Proceedings</u>	41
<u>Item 1A. Risk Factors</u>	41
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
<u>Item 3. Defaults Upon Senior Securities</u>	42
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	42
<u>Item 5. Other Information</u>	42
<u>Item 6. Exhibits</u>	42

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Xerium Technologies, Inc.****Condensed Consolidated Balance Sheets (Unaudited)**

(dollars in thousands, except per share data)

	March 31, 2007 (As restated)	December 31, 2006 (As restated)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 17,718	\$ 16,816
Accounts receivable (net of allowance for doubtful accounts of \$4,690 at March 31, 2007 and \$4,220 at December 31, 2006)	103,893	109,694
Inventories	110,887	103,853
Prepaid expenses	6,645	4,426
Other current assets	18,191	19,273
Total current assets	257,334	254,062
Property and equipment, net	376,533	375,179
Goodwill	318,681	318,019
Intangible assets and deferred financing costs, net	35,196	37,151
Other assets	6,336	6,315
Total assets	\$ 994,080	\$ 990,726
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable	\$ 9,222	\$ 10,571
Accounts payable	37,334	39,778
Accrued expenses	51,219	48,574
Current maturities of long-term debt	7,467	10,110
Total current liabilities	105,242	109,033
Long-term debt, net of current maturities	622,919	618,379
Deferred and long term taxes	42,335	40,479
Pension, other postretirement and postemployment obligations	109,046	106,255
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized; no shares outstanding as of March 31, 2007 and December 31, 2006		
Common stock, \$0.01 par value, 150,000,000 shares authorized; 44,434,325 and 43,799,662 shares outstanding as of March 31, 2007 and December 31, 2006	444	438
Paid-in capital	207,285	201,563
Accumulated deficit	(77,012)	(65,137)
Accumulated other comprehensive loss	(16,179)	(20,284)

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

Total stockholders' equity	114,538	116,580
Total liabilities and stockholders' equity	\$ 994,080	\$ 990,726

See accompanying notes.

Table of Contents**Xerium Technologies, Inc.****Condensed Consolidated Income Statements (Unaudited)**

(dollars in thousands, except per share data)

	Three Months Ended	
	March 31,	
	2007 (As restated)	2006 (As restated)
Net sales	\$ 143,958	\$ 146,732
Costs and expenses:		
Cost of products sold	82,956	85,029
Selling	19,259	18,565
General and administrative	18,031	16,620
Restructuring and impairments	4,133	222
Research and development	2,554	2,561
	126,933	122,997
Income from operations	17,025	23,735
Interest expense	(12,434)	(6,839)
Interest income	247	623
Foreign exchange loss	(396)	(136)
Income before provision for income taxes	4,442	17,383
Provision for income taxes	1,401	4,948
Net income	\$ 3,041	\$ 12,435
Net income per share:		
Basic	\$ 0.07	\$ 0.28
Diluted	\$ 0.07	\$ 0.28
Shares used in computing net income per share:		
Basic	43,912,491	43,725,093
Diluted	44,076,366	43,817,839
Dividends per common share:	\$ 0.225	\$ 0.225

See accompanying notes.

Table of Contents**Xerium Technologies, Inc.****Condensed Consolidated Statements of Cash Flows (Unaudited)**

(dollars in thousands)

	Three Months Ended March 31,	
	2007 (As restated)	2006 (As restated)
Operating activities		
Net income	\$ 3,041	\$ 12,435
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	535	778
Depreciation	9,888	9,937
Amortization of intangibles	1,111	1,043
Deferred financing cost amortization	918	923
Unrealized foreign exchange loss on revaluation of debt	19	392
Deferred taxes	(1,123)	5,185
Asset impairment	389	
(Gain) loss on disposition of property and equipment	78	(22)
Change in fair value of interest rate swaps	1,563	(3,795)
Change in assets and liabilities which provided (used) cash:		
Accounts receivable	6,811	(2,202)
Inventories	(5,815)	(3,371)
Prepaid expenses	(2,219)	(2,097)
Other current assets	1,639	(444)
Accounts payable and accrued expenses	(2,848)	(11,921)
Deferred and other long term liabilities	1,267	(3,127)
Net cash provided by operating activities	15,254	3,714
Investing activities		
Capital expenditures, gross	(7,101)	(8,110)
Proceeds from disposals of property and equipment	64	131
Payment for acquisitions, net of cash acquired		(6,912)
Other	95	20
Net cash used in investing activities	(6,942)	(14,871)
Financing activities		
Net increase in borrowings (maturities of 90 days or less)	(327)	1,872
Proceeds from borrowings (maturities longer than 90 days)	2,494	155
Principal payments on debt	(5,722)	(7,581)
Cash dividends on common stock	(4,700)	(9,838)
Other		(829)
Net cash used in financing activities	(8,255)	(16,221)
Effect of exchange rate changes on cash flows	845	1,926
Net increase (decrease) in cash	902	(25,452)
Cash and cash equivalents at beginning of period	16,816	59,976
Cash and cash equivalents at end of period	\$ 17,718	\$ 34,524

Supplemental schedule of noncash investing and financing activities:

The Company purchased all of the capital stock and manufacturing facility of Coldwater Covers, Inc. for \$6,961 and assumed liabilities as follows:

Fair value of assets acquired	\$	\$	7,020
Cash paid for capital stock and manufacturing facility			(6,961)
Liabilities assumed	\$	\$	59
Common stock issued in lieu of cash dividends pursuant to the Dividend Reinvestment Plan	\$	5,152	\$

See accompanying notes.

Table of Contents

Xerium Technologies, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

1. Company History

Xerium Technologies, Inc. (the Company), is a leading global manufacturer and supplier of two types of consumable products used primarily in the production of paper clothing and roll covers. Operations are strategically located in the major paper-making regions of the world, including North America, Europe, South America and Asia-Pacific.

2. Restatement and Basis of Presentation

On August 10, 2007, the Company filed a Current Report on Form 8-K announcing that it has determined to restate certain of its previously issued financial statements. The Company is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2007, originally filed on May 9, 2007 (the Original Filing), to amend and restate the consolidated balance sheet as of March 31, 2007 and the consolidated statements of operations and cash flows for each of the three month periods ended March 31, 2007 and 2006. In addition, the Company filed an amendment to its Annual Report on Form 10-K/A for the year ended December 31, 2006 to amend and restate its consolidated balance sheets as of December 31, 2006 and 2005 and consolidated statements of operations, stockholders' equity (deficit), and cash flows for the years 2006 and 2005 and the Company's unaudited quarterly financial statements during these years, commencing with the quarter ended June 30, 2005.

Subsequent to the Original Filing, an error in accounting for the Company's interest rate swap agreements was identified. The Company entered into floating-to-fixed interest rate swaps in June 2005 and had accounted for these interest rate swaps as hedging instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities-an amendment of FASB Statement No. 133 and SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities. The fair value of these interest rate swap agreements was adjusted quarterly with the changes recorded as deferred gains or losses in the Company's consolidated balance sheet with the offset recorded in accumulated other comprehensive loss, net of tax. In August 2007, the Company determined that the swaps do not qualify for hedge accounting because of the inappropriate application of the short cut method to evaluate these interest rate swaps for hedge accounting purposes from the date of inception. Accordingly, the Company is required to recognize the change in the fair value of these interest rate swap derivatives as a component of earnings for the periods commencing in June 2005. The restatements had no effect on cash flows from operating, investing or financing activities or on the Company's debt covenant calculations.

The accompanying unaudited condensed consolidated interim financial statements at March 31, 2007 and for the three months ended March 31, 2007 and 2006 include the accounts of the Company and its wholly-owned subsidiaries and have been prepared in conformity with accounting principles generally accepted in the United States (GAAP) for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. The interim results presented herein are not necessarily indicative of the results to be expected for the entire year. These interim results reflect restated balances as a result of the restatement described above. In addition, the Company has filed a Form 10-K/A for the year ended December 31, 2006 to amend and restate financial statements and other financial information for such periods.

In management's opinion, these unaudited condensed consolidated interim financial statements contain all adjustments of a normal recurring nature necessary for a fair presentation of the financial statements for the interim periods presented. These unaudited condensed consolidated interim financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2006 as reported on Form 10-K/A.

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

2. Restatement and Basis of Presentation (continued)

The following tables detail the restatements (in thousands, except per share amounts):

	December 31, 2006		
	As Originally Reported	Adjustments	As Restated
Deferred and long term taxes	\$ 40,479	\$	\$ 40,479
Accumulated deficit	(74,572)	9,435	(65,137)
Accumulated other comprehensive loss	(10,849)	(9,435)	(20,284)
Total stockholders' equity	116,580		116,580

	March 31, 2007		
	As Originally Reported	Adjustments	As Restated
Deferred and long term taxes	\$ 42,760	\$ (425)	\$ 42,335
Accumulated deficit	(85,350)	8,338	(77,012)
Accumulated other comprehensive loss	(8,266)	(7,913)	(16,179)
Total stockholders' equity	114,113	425	114,538

	Three Months Ended March 31, 2007		
	As Originally Reported	Adjustments	As Restated
Interest expense	\$ (10,871)	\$ (1,563)	\$ (12,434)
Provision for income taxes	1,867	(466)	1,401
Net income	4,138	(1,097)	3,041
Net income per share - basic	\$ 0.09	\$ (0.02)	\$ 0.07
Net income per share - diluted	\$ 0.09	\$ (0.02)	\$ 0.07

	Three Months Ended March 31, 2006		
	As Originally Reported	Adjustments	As Restated
Interest expense	\$ (10,634)	\$ 3,795	\$ (6,839)
Provision for income taxes	4,050	898	4,948
Net income	9,538	2,897	12,435
Net income per share - basic	\$ 0.22	\$ 0.06	\$ 0.28
Net income per share - diluted	\$ 0.22	\$ 0.06	\$ 0.28

3. Accounting Policies***Derivatives and Hedging***

The Company has historically entered into several types of derivative instruments. Certain of these derivatives are treated as hedges under Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, and include interest rate swaps that qualify as cash flow hedges, and foreign currency forward contracts that qualify as either cash flow or fair value hedges.

Table of Contents

Xerium Technologies, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

3. Accounting Policies (continued)

Derivatives and Hedging (continued)

Cash Flow and Fair Value Hedges

The Company utilizes interest rate swaps to reduce interest rate risks and utilizes foreign currency forward contracts to manage risk exposure to movements in foreign exchange rates.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various hedge transactions. The Company links all hedges that are designated as fair value hedges to specific assets or liabilities on the consolidated balance sheets or to the specific firm commitments.

The Company links all hedges that are designated as cash flow hedges to forecasted transactions or to floating-rate liabilities on the consolidated balance sheets. The Company also assesses, both at inception of the hedge and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Should it be determined that a derivative is not highly effective as a hedge, the Company will discontinue hedge accounting prospectively.

The Company's derivative activities are as follows:

(i) Cash Flow Hedges

The Company entered into interest rate swap contracts effective June 30, 2005 pursuant to which it pays fixed rates on U.S. Dollar notional amounts while receiving the applicable floating LIBOR rates. In connection with the restatement discussed in Note 2, the interest rate swaps do not qualify for hedge accounting under SFAS No. 133 and the change in their fair value is subject to mark to market accounting through earnings. The Company recorded an increase to interest expense of \$1,563 for the three months ended March 31, 2007 and a decrease to interest expense of \$3,795 for the three months ended March 31, 2006 as a result of the mark to market accounting through earnings. The fair value of the interest rate derivative contracts was \$8,260 and \$9,710 at March 31, 2007 and December 31, 2006, respectively, and is included in other current assets.

Although these interest rate swaps are subject to mark to market accounting through earnings, the interest rate swap contracts effectively fix, from a cash flow hedge perspective, the interest rate on approximately 90% of the term loan portion of the credit facility through June 30, 2008. The mark to market accounting through earnings has no effect on cash flows from operating, investing or financing activities nor has the effectiveness of the swaps as cash flow hedging instruments been affected by the changes in accounting treatment. As of March 31, 2007, the weighted average interest rate on the effectively fixed portion of the term loan facility was 6.12% and the weighted average interest rate on the portion of the term loan facility not effectively fixed by interest rate swap contracts, based on the 90-day LIBOR, was 7.21%.

Table of Contents

Xerium Technologies, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

3. Accounting Policies (continued)

The Company, from time to time, enters into foreign exchange forward contracts to fix currencies at specified rates based on expected future cash flows to protect against the fluctuations in cash flows resulting from sales denominated in foreign currencies over the next year. The fair value of these contracts is recognized at fair value based on market exchange forward rates. The fair value of these contracts amounted to \$57 and \$123 at March 31, 2007 and December 31, 2006, respectively. The change in fair value of these contracts is included in accumulated other comprehensive loss.

(ii) Fair Value Hedges

The Company is subject to exposure from fluctuations in foreign currencies. To manage this exposure, the Company uses foreign exchange forward contracts. The value of these contracts is recognized at fair value based on forward market exchange rates and the change in the fair value of these contracts is included in foreign exchange gain (loss). The amount was not material to the Company's consolidated income statements for the three months ended March 31, 2007 and 2006.

Goodwill

The Company accounts for goodwill and other intangible assets in accordance with SFAS No. 142, *Accounting for Goodwill and Other Intangible Assets* (SFAS No. 142). SFAS No. 142 requires that goodwill and intangible assets that have indefinite lives not be amortized but, instead, must be tested at least annually for impairment or whenever events or business conditions warrant. The Company performs the test for goodwill impairment as of December 31st each year. The results of the test as of December 31, 2006 indicated that there was no impairment of goodwill.

Net Income Per Common Share

Net income per common share has been computed and presented pursuant to the provisions of SFAS No. 128, *Earnings per Share* (SFAS No. 128). Net income per share is based on the weighted-average number of shares outstanding during the period. As of March 31, 2007 and 2006, the Company had outstanding restricted stock units (RSUs), the majority of which were granted in 2005 (see Note 13). For the three months ended March 31, 2007 and 2006, the dilutive effect of potential future issuances of common stock underlying the Company's RSUs was computed using (i) the average market price during the respective period for time based RSUs and (ii) the actual grant date market price for non-employee director RSUs. The calculation of diluted earnings per share for the three months ended March 31, 2007 and 2006 excludes the Company's performance-based RSUs that are based on shareholder targets because the performance criteria have not been contingently achieved and therefore the underlying RSUs are not contingently issuable. In March 2007, the Company granted 368,350 performance-based RSUs to certain officers and employees of the Company that are based on achieving a performance metric based upon 2007 Adjusted EBITDA, as defined in the Company's senior credit facility as in effect on March 29, 2007. The calculation of diluted earnings per share for the three months ended March 31, 2007 excludes the impact of these Adjusted EBITDA based RSUs because at March 31, 2007, the Company determined that it was not probable that the performance conditions will be achieved.

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

The following table sets forth the computation of basic and diluted earnings weighted average shares:

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Weighted-average common shares outstanding basic	43,912,491	43,725,093
Dilutive effect of stock-based compensation awards outstanding	163,875	92,746
Weighted-average common shares outstanding diluted	44,076,366	43,817,839

3. Accounting Policies (continued)**Reclassifications**

Certain prior year balances have been reclassified to conform to the current year presentation. The Company has reclassified certain costs previously recorded in general and administrative expense to cost of sales, selling expenses and research and development expenses for prior periods to conform to the current period presentation.

New Accounting Standards

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The Company adopted FIN 48 on January 1, 2007 and recorded the \$3,323 cumulative effect of adopting FIN 48 as an increase to accumulated deficit and to current and long term income taxes payable. See Note 6 for further discussion related the adoption of FIN 48.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. This pronouncement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability on its balance sheet, measured as the difference between the fair value of plan assets and the benefit obligation (the projected benefit obligation for defined benefit plans and the accumulated postretirement benefit obligation for other postretirement plans). SFAS No. 158 also requires an employer to recognize changes in its funded status in the year in which the changes occur through comprehensive income. The Company adopted the funded status provisions of SFAS No. 158 as of December 31, 2006. In addition, effective for fiscal years ending on or after December 15, 2008, this statement requires an employer to measure the funded status of a plan as of the date of its year-end balance sheet, with limited exceptions. Earlier application of this provision is encouraged and accordingly, the Company changed the September 30 measurement date of its U.S. pension and postretirement plans to December 31 for the fiscal year ending December 31, 2007. The Company remeasured the plan assets and obligations of its U.S. plans using the remeasurement method allowed under SFAS No. 158 and, accordingly, as of January 1, 2007, recognized a \$1,700 increase to accumulated deficit, a \$500 decrease to accumulated other comprehensive loss and a \$1,200 increase to pension, other postretirement and postemployment obligations.

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the Fair Value Option). Unrealized gains and losses on items for which the Fair Value Option has been elected are reported in earnings. The Fair Value Option is applied instrument by instrument (with certain exceptions), is irrevocable (unless a new election date occurs) and is applied only to an entire instrument. The effect of the first remeasurement to fair value is reported as a cumulative-effect adjustment to the opening balance of retained earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 with earlier application permitted, subject to certain conditions. The Company believes that the adoption of SFAS No. 159 will not have a material effect on its financial position or results of operations.

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

4. Inventories

The components of inventories are as follows at:

	March 31, 2007	December 31, 2006
Raw materials	\$ 24,574	\$ 23,221
Work in process	40,600	38,839
Finished units	45,713	41,793
	\$ 110,887	\$ 103,853

5. Debt

In March 2007, the Company made a mandatory debt repayment of \$4,075 based on the difference between its pre-dividend free cash flow, as defined in its credit facility agreement, and cash dividends paid in the prior year.

On May 2, 2007, the Company amended its credit facility agreement with the lenders thereunder to modify certain covenants, ratios and definitions and, in addition to other limitations on dividends, to limit the amount of any quarterly dividends payable on the Company's common stock to not more than \$0.1125 per share. In connection with the amendment, the Company paid an amendment fee of \$1,500, as well as other fees and expenses. See Note 15 for further discussion related to the amendment.

6. Income Taxes

The Company adopted FIN 48 on January 1, 2007 and, accordingly, recorded a cumulative effect increase of \$3,323 to accumulated deficit, an increase of \$627 to income taxes payable and an increase of \$2,696 to deferred and long term taxes for uncertain tax positions. On January 1, 2007, the Company had \$4,126 in unrecognized tax benefits, the recognition of which would have an effect of \$3,779 on the effective tax rate. The Company recorded an increase of its unrecognized tax benefits of approximately \$100 during the first quarter.

The Company's policy is to recognize interest and penalties related to income tax matters as income tax expense. As of March 31, 2007, the Company has approximately \$400 of accrued interest related to uncertain tax positions.

The tax years 2000 through 2006 remain open to examination by the major taxing jurisdictions to which the Company and its subsidiaries are subject.

The Company utilizes the asset and liability method for accounting for income taxes in accordance with SFAS No. 109. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company reduces the deferred tax assets by a valuation allowance if, based upon the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Relevant evidence, both positive and negative, is considered in determining the need for a valuation allowance. Information evaluated includes our financial position and results of operations for the current and preceding years as well as an evaluation of currently available information about future years. Because of the Company's accumulated loss position in certain tax jurisdictions on March 31, 2007, and the uncertainty of profitability in future periods, the Company continues to have valuation allowances for deferred tax assets primarily related to net operating loss carryforwards in the United States, the United Kingdom and Sweden.

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

6. Income Taxes (continued)

The Company's effective tax rate of 32% for the three months ended March 31, 2007 is less than the statutory United States tax rate of 35% primarily due to the income generated in certain taxing jurisdictions being offset by net operating loss carryforwards for which the Company did not previously record a benefit. This was partially offset by the tax effect of forecasted operating losses in taxing jurisdictions for which valuation allowances have been recognized due to the uncertainty surrounding the future utilization of such net operating loss carryforwards.

7. Pensions, Other Postretirement and Postemployment Benefits

The Company has defined benefit pension plans covering substantially all of its U.S. and Canadian employees, and employees of certain subsidiaries in other countries. Benefits are generally based on the employee's years of service and compensation. These plans are funded in conformity with the funding requirements of applicable government regulations.

The Company also sponsors various unfunded defined contribution plans that provide for retirement benefits to employees, most of which are in accordance with local government requirements.

Also, the Company sponsors an unfunded plan that offers the opportunity to obtain health care benefits to substantially all retired U.S. employees and their covered dependents and beneficiaries. A portion of this plan is contributory, with retiree contributions adjusted periodically. Eligibility varies according to date of hire, age and length of service. Certain retirees also have a life insurance benefit provided at no cost.

As required by SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits (revised 2003)*, the following tables summarize the components of net periodic benefit cost:

Defined Benefit Plans

	Three Months Ended	
	March 31,	March 31,
	2007	2006
Service cost	\$ 1,791	\$ 1,601
Interest cost	1,568	1,348
Expected return on plan assets	(1,209)	(904)
Amortization of prior service cost	40	26
Amortization of net loss	245	252
Net periodic benefit cost	\$ 2,435	\$ 2,323

Other Postretirement Benefit Plans**Three Months Ended**

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

	March 31,	March 31,
	2007	2006
Service cost	\$ 172	\$ 108
Interest cost	554	655
Amortization of prior service cost	(116)	(116)
Amortization of net loss	16	172
Net periodic benefit cost	\$ 626	\$ 819

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

8. Comprehensive Income and Accumulated Other Comprehensive Loss

As restated for the discussion in Note 2, comprehensive income for the period ended March 31, 2007 and 2006 is as follows:

	Three Months Ended	
	March 31,	March 31,
	2007	2006
	(As restated)	(As restated)
Net income	\$ 3,041	\$ 12,435
Foreign currency translation adjustments	3,159	7,076
Minimum pension liability/SFAS No. 158 Liability	994	(83)
Change in value of derivative instruments	(48)	175
Comprehensive income	\$ 7,146	\$ 19,603

As restated for the discussion in Note 2, the components of accumulated other comprehensive loss are as follows:

	Foreign Currency Translation Adjustment	Minimum Pension Liability/SFAS No. 158 Liability (Note 3)	Change in Value of Derivative Instruments (Note 3)	Accumulated Other Comprehensive Loss
Balance at December 31, 2006 (As restated)	\$ (622)	\$ (19,752)	\$ 90	\$ (20,284)
Current period change, net of tax (As restated)	3,159	994	(48)	4,105
Balance at March 31, 2007 (As restated)	\$ 2,537	\$ (18,758)	\$ 42	\$ (16,179)

9. Warranties

The Company offers warranties on certain products that it sells. The specific terms and conditions of these warranties vary depending on the product sold, the country in which the product is sold and arrangements with the customer. The Company estimates the costs that may be incurred under its warranties and records a liability for such costs. Factors that affect the Company's warranty liability include the number of units sold, historical and anticipated rates of warranty claims, cost per claim and new product introduction. The Company periodically assesses the adequacy of its recorded warranty claims and adjusts the amounts as necessary. Changes in the Company's combined short-term and long-term warranty liabilities during the three months ended March 31, 2007 are as follows:

Balance at December 31, 2006	\$ 2,969
Warranties provided during period	390
Settlements made during period	(336)

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

Changes in liability estimates, including expirations and currency effects

(74)

Balance at March 31, 2007

\$ 2,949

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

(dollars in thousands, except per share information)

10. Restructuring and Impairments Expense

Restructuring and impairments expense included in the Company's income statements are the result of its long-term strategy to reduce production costs and improve long-term competitiveness. Restructuring and impairments expense consists principally of severance costs related to reductions in work force and of facility costs and impairments of assets related to closing facilities and/or shifting production from one facility to another. Facility costs are principally comprised of costs to relocate assets to the Company's other facilities, operating lease termination costs and other associated costs.

The table below sets forth for the three months ended March 31, 2007, the significant components and activity under restructuring programs.

	Balance at December 31, 2006	Charges	Write-offs	Cash Payments	Balance at March 31, 2007
Severance	\$ 949	\$ 3,282	\$	\$ (1,049)	\$ 3,182
Asset impairment		389	(389)		
Facility costs and other		462			462
Total	\$ 949	\$ 4,133	\$ (389)	\$ (1,049)	\$ 3,644

Restructuring and impairments expense by segment, which is not included in Segment Earnings (Loss) in Note 11, is as follows:

	For the Three Months Ended March 31,	
	March 31, 2007	2006
Clothing	\$ 1,698	\$ 222
Roll Covers	2,435	
Total	\$ 4,133	\$ 222

In March 2007, the Company announced that it will cease manufacturing activity at its roll covers manufacturing facility in the U.K. on March 31, 2007 and recorded restructuring expenses of \$1,268 related thereto during the first quarter of 2007. The Company had recorded asset impairment charges of \$1,700 related to this facility during the fourth quarter of 2006. In the first quarter of 2007, the Company also initiated the closure of a roll covers manufacturing facility in the U.S. for which restructuring expenses and asset impairments of \$205 and \$389, respectively, were recorded during the first quarter of 2007. The Company expects to incur additional expenses of approximately \$850 during the remainder of 2007 related to these restructuring programs.

During the first quarter of 2007, the Company initiated a program to streamline its operating structure and recorded restructuring expenses of \$2,271 related thereto, of which \$1,698 was in the clothing segment and \$573 in the roll covers segment. The Company expects to incur additional expenses of approximately \$1,400 during the remainder of 2007 related to this restructuring program, the majority of which will be in the clothing segment.

11. Business Segment Information

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

The Company is a global manufacturer and supplier of consumable products primarily used in the production of paper, and is organized into two reportable segments: Clothing and Roll Covers. The Clothing segment represents the manufacture and sale of synthetic textile belts used to transport paper along the length of papermaking machines. The Roll Covers segment primarily represents the manufacture and refurbishment of covers used on the steel rolls of a papermaking machine. The Company manages each of these operating segments separately.

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

11. Business Segment Information (continued)

Management evaluates segment performance based on earnings before interest, taxes, depreciation and amortization and before allocation of corporate charges. Such measure is then adjusted to exclude items that are of an unusual nature and are not used in measuring segment performance or are not segment specific (Segment Earnings (Loss)). The accounting policies of these segments are the same as those for the Company as a whole. Inter-segment net sales and inter-segment eliminations are not material for any of the periods presented.

Summarized financial information for the Company's reportable segments is presented in the tables that follow for the three months ended March 31, 2007 and 2006, respectively.

	Clothing	Roll Covers	Corporate	Total
Three Months Ended March 31, 2007:				
Net sales	\$ 93,333	\$ 50,625	\$	\$ 143,958
Segment Earnings (Loss)	23,748	12,139	(3,572)	

Three Months Ended March 31, 2006:				
Net sales	\$ 95,295	\$ 51,437	\$	\$ 146,732
Segment Earnings (Loss)	27,103	12,494	(3,626)	

Segment Earnings (Loss) above excludes restructuring and impairments expense.

Provided below is a reconciliation of Segment Earnings (Loss) to income before provision for income taxes for the three months ended March 31, 2007 and 2006, respectively.

	Three Months Ended March 31,	
	2007	2006
	(As restated)	(As restated)
Segment Earnings (Loss):		
Clothing	\$ 23,748	\$ 27,103
Roll Covers	12,139	12,494
Corporate	(3,572)	(3,626)
Non-cash compensation and related expenses	(535)	(778)
Net interest expense	(12,187)	(6,216)
Depreciation and amortization	(10,999)	(10,980)
Restructuring and impairments expense	(4,133)	(222)
Unrealized foreign exchange loss on revaluation of debt	(19)	(392)
Income before provision for income taxes	\$ 4,442	\$ 17,383

Table of Contents

Xerium Technologies, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

12. Commitments and Contingencies

Legal Proceedings

Stockholder Litigation

On June 7, 2006, a purported class action complaint was filed in the United States District Court for the District of Massachusetts on behalf of a putative class of investors who purchased shares pursuant or traceable to the Company's initial public offering on or about May 16, 2005 through November 15, 2005 against the Company, the Company's Chief Executive Officer and the Company's Chief Financial Officer. The Company was served with the complaint on June 8, 2006. The complaint concerns the Company's initial public offering of common stock and alleges violations of Sections 11 and 12(a)(2) and liability under Section 15 of the Securities Act of 1933. The plaintiff seeks rescission rights, attorneys' fees and other costs and unspecified damages on behalf of a purported class of purchasers of the Company's common stock pursuant and/or traceable to the Company's IPO on or about May 16, 2005 through November 15, 2005. The Company believes that the complaint is without merit and intends to defend the litigation vigorously.

The Company is involved in various legal matters, which have arisen in the ordinary course of business. The Company does not believe that the ultimate resolution of these matters will have a material adverse effect on its financial position, results of operations or cash flow.

Environmental Matters

In connection with the closure of certain manufacturing facilities under its restructuring programs, the Company had conducted environmental site assessments which had indicated contamination at two sites. Management believes that both sites have been remediated and no further remediation costs are expected to be incurred. During the first quarter of 2007, the Company paid approximately \$2,100 related to the environmental remediation, which costs had been accrued as of December 31, 2006. The Company believes that any additional liability in excess of amounts provided which may result from the resolution of such matters will not have a material adverse effect on the financial condition, liquidity or cash flow of the Company.

13. Stock-Based Compensation

On January 1, 2006, the Company adopted SFAS No. 123R, *Share-Based Payment (Revised 2004)* (SFAS No. 123R), which discontinues the accounting for share-based compensation using APB No. 25 and generally requires that such transactions be recognized in the income statement based on their fair values at the date of grant. The Company adopted the modified prospective method permitted under SFAS No. 123R. Under this transition method, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R, compensation expense is recognized on all share-based payments granted prior to, but not yet vested, as of December 31, 2005 and for share-based payments granted subsequent to December 31, 2005. Accordingly, compensation expense of \$535 and \$778 was recorded for the three months ended March 31, 2007 and 2006, respectively, and a related tax benefit thereon of \$51 and \$299 was recorded for the three months ended March 31, 2007 and 2006, respectively.

2005 Equity Incentive Plan

Effective May 19, 2005, the Company adopted the 2005 Equity Incentive Plan (the 2005 Plan). The Board of Directors has authorized 2,500,000 shares for grant under the 2005 Plan. Under the 2005 Plan, time-based and performance-based RSUs (based on shareholder return targets) were granted to officers and employees of the Company in 2005. Non-employee directors were also awarded RSUs under the 2005 Plan in 2005 and 2006. Each RSU represents an equal number of shares of common stock.

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

13. Stock-Based Compensation (continued)**2005 Equity Incentive Plan (continued)**

To earn common stock under time-based RSUs, generally the grantee must be employed by the Company through the applicable vesting date, which occurs annually on May 19, 2006, 2007 and 2008. To earn common stock under performance-based RSUs, generally defined shareholder return targets must be met over the four years (or two years in the case of 20,834 RSUs) following the completion of the Company's initial public offering on May 19, 2005 and the grantee must be employed by the Company through May 19, 2009 (or May 19, 2007 in the case of 20,834 RSUs). Awards to directors vest upon grant and the underlying shares are issued to them upon termination of service as a member of the Board of Directors or a change in control, as defined in the 2005 Plan.

On March 29, 2007, under the 2005 Plan, the Company granted 368,350 performance-based RSUs to certain officers and employees of the Company. The awards will generally only vest if the individual remains employed by the Company through December 31, 2007 and if a performance metric based upon 2007 Adjusted EBITDA, as defined in the Company's senior credit facility as in effect on March 29, 2007 and with certain adjustments, equals or exceeds a target level that has been specified by the Compensation Committee of the Board of Directors. If the performance metric equals or exceeds the target level specified, the RSUs will vest on the day the Company files its Annual Report on Form 10-K for fiscal year 2007, and the Company will within thirty days thereafter issue one share of common stock in respect of each fully vested RSU. Under the provisions of SFAS No. 123R, during the first quarter of 2007 no compensation expense was recorded for the performance-based grants that are based on an Adjusted EBITDA target as it is not probable that the performance conditions will be achieved. The probability of achieving the Adjusted EBITDA performance conditions will be reevaluated each reporting period and compensation expense recorded as appropriate.

A summary of RSUs outstanding as of March 31, 2007 and their vesting dates is as follows:

	Vesting Dates	Number of RSUs
Time-based RSUs	Annually, in varying amounts, on May 19, 2007 and 2008	313,401
Performance-based RSUs (shareholder return targets)	May 19, 2009, assuming performance criteria are achieved	710,173
Performance-based RSUs (shareholder return targets)	May 19, 2007, assuming performance criteria are achieved	20,834
Performance-based RSUs (Adjusted EBITDA target)	Date of filing of 2007 Annual Report on Form 10-K	368,350
Non-employee directors' RSUs	Date of grant	27,859
Total RSUs outstanding		1,440,617

Certain time-based RSUs and all non-employee director RSUs automatically adjust to reflect awards of additional RSUs upon payment of dividends by the Company. Outstanding RSUs that were awarded in connection with the payment of dividends are included in the table below. During the three months ended March 31, 2007, 4,247 additional time-based RSUs and 640 additional non-employee director RSUs were issued

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

in connection with the payment of dividends that occurred on March 15, 2007. These dividend RSUs were charged to accumulated deficit, in accordance with SFAS No. 123R.

Table of Contents**Xerium Technologies, Inc.**

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

13. Stock-Based Compensation (continued)**2005 Equity Incentive Plan (continued)**

RSU activity during the three months ended March 31, 2007, is presented below.

	Number of RSUs	Price Range of Grant-Date Fair Value Price Per RSU	Weighted Average Grant-Date Fair Value Price Per RSU
Outstanding, December 31, 2006	1,067,380	\$ 8.40 - 12.01	\$ 11.59
Granted	368,350	7.81	7.81
Granted (as dividends)	4,887	7.99 - 9.57	8.20
Outstanding, March 31, 2007	1,440,617	\$ 7.99 - 12.01	\$ 10.61
Vested, March 31, 2007 (1)	27,859	\$ 8.40 - 12.01	\$ 10.53

(1) Vested RSUs at March 31, 2007 consist entirely of non-employee director RSUs. The common stock underlying these RSUs will be issued to the directors upon termination of their service as members of the Board and/or a change in control, as defined in the 2005 Plan. The total grant-date fair value of RSUs that vested during the three months ended March 31, 2007 was not material.

As of March 31, 2007, there was approximately \$2,850 of total unrecognized compensation expense related to unvested share-based awards which is expected to be recognized over a weighted average period of 1.8 years.

14. Dividend Reinvestment Plan

In February 2007 the Company established a dividend reinvestment plan (DRIP) that allows shareholders of record to elect to receive all or part the dividends on shares of the Company s common stock that otherwise would be paid in cash in the form of additional shares of common stock. Pursuant to a letter agreement with the Company dated December 22, 2006, as amended on May 2, 2007, Apax WW Nominees Ltd. and Apax-Xerium APIA LP (collectively the Apax entities) agreed that they will participate in the DRIP through December 31, 2008 at a level such that at a minimum 50% of each dividend otherwise payable in cash on the Company s common stock, including shares not held by Apax entities, is reinvested in the Company s common stock through the DRIP, provided that the Apax entities are not required to reinvest more than 100% of the cash dividends payable to them with respect to such dividend declaration. In connection with the dividend payment made by the Company on March 15, 2007, 634,663 shares of the Company s common stock were issued pursuant to the DRIP. The Apax entities held approximately 53% of the Company s outstanding common stock as of March 31, 2007.

15. Subsequent Events**Amendment to Credit Facility Agreement**

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

On May 2, 2007, the Company amended its credit facility agreement with the lenders thereunder to modify certain covenants, ratios and definitions and, in addition to other limitations on dividends, to limit any quarterly dividend payable on the Company's common stock to no more than \$0.1125 per share. In connection with the amendment, the Company paid an amendment fee of approximately \$1,500, as well as other fees and expenses.

Table of Contents

Xerium Technologies, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except per share data)

15. Subsequent Events (continued)

Dividends

In connection with the Company's amendment of its senior credit facility in May of 2007, the Company's Board of Directors adopted a new dividend policy. Under the new dividend policy, quarterly dividends will be paid, if at all, at an amount to be determined by the Company's Board of Directors on a quarterly basis taking into account those factors it deems relevant. On May 2, 2007, the Company's Board of Directors declared a cash dividend of \$0.1125 per share of common stock, payable on June 15, 2007 to shareholders of record at the close of business on June 5, 2007.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Forward Looking Statements

The following discussion of our financial condition and results of operations should be read together with our unaudited condensed consolidated interim financial statements and the related notes thereto contained elsewhere in this quarterly report on Form 10-Q/A. The discussion included in this section, as well as other sections of this quarterly report on Form 10-Q/A contains forward-looking statements. These statements relate to future events or to our future financial performance and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by the use of words such as may, could, expect, intend, plan, seek, anticipate, believe, estimate, predict, potential, or continue terms or other comparable terminology. You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties, and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance, or achievements. Factors that could materially affect our actual results, levels of activity, performance or achievements include the following items:

our revenues and profitability could be adversely affected by fluctuations in currency exchange rates;

our profitability would be reduced by a decline in the prices of our products;

we may not be able to develop and market new products successfully or we may not be successful in competing against new technologies developed by competitors;

we are not required to make dividend payments on our common stock at any particular level or at all;

we are limited by our credit facility as to the amount of dividends we are permitted to pay;

Table of Contents

we may have insufficient cash to fund growth and unexpected cash needs after satisfying our debt service obligations and paying dividends due to our high degree of leverage and significant debt service obligations;

we are subject to the risk of weaker economic conditions in the locations around the world where we conduct business;

we may be required to incur significant costs to reorganize our operations in response to market changes in the paper industry;

we are subject to the risk of terrorist attacks or an outbreak or escalation of any insurrection or armed conflict involving the United States or any other country in which we conduct business, or any other national or international calamity;

we are subject to any future changes in government regulation; and

we are subject to any changes in U.S. or foreign government policies, laws and practices regarding the repatriation of funds or taxes. Other factors that could materially affect actual results, levels of activity, performance, or achievements can be found in our Annual Report on Form 10-K/A for the year ended December 31, 2006 filed with Securities and Exchange Commission on August 23, 2007. If any of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you read in this quarterly report on Form 10-Q/A reflects our current views with respect to future events and is subject to these and other risks, uncertainties, and assumptions relating to our operations, results of operations, growth strategy, and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, whether as a result of new information, future events, or otherwise.

Restatement

On August 10, 2007, we filed a Current Report on Form 8-K announcing that we determined to restate certain of our previously issued financial statements. We are filing this Amendment No. 1 to our Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2007, originally filed on May 9, 2007 (the "Original Filing"), to amend and restate the consolidated balance sheet as of March 31, 2007 and the consolidated statements of operations and cash flows for each of the three month periods ended March 31, 2007 and 2006. In addition, the Company filed an amendment to its Annual Report on Form 10-K/A for the year ended December 31, 2006 to amend and restate consolidated balance sheets as of December 31, 2006 and 2005 and the consolidated statements of operations, stockholders' equity (deficit), and cash flows for the years 2006 and 2005 and the Company's unaudited quarterly financial statements during these years, commencing with the quarter ended June 30, 2005.

Subsequent to the Original Filing, an error in accounting for our interest rate swap agreements was identified. We entered into floating-to-fixed interest rate swaps in June 2005 and had accounted for these interest rate swaps as hedging instruments in accordance with SFAS No. 133,

Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities-an amendment of FASB Statement No. 133 and SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities. The fair value of these interest rate swap agreements was adjusted quarterly with the changes recorded as deferred gains or losses in our consolidated balance sheet with the offset recorded in accumulated other comprehensive loss, net of tax. It has been determined that the swaps do not qualify for hedge accounting because of the inappropriate application of the "short cut" method to evaluate these interest rate swaps for hedge accounting purposes from the date of inception. Accordingly, we are required to recognize the change in the fair value of these interest rate swap derivatives as a component of earnings for the periods commencing in June 2005. The restatement has no effect on cash flows from operating, investing or financing activities or on our debt covenant calculations.

Table of Contents

Overview

We are a leading global manufacturer and supplier of two categories of consumable products used primarily in the production of paper clothing and roll covers. Our operations are strategically located in the major paper-producing regions of North America, Europe, South America and Asia-Pacific.

Our products play key roles in the formation and processing of paper along the length of a paper-making machine. Paper producers rely on our products and services to help improve the quality of their paper, differentiate their paper products, operate their paper-making machines more efficiently and reduce production costs. Our products and services typically represent only a small fraction of a paper producer's overall production costs, yet they can reduce costs by permitting the use of lower-cost raw materials and reducing energy consumption. Paper producers must replace clothing and refurbish or replace roll covers regularly as these products wear down during the paper production process. Our products are designed to withstand extreme temperature, chemical and pressure conditions, and are the result of a substantial investment in research and development and highly sophisticated manufacturing processes.

We operate in two principal business segments: clothing and roll covers. In our clothing segment, we manufacture and sell highly engineered synthetic textile belts that transport paper as it is processed on a paper-making machine. Clothing plays a significant role in the forming, pressing and drying stages of paper production. Because paper-making processes and machine specifications vary widely, the clothing size, form, material and function is selected to fit each individual paper-making machine and process. For the three months ended March 31, 2007, our clothing segment represented 65% of our net sales.

Our roll cover products provide a surface with the mechanical properties necessary to process the paper sheet in a cost-effective manner that delivers the sheet qualities desired by the paper producer. Roll covers are tailored to each individual paper-making machine and process, using different materials, treatments and finishings. In addition to manufacturing and selling new roll covers, we also provide refurbishment services for previously installed roll covers and manufacture spreader rolls. For the three months ended March 31, 2007, our roll covers segment represented 35% of our net sales.

Industry Trends and Outlook

Demand for our products depends primarily on the volume of paper produced on a worldwide basis. The profitability of paper producers has historically been highly cyclical due to wide swings in the price of paper, driven to a high degree by the oversupply of paper during periods when paper producers have more aggregate capacity than the market requires. A sustained downturn in the paper industry, either globally or in a particular region, can cause paper manufacturers to reduce production or cease operations, which could adversely affect our revenues and profitability. Paper producers began in 2000 to take actions that seek to structurally improve the balance between the supply of and demand for paper. As part of these efforts, they have shut down many paper-making machines. Between 2001 and 2004 the bulk of these closures occurred in North America and announcements by paper producers for shutdowns of paper-making machines in North America have continued, although at a reduced level compared to 2001 through 2004. In 2005 and 2006, there was an increase in the number of planned shutdowns of paper-making machines in Europe, although not at the level experienced in recent years in North America. During 2005 and 2006, the sales and profitability of our North American and European operations were adversely affected by these shutdowns. Papermakers continue to experience low levels of profitability, and we believe that further consolidation among papermakers, reducing the number of paper producers, and shutdowns of paper-making machines will occur in Europe and North America, until there is a better balance between supply and demand for paper and the profit levels of paper producers improve. The balance between supply and demand is expected to improve as the industry consolidates further and shuts down excess capacity. In addition, consumption growth of paper is expected to drive an increase in the production rates required to maintain balance between supply and demand.

According to the Food and Agriculture Organization of the United Nations, the volume of paper productions between 1980 and 2005 increased at a compound annual growth rate of approximately 2.95%. Jaako Pöyry Consulting, a global consulting firm focusing on the forest industry, expects the growth of global paper production from 2005 to 2020 to slow down to an average of slightly less than 2% per annum. We expect growth to be greater in Asia, South America and Eastern Europe than in the more mature North American and Western European regions. Given that demand for our products is primarily driven by the level of global paper production, we expect that demand for our products will grow in a manner consistent with these trends but be moderated by the level of industry

Table of Contents

consolidation and paper-machine shutdown activity in North America and Western Europe. We expect to increase our footprint in Asia in order to take advantage of the high growth potential in that region.

We anticipate that pricing pressure for our products, roll covers in particular, will continue to escalate with the consolidation among paper producers and as the shift of paper production growth in Asia develops. In response to this pricing pressure, we expect to increase our expenditure levels on research and development expenses and continue to develop our value added selling approach as part of our strategy to differentiate our products.

Sales and Expenses

Sales in both our clothing and roll covers segments are primarily driven by the following factors:

The volume of worldwide paper production;

Advances in the technology of our products, which can provide value to our customers by improving the efficiency of paper-making machines; and

Our ability to provide products and services which reduce paper-making machine downtime, while at the same time allowing the manufacture of high quality paper products.

Sales in our roll covers segment include our mechanical services business. We have expanded this business in response to demand from paper producers that we perform work on the internal mechanisms of a roll while we refurbish or replace a roll cover. In our clothing segment, a portion of our business has been conducted pursuant to consignment arrangements under which we do not recognize a sale of a product to a customer until the customer placed the product into use, which typically occurs some period after the product is shipped to the customer or to a warehouse location near the customer's facility. Recently, we have been reducing the number of consignment arrangements and increasing the use of standard terms of sale under which we recognize a sale upon product shipment. We expect this trend to continue, although at a slower pace than in 2006.

Key factors affecting our costs include:

Our total sales volume (which directly impacts the level of our cost of products sold and production capacity utilization);

The amount of our property and equipment depreciation; and

The level of our research and development spending.

The level of our cost of products sold is primarily attributable to labor costs, raw material costs, product shipping costs, plant utilization and depreciation, with labor costs constituting the largest component.

We invest in facilities and equipment that enable innovative product development and improve production efficiency and costs. Recent examples of capital spending for such purposes include faster weaving looms and seaming machines with accurate electronic controls, automated compound mixing equipment and computer-controlled lathes and mills.

The level of research and development spending is driven by market demand for technology enhancements, including both specific customer needs and general market requirements, as well as by our own analysis of applied technology opportunities. With the exception of purchases of equipment and similar capital items used in our research and development activities, all research and development is expensed as incurred. Research and development expenses were \$2.6 million for the three months ended March 31, 2007 and 2006, respectively. We expect that future research and development expenses as compared to these levels, will increase based on an increased focus on advanced research.

Foreign Exchange

We have a geographically diverse customer base. For the three months ended March 31, 2007, approximately 39% of our sales was in North America, 38% was in Europe, 9% was in South America, 12% was in Asia-Pacific and 2% was in the rest of the world.

Table of Contents

A substantial portion of our sales is denominated in Euros or other currencies. As a result, changes in the relative values of U.S. Dollars, Euros and other currencies affect our reported levels of revenues and profitability as the results are translated into U.S. Dollars for reporting purposes. In particular, increases in the value of the U.S. Dollar relative to the value of the Euro and these other currencies adversely impact our levels of revenue and profitability because the translation of a certain number of Euros or units of such other currencies into U.S. Dollars for financial reporting purposes will represent fewer U.S. Dollars.

For certain transactions, our sales are denominated in U.S. Dollars or Euros but all or a substantial portion of the associated costs are denominated in a different currency. As a result, changes in the relative values of U.S. Dollars, Euros and other currencies can affect the level of the profitability of these transactions. The largest proportion of such transactions consist of transactions in which the sales are denominated in U.S. Dollars and all or a substantial portion of the associated costs are denominated in Euros or other currencies.

Currency fluctuations have a greater effect on the level of our net sales than on the level of our income from operations. For example, for the three months ended March 31, 2007 as compared with the three months ended March 31, 2006, the change in the value of the U.S. Dollar against the currencies we conduct our business in resulted in currency translation increases in net sales and income from operations of \$6.5 million and \$0.5 million, respectively. Although the results for the three months ended March 31, 2007 reflect a period in which the value of the U.S. Dollar decreased against the currencies in which we conduct the majority of our non-U.S. Dollar denominated business as compared to the three months ended March 31, 2006, we would expect a similar but opposite effect in a period in which the value of the U.S. Dollar increases. For any period in which the value of the dollar changes relative to other currencies, we would expect our income from operations to be proportionately affected less than our net sales.

During the three months ended March 31, 2007, we conducted business in nine foreign currencies. The following table provides the average exchange rate for the three months ended March 31, 2007 and 2006, respectively, of the U.S. Dollar against each of the five foreign currencies in which we conduct the largest portion of our operations, and indicates the percentage of our net sales for the three months ended March 31, 2007 denominated in such foreign currency.

Currency	Average exchange rate of the U.S. Dollar for the three months ended March 31, 2007	Average exchange rate of the U.S. Dollar for the three months ended March 31, 2006	Percentage of net sales for the three months ended March 31, 2007 denominated in such currency
Euro	\$1.31 = 1 Euro	\$1.20 = 1 Euro	42.0%
Canadian Dollar	\$0.85 = 1 Canadian Dollar	\$0.87 = 1 Canadian Dollar	9.2%
Brazilian Real	\$0.47 = 1 Brazilian Real	\$0.46 = 1 Brazilian Real	7.1%
Australian Dollar	\$0.79 = 1 Australian Dollar	\$0.74 = 1 Australian Dollar	3.7%
British Pound	\$1.95 = 1 British Pound	\$1.75 = 1 British Pound	3.6%

To mitigate the risk of transactions in which a sale is made in one currency and associated costs are denominated in a different currency, we utilize forward currency contracts in certain circumstances to lock in exchange rates with the objective that the gain or loss on the forward contracts will approximate the loss or gain that results from the transaction or transactions being hedged. We determine whether to enter into hedging arrangements based upon the size of the underlying transaction or transactions, an assessment of the risk of adverse movements in the applicable currencies and the availability of a cost effective hedge strategy. To the extent we do not engage in hedging or such hedging is not effective, changes in the relative value of currencies can affect our profitability.

Table of Contents

Any dividends on our common stock will be paid in U.S. Dollars. We do not expect to generate sufficient cash flows denominated in U.S. Dollars to make our anticipated dividend payments and will therefore rely, in part, on the conversion to U.S. Dollars of cash flows generated in other currencies. The amount of U.S. Dollars received from the conversion of cash flows generated in other currencies will depend on the then-current exchange rates. If the value of the U.S. Dollar increases relative to the value of these other currencies, the cash flows will represent fewer U.S. Dollars. As a result, even if our results of operations meet our expectations in local currencies and we are permitted to pay dividends under our credit facility, we may not have sufficient cash to pay such dividends.

Cost Reduction Programs

An important part of our strategy is to seek to reduce our overall costs and improve our competitiveness. As a part of this effort, we have engaged in a series of cost reduction programs since 2002, which were designed to improve the cost structure of our operations in North America, South America and Europe, in response to changing market conditions. These cost reduction programs include headcount reductions throughout the world as well as plant closures that have rationalized production among our facilities to better enable us to meet customer demands.

Our cost reduction efforts between 2002 and 2006 include the closing of eight manufacturing facilities and the movement of certain production from two other facilities. Four facilities were closed in the clothing segment, of which three were in North America and one was in the United Kingdom and we closed four facilities in the rolls segment, of which three were in North America and one was in the United Kingdom. From 2002 to 2006, we eliminated approximately 370 positions in connection with our cost reduction efforts. As a result of these actions, offset by other changes in workforce, our headcount decreased by approximately 260 positions during that period.

We have substantially completed the major restructuring programs that have already been initiated both in roll covers and clothing in 2006 and prior and do not currently anticipate significant plant closures of the type we completed in 2003 through 2005. We believe that our manufacturing footprint for clothing in North America has been adequately consolidated and that potential exists to improve our fixed overhead structure and to initiate further consolidations of our rolls manufacturing footprint in Europe and North America.

In March 2007, we announced that we will cease manufacturing activity at our roll covers manufacturing facility in the U.K. on March 31, 2007 and recorded restructuring expenses of \$1,268 related thereto during the first quarter of 2007. We had recorded asset impairment charges of \$1,700 related to this facility during the fourth quarter of 2006. In the first quarter of 2007 we also initiated the closure of a roll covers manufacturing facility in the U.S. for which restructuring expenses and asset impairments of \$205 and \$389, respectively, were recorded during the first quarter of 2007. We expect to incur additional restructuring expenses of approximately \$850 during the remainder of 2007 related to these restructuring programs.

During the first quarter of 2007, we initiated a program to streamline our operating structure and recorded restructuring expenses of \$2,271 related thereto. We expect to incur additional restructuring expenses of approximately \$1,400 during the remainder of 2007 related to this restructuring program.

In addition, we have also initiated lean manufacturing and procurement initiatives designed to enhance the efficiency of our manufacturing process, which we believe will help offset the effect of inflation on our bottom line following the initial investments required for these initiatives.

There can be no assurance that our cost reduction programs will be successful. While our cost reduction programs are designed to help mitigate the effect of increases in our operating costs, we may experience sales or cost changes from period to period which have a greater effect on the level of our profitability than savings derived from our cost reduction programs.

Table of Contents**Results of Operations**

The tables that follow set forth for the periods presented certain consolidated operating results and the percentage of net sales they represent:

<i>(in millions)</i>	Three Months Ended March 31,	
	2007 (As restated)	2006 (As restated)
Net sales	\$ 144.0	\$ 146.7
Cost of products sold	83.0	85.0
Selling expenses	19.3	18.6
General and administrative expenses	18.0	16.6
Restructuring and impairments expenses	4.1	0.2
Research and development expenses	2.6	2.6
Income from operations	17.0	23.7
Interest expense, net	(12.2)	(6.2)
Foreign exchange loss	(0.4)	(0.1)
Income before provision for income taxes	4.4	17.4
Provision for income taxes	1.4	4.9
Net income	\$ 3.0	\$ 12.5

	Percentage of Sales Three Months Ended March 31,	
	2007 (As restated)	2006 (As restated)
Net sales	100.0%	100.0%
Cost of products sold	57.6	57.9
Selling expenses	13.4	12.7
General and administrative expenses	12.5	11.3
Restructuring and impairments expenses	2.9	0.1
Research and development expenses	1.8	1.8
Income from operations	11.8	16.2
Interest expense, net	(8.5)	(4.2)
Foreign exchange loss	(0.3)	(0.1)
Income before provision for income taxes	3.0	11.9
Provision for income taxes	0.9	3.3
Net income	2.1%	8.6%

Three Months Ended March 31, 2007 Compared to the Three Months Ended March 31, 2006.

Net Sales. Net sales for the three months ended March 31, 2007 decreased by \$2.7 million, or 1.8%, to \$144.0 million from \$146.7 million for the three months ended March 31, 2006. For the three months ended March 31, 2007, 65% of our net sales were in our clothing segment and 35% were in our roll covers segment.

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

In our clothing segment, net sales for the three months ended March 31, 2007 decreased by \$2.0 million, or 2.1%, to \$93.3 million from \$95.3 million for the three months ended March 31, 2006 primarily due to (i) decreased sales volume in North America and Europe reflecting primarily the timing of orders and the higher conversion of consignment inventory to sales in the prior year period and (ii) unfavorable currency effects on pricing related to sales prices indexed in U.S. Dollars by certain non-U.S. operations of \$0.9 million, partially offset by favorable currency effects on net sales of \$4.5 million related to the translation of sales made in currencies other than the U.S. Dollar to U.S. Dollars for financial reporting. Overall pricing levels in our clothing segment decreased less than 1% during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006.

In our roll covers segment, net sales for the three months ended March 31, 2007 decreased by \$0.7 million or 1.4%, to \$50.7 million from \$51.4 million for the three months ended March 31, 2006 due to lower sales primarily in North America, partially offset by favorable currency effects of \$2.0 million related to the translation of sales made in currencies other than the U.S. Dollar to U.S. Dollars for financial reporting purposes. Overall pricing levels in our roll covers segment decreased by approximately 2% during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006.

Cost of Products Sold. Cost of products sold for the three months ended March 31, 2007 decreased by \$2.0 million, or 2.4%, to \$83.0 million from \$85.0 million for the three months ended March 31, 2006.

Table of Contents

In our clothing segment, cost of products sold decreased by \$2.1 million, or 3.9%, to \$52.1 million for the three months ended March 31, 2007 from \$54.2 million for the three months ended March 31, 2006 primarily due to (i) lower sales resulting in lower cost of products sold of \$3.3 million, (ii) decreased added operating costs of \$1.3 million as compared with the three months ended March 31, 2006 due to shifting production from closed facilities to other facilities under our restructuring programs and (iii) rebates on material costs of \$0.5 million during the three months ended March 31, 2007 related to a purchase contract we signed during the fourth quarter of 2006. The decreases were partially offset by unfavorable currency translation effects of \$3.0 million.

In our roll covers segment, cost of products sold remained constant at \$30.9 million for the three months ended March 31, 2007 and the three months ended March 31, 2006. The decrease in cost of products sold due to lower sales volume in this segment during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006 was entirely offset by unfavorable currency translation effects of \$1.3 million.

Selling Expenses. For the three months ended March 31, 2007, selling expenses increased by \$0.7 million, or 3.8%, to \$19.3 million from \$18.6 million for the three months ended March 31, 2006. The increase was primarily due to unfavorable currency translation effects of \$0.9 million, partially offset by reduced sales commissions due to lower sales volume.

General and Administrative Expenses. For the three months ended March 31, 2007, general and administrative expenses increased by \$1.4 million, or 8.4%, to \$18.0 million from \$16.6 million for the three months ended March 31, 2006. The increase was primarily due to (i) unfavorable currency translation effects of \$0.8 million and (ii) an increase in payroll and related costs of \$1.0 million in the three months ended March 31, 2007 as compared to March 31, 2006. These increases were partially offset by (i) a \$0.2 million decrease in compensation expense relating to restricted stock units granted under our 2005 Equity Incentive Plan and (ii) the \$0.5 million impact of a lower cost structure resulting from our cost reduction programs during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006.

Restructuring and Impairments Expenses. For the three months ended March 31, 2007, restructuring and impairments expenses increased by \$3.9 million to \$4.1 million from \$0.2 million for the three months ended March 31, 2006. Restructuring expenses result from our long-term strategy to reduce production costs and improve long-term competitiveness as described above under Cost Reduction Programs by closing and/or transferring production from certain of our manufacturing facilities and through headcount reductions. For the three months ended March 31, 2007, restructuring expenses consisted of severance, asset impairments and facility costs of \$3.3 million, \$0.4 million and \$0.4 million, respectively.

Research and Development Expenses. For the three months ended March 31, 2007, research and development expenses remained constant at \$2.6 million as compared with the three months ended March 31, 2006.

Interest Expense, Net. Net interest expense for the three months ended March 31, 2007 increased by \$6.0 million, or 96.8%, to \$12.2 million from \$6.2 million for the three months ended March 31, 2006. The increase is primarily attributable to (i) the \$5.4 million increase in interest expense recognized during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006 in connection with the change in the fair value of our interest rate swaps and to (ii) increased interest rates during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006.

Foreign Exchange Loss. For the three months ended March 31, 2007 and 2006, we had a foreign exchange loss of \$0.4 million and \$0.1 million, respectively. The increase of \$0.3 million was primarily attributable to the manner in which swings in the value of the U.S. Dollar as compared to other currencies, primarily the Euro and the Brazilian Real, affect the reported amount of intercompany transactions. Foreign exchange gains and losses result primarily from intercompany activity.

Provision for Income Taxes. For the three months ended March 31, 2007 and 2006, the provision for income taxes was \$1.4 million and \$4.9 million, respectively. The decrease in the provision for income taxes for the first quarter, 2007 compared to the first quarter, 2006 was primarily due to a decrease in income before provision for income taxes. In 2006, certain jurisdictions which had actual operating losses in 2005 had forecasted profits in 2006 which allowed the recognition of deferred tax assets for which a valuation allowance had been previously established.

Table of Contents

Dividend Policy

In May of 2007, at the time of the adoption of an amendment to our senior credit facility, our Board of Directors reevaluated our previously existing dividend policy, adopted in May of 2005, and the rate at which we pay quarterly dividends. Under the new dividend policy, adopted May 2, 2007, quarterly dividends will be paid, if at all, in an amount to be determined by the Board of Directors on a quarterly basis taking into account factors that our Board of Directors deems relevant. These factors may include such matters as our financial performance, the sufficiency of cash flow from operations to fund dividends, our cash position and cash requirements, growth opportunity and acquisition strategies, competitive or technological developments, the level of participation in our dividend reinvestment plan, credit facility limitations and other contractual restrictions, debt repayment considerations, provisions of applicable law, and other considerations that our Board of Directors may deem appropriate. On May 2, 2007 our Board of Directors declared a cash dividend of \$0.1125 per share of common stock payable on June 15, 2007 to shareholders of record at the close of business on June 5, 2007. This dividend was declared in accordance with the new dividend policy and reflects a reduction from the preceding six quarterly dividend declarations, including the dividend paid on March 15, 2007 to shareholders of record as of the close of business on March 5, 2007, of \$0.225 per share of common stock.

The declaration and payment of dividends remains subject to the discretion of the Board of Directors. Shareholders may not receive any dividends as a result of the following factors:

we are not obligated to pay dividends;

our credit facility limits the amount of dividends we are permitted to pay;

our credit facility contains restrictive covenants, including covenants requiring compliance with minimum interest coverage and fixed charge coverage ratios and maximum leverage ratios, that will require us to improve our performance over time to remain in compliance therewith;

our Board of Directors may modify or revoke our dividend policy;

even if our dividend policy is not modified or revoked, our Board of Directors could decide to reduce dividends or not to pay dividends at all, at any time and for any reason;

the amount of dividends distributed is subject to state law restrictions;

our shareholders have no contractual or other legal right to dividends;

we may not have enough cash to pay dividends due to changes to our operating earnings, working capital requirements, funding of growth initiatives and anticipated cash needs; and

our foreign subsidiaries may be subject to legal restrictions that prevent them from distributing cash to us to enable the payment of dividends.

See [Credit Facility](#) below for a discussion of the limitations on our ability to pay dividends imposed by our credit facility.

In February 2007, we established a dividend reinvestment plan ([DRIP](#)) that allows shareholders of record to elect to receive all or part the dividends on shares of our common stock that otherwise would be paid in cash in the form of additional shares of common stock. Under the DRIP, the source of such additional shares will be from our authorized and unissued shares or from our treasury shares. The number of shares

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

credited to a participant's account with respect to a dividend will be determined based upon the cash value of the dividends elected to be received in additional shares of common stock divided by the average closing price for shares of our common stock on the New York Stock Exchange on the five trading days up to and including the declared payment date. Pursuant to a letter agreement with the Company dated December 22, 2006, as amended on May 2, 2007, Apax WW Nominees Ltd. and Apax-Xerium APIA LP (collectively the "Apax entities") agreed that they will participate in the DRIP through December 31, 2008 at a

Table of Contents

level such that at a minimum 50% of each dividend otherwise payable in cash on our common stock, including shares not held by Apax entities, is reinvested in our common stock through the DRIP, provided that the Apax entities are not required to reinvest more than 100% of the cash dividends payable to them with respect to such dividend declaration. The Apax entities have made no commitment to participate in the DRIP beyond 2008. The participation of the Apax Entities and other shareholders in the DRIP would increase the number of outstanding shares of common stock eligible to participate in future dividends and, to the extent other shareholders do not participate in the DRIP, result in the participating shareholders owning an increased percentage of our common stock. In March 2007, 634,663 shares of our common stock were issued pursuant to the DRIP, and as of April 1, 2007 there were 44,434,325 shares of our common stock outstanding, of which 23,532,351.8 were held by the Apax entities.

Under Delaware law, we can only pay dividends either out of surplus (which is defined as total assets at fair market value minus total liabilities, minus statutory capital) or out of current or the immediately preceding year's earnings. We historically have not had sufficient earnings to pay dividends at the level contemplated by our dividend policy. We do not know whether we will have sufficient earnings to pay dividends in the future and therefore may have to pay dividends out of surplus. Our Board of Directors will seek periodically to assure itself that we have sufficient surplus to pay dividends before actually declaring any dividends. Further, our Board of Directors may seek opinions from outside valuation firms to the effect that there is sufficient surplus to pay dividends, and such opinions may not be forthcoming. If we sought and were not able to obtain such an opinion, we likely would not be able to declare and pay dividends.

LIQUIDITY AND CAPITAL RESOURCES

Our principal liquidity requirements are for working capital, capital expenditures, debt service and to pay dividends. We will fund our liquidity requirements primarily with cash generated from operations and, to the extent necessary, through borrowings under our credit facility.

Net cash provided by operating activities was \$15.3 million for the three months ended March 31, 2007 and \$3.7 million for the three months ended March 31, 2006. The increase is principally attributable to working capital changes during the first quarter of 2007 as compared with the first quarter of 2006.

Net cash used in investing activities was \$6.9 million for the three months ended March 31, 2007 and \$14.9 million for the three months ended March 31, 2006. The decrease of \$8.0 million was primarily due to our acquisition on February 2, 2006 of Coldwater Covers, Inc. and a related manufacturing facility for a total purchase price of \$7.0 million and to a decrease in capital equipment spending of \$1.0 million in the three months ended March 31, 2007 as compared with the three months ended March 31, 2006.

Net cash used in financing activities was \$8.3 million for the three months ended March 31, 2007 and \$16.2 million for the three months ended March 31, 2006. The decrease of \$7.9 million was primarily the result of (i) lower cash dividends of \$5.1 million paid to our shareholders during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006 as a result of the participation in the dividend reinvestment plan that became effective for 2007 (ii) lower debt payments of \$1.9 million during the three months ended March 31, 2007 as compared with the three months ended March 31, 2006 principally related to a \$5.0 million voluntary repayment of senior debt made in February 2006 and (iii) a \$0.8 million fee related to the amendment of our credit facility on February 8, 2006.

As of March 31, 2007, there was a \$626.5 million balance of term loans outstanding under our senior credit facility. The decrease from the \$650 million issued on May 19, 2005 was due to (i) changes in currency exchange rates impacting debt denominated in currencies other than the U.S. Dollar (ii) quarterly principal payments of \$1.6 to \$1.7 million as required under the term loan, (iv) voluntary repayments of senior debt during 2006 totaling \$28 million and (v) mandatory repayments of \$4.1 million in the first quarter of 2007. In addition, as of March 31, 2007, we had an aggregate of \$9.2 million outstanding under our current revolving lines of credit, including the revolving credit facility under our senior credit facility and lines of credit in various foreign countries that are used to facilitate local short-term operating needs and an aggregate of \$48.1 million available for additional borrowings under these revolving lines of credit. On May 2, 2007, the Company amended its credit facility agreement with the lenders to modify certain covenants, ratios and definitions and, in addition to other limitations on dividends, to limit any quarterly dividend payable on the Company's common stock, to eliminate covenant limiting capital expenditures and substituting a limitation on investment expenditures, including capital expenditures. See Credit Facility below.

Table of Contents

We had \$17.7 million of cash and cash equivalents at March 31, 2007 compared to \$16.8 million at December 31, 2006.

CAPITAL EXPENDITURES

For the three months ended March 31, 2007, we had capital expenditures of \$7.1 million consisting of growth capital expenditures of \$5.1 million and maintenance capital expenditures of \$2.0 million. Growth capital expenditures consist of items that are intended to increase the manufacturing, production and/or distribution capacity or efficiencies of our operations in conjunction with the execution of our business strategies. Maintenance capital expenditures are designed to sustain the current capacity or efficiency of our operations and include items relating to the renovation of existing manufacturing or service facilities, the purchase of machinery and equipment for existing manufacturing or service facilities and safety and environmental needs. For the three months ended March 31, 2006, capital expenditures were \$8.1 million, consisting of growth capital expenditures of \$6.0 million and maintenance capital expenditures of \$2.1 million.

We plan to build a clothing manufacturing facility in Vietnam and are expanding production capacity in Brazil. In connection with these actions and other planned capital expenditures for 2007 we expect capital expenditures for 2007 to be approximately \$50 million. We analyze our planned capital expenditures based on investment opportunities available to us and our financial and operating performance, and accordingly, actual capital expenditures for 2007 may be more or less than this amount. See [Credit Facility](#) below for a description on limitations on capital expenditures imposed by our credit facility.

CREDIT FACILITY

Upon the completion of the initial public offering of our common stock on May 19, 2005 we and certain of our subsidiaries entered into a senior secured credit facility. The credit facility has been amended three times: on February 8, 2006, December 22, 2006 and May 2, 2007. The third amendment, entered into on May 2, 2007, includes among other changes, the following changes:

Reduction of the minimum interest coverage ratio covenant for the period from the second quarter of 2007 through 2012 and of the minimum fixed charge ratio covenant for the period from the second quarter of 2007 through 2012, as set forth in Sections 1.8 and 1.9 of the amendment.

Changes to the definition of Adjusted EBITDA to add back consolidated restructuring and growth program costs subject to certain limitations (see [Non-GAAP Liquidity Measures](#) below).

Changes to the restrictions on our ability to declare and pay dividends (see the description of these restrictions below).

An extension to 365 days of the period in which net asset sale proceeds (as defined in the credit facility) may be reinvested in long term productive assets instead of being used to prepay debt under the credit facility. Also provides for an option to invest net asset sale proceeds in capital expenditures, permitted acquisitions, consolidated cash restructuring and growth program costs, and other investments within 365 days so long as no default or event of default has occurred or is continuing.

Reduction of mandatory excess cash flow prepayment percentages in the event there is Excess Cash (as defined in the credit facility) to 40% in fiscal year 2007, 27.5% in fiscal year 2008, and 50% in each fiscal year thereafter.

Addition of the ability of our Board of Directors to designate certain subsidiaries to be [Excluded Subsidiaries](#), which will not be subject to the financial covenants and negative covenants under the Credit Agreement. The Company and its [Non-Excluded Subsidiaries](#) (as defined in the credit facility) may not invest more than \$30 million in the aggregate in [Excluded Subsidiaries](#) between March 31, 2007 and May 17, 2012.

Edgar Filing: XERIUM TECHNOLOGIES INC - Form 10-Q/A

Deletion of covenant limiting capital expenditures and substitution of a limitation on investment expenditures, including capital expenditures, set forth in Section 1.10 of the amendment.

Table of Contents

Allowing additional asset sales with proceeds of up to \$20 million per fiscal year and \$50 million in the aggregate between March 31, 2007 and May 17, 2012, subject to certain restrictions.

Addition of permission to expend an aggregate of up to \$40 million investing in or acquiring subsidiaries that are not directly or indirectly wholly owned by the Company during the period commencing March 31, 2007.

In connection with this amendment we paid an amendment fee of approximately \$1.5 million, as well as other fees and expenses.

The description of the credit facility below describes the facility as amended.

Our credit facility provides for a \$50 million senior secured revolving credit facility and a term loan in a total principal amount of \$650 million. In December 2005 the funding of a legal reorganization of a portion of our international operations was completed and \$50 million of our previous \$100 million revolving credit facility was canceled.

The credit facility, as amended, is secured by substantially all of our assets and the assets of most of our subsidiaries that were guarantors under the previously existing credit facility in all cases subject to legal and tax considerations and requirements. Borrowings under the revolving credit facility and term loan facility bear interest, at our option, at either (a) LIBOR plus the applicable margin or (b) the Euribor rate plus the applicable margin, in each case in addition to certain other mandatory costs associated with syndication in the European markets. The applicable margin for LIBOR term loans, LIBOR revolving loans, Euribor loans and CDOR loans is set at 2.50%, subject to an increase by 0.25% in the event that the indebtedness under the senior credit facility is rated lower than B1 by Moody's or lower than B+ by Standard & Poor's. In February 2007, Moody's reduced its rating of the senior credit facility to below B1, triggering this 0.25% increase in the applicable margin. If the indebtedness under the credit facility subsequently achieves ratings of B1 or higher by Moody's and B+ or higher by Standard and Poor's after having fallen below one or both of these levels, the applicable margin will be decreased by 0.25%. The applicable margin with respect to the revolving loans may be reduced by 0.25% or 0.50% based on a leverage test set forth in the credit agreement. Following the initial public offering we entered into interest rate swap agreements that effectively fixed the interest rate on approximately 90% of the term loan credit facility through June 30, 2008 and, as of March 31, 2007, the weighted average interest rate on the effectively fixed portion of the term loan facility was 6.12%. The revolving credit facility has a 6.5 year maturity and the term loan facility has a 7 year maturity from the date of the agreement.

The credit facility provides for scheduled principal payments on the term loan of \$6.7 million each year, payable in quarterly installments that began September 30, 2005, \$1.7 million due in March 2012 and \$589.9 million due at maturity in May 2012. The credit facility will also require us to prepay outstanding loans under the term loan facility under the following circumstances:

with 100% of the net cash proceeds received by us from any sale, transfer or other disposition of any assets, subject to certain reinvestment rights and with an exemption for sales of up to \$100,000 for any transaction or series of related transactions, exemption of the first \$10 million of cumulative net proceeds and exemption of up to an additional \$10 million of net proceeds from the sale of four identified manufacturing facilities;

with 100% of the net cash proceeds received by us from any insurance recovery or condemnation events, subject to certain exceptions and reinvestment rights and with an exemption for the first \$2 million of cumulative net insurance or condemnation proceeds;

with 100% of the net cash proceeds from the incurrence of any indebtedness by us, subject to customary exceptions; and

on an annual basis with a percentage of the amount equal to our excess cash, that is our pre-dividend free cash flow (as defined in our credit facility and described below) minus our actual dividend payments for the preceding fiscal year excluding the amount of dividends applied to newly-issued or treasury shares of our common stock pursuant to a dividend reinvestment program, where such percentage is 40% for 2007, 27.5% for 2008 and 50% for each fiscal year thereafter.

Table of Contents

During the first quarter of 2007, we made a mandatory prepayment of \$4.1 million.

Our credit facility requires that we meet certain financial covenants in order to avoid a default or event of default under the facility. These covenants are as follows:

Our interest coverage ratio as of the end of any period set forth below must exceed the ratio set forth for such period:

Period	Ratio
Fiscal quarters ending March 31, 2007 through September 30, 2007	3.25:1
Fiscal quarters ending December 31, 2007 through June 30, 2009	3.50:1
Fiscal quarters ending September 30, 2009 through March 31, 2010	3.75:1
Fiscal quarters ending June 30, 2010 through December 31, 2010	4.00:1
Fiscal quarters ending March 31, 2011 and June 30, 2011	4.25:1
Fiscal quarters ending September 30, 2011 through March 31, 2012	4.50:1

Our leverage ratio as of the end of any period set forth below must not exceed the ratio set forth for such period:

Period	Ratio
Fiscal quarter ending March 31, 2007 and June 30, 2007	4.75:1
Fiscal quarters ending September 30, 2007 and December 31, 2007	4.50:1
Fiscal quarters ending March 31, 2008 through September 30, 2008	4.25:1
Fiscal quarters ending December 31, 2008 and March 31, 2009	4.00:1
Fiscal quarters ending June 30, 2009 through December 31, 2009	3.75:1
Fiscal quarters ending March 31, 2010 through December 31, 2010	3.50:1
Fiscal quarters ending March 31, 2011 through March 31, 2012	3.25:1

Our fixed charge coverage ratio as of the end of any period set forth below must exceed the ratio set forth for such period:

Period	Ratio
Fiscal quarters ending March 31, 2007 through December 31, 2007	1.80:1
Fiscal quarters ending March 31, 2008 and thereafter	1.85:1

For the four fiscal quarters ended March 31, 2007 our interest coverage ratio was 3.68:1, our leverage ratio was 4.45:1 and our fixed charge coverage ratio was 2.28:1. Our ability to comply with the financial ratios will depend on our ongoing financial and operating performance, which will be substantially dependent on the level of demand for our products, our ability to compete effectively and our ability to otherwise successfully implement our overall business strategies, including our ability to realize the benefits of our cost reduction programs, and may be affected by events beyond our control, such as prevailing economic, financial and industry conditions, including unfavorable foreign currency movements relative to the U.S. Dollar and increases in the interest rate on our debt resulting from changes in market interest rates. Costs we incur as a result of initiatives we undertake may also impact our ability to comply with the financial ratios. In addition, as described above, in February 2007, the interest rate on our debt increased as a result of a downgrade in the rating of our senior indebtedness by Moody's. There can be no assurance that we will continue to be in compliance with such financial ratios. In particular, based upon our current expectations for the level of our funded indebtedness as of the end of the applicable period as calculated for the purposes of the leverage ratio covenant, in order to be in compliance with the leverage ratio covenant in respect of the four fiscal quarters ending June 30, 2007, we will need to generate Adjusted EBITDA during the second quarter of 2007 that is nearly equal to the amount of Adjusted EBITDA that we generated in the first quarter of 2007, in order to be in compliance with the leverage ratio covenant in respect of the four fiscal quarters ending September 30, 2007, we will need to generate Adjusted EBITDA during the six months ended September 30, 2007 that is in excess of the amount of Adjusted EBITDA that we generated in the six months ended March 31, 2007, and in order to be in compliance with the leverage ratio covenant in respect of the four fiscal quarters ending December 31, 2007, we will need to generate Adjusted EBITDA during the nine months ended December 31, 2007 in excess of the amount of Adjusted EBITDA we generated in the nine months ended March 31, 2007. Because the financial ratios become more restrictive over time, our financial performance will need to improve in subsequent periods in order for us to remain in compliance with the

financial ratios in subsequent periods.

Table of Contents

Our credit facility defines consolidated investment expenditures for a particular fiscal year as the sum of (a) consolidated capital expenditures incurred in such fiscal year, (b) the aggregate consideration paid in respect of Permitted Acquisitions (as defined in our credit facility) in such fiscal year, (c) the aggregate amount of consolidated cash restructuring and growth program (programs intended to increase productivity and economic efficiency or our market share capacity, reduce cost structure, improve equipment utilization or provide additional regional capacity to better serve growth markets) costs incurred in such fiscal year, (d) the aggregate amount of investments in subsidiaries which are not wholly owned by a borrower under the credit facility made in accordance with the credit facility in such fiscal year and (e) the aggregate amount of investments in Excluded Subsidiaries (as defined in our credit facility) made in accordance with the credit facility in such fiscal year. The credit facility limits the amount of our consolidated investment expenditures in any given fiscal year to an amount not exceeding \$80.7 million for fiscal year 2007, \$74.3 million for fiscal year 2008, \$70.5 million for fiscal year 2009, \$76.5 million for fiscal year 2010 and \$76.5 million for fiscal year 2011, in each such case exclusive of excess cash amounts and net insurance and condemnation proceeds permitted to be spent on capital expenditures; provided that commencing with fiscal year 2008 the maximum amount is increased by amounts below the maximum not spent in prior years beginning with fiscal year 2007 and that the amount of consolidated investment expenditures may be increased by an amount, not to exceed \$20 million per fiscal year and \$50 million in the aggregate during the period from March 31, 2007 to May 17, 2012, with net asset sale proceeds resulting from certain asset sales contemplated by the credit facility.

Our credit facility also restricts our ability to declare and pay dividends on our common stock as follows:

Dividends are restricted by a covenant that (1) limits the amount of quarterly dividends that we may pay in June 2007 through December 2008 to the lesser of (a) 11.25% of pre-dividend free cash flow (as defined in our credit facility and described below) for the preceding four quarters and (b) an amount equal to the product of \$0.1125 and the sum of the number of outstanding shares as of May 2, 2007, shares of common stock issued pursuant to a dividend reinvestment plan and shares of common stock issued in the ordinary course of business as compensation to employees and directors (such sum referred to herein as the Authorized Dividend Amount) and (2) limits the amount of quarterly dividends that the Company may pay commencing December 31, 2008 to the lesser of 18.75% of pre-dividend free cash flow for the preceding four quarters and the Authorized Dividend Amount; provide that any amount of dividends applied to newly-issued or treasury shares of our common stock pursuant to the DRIP are not treated as dividends paid and declared for the purposes of these limitations.

In addition, the amount of the quarterly dividend payable on our common stock may not exceed \$0.1125 per share.

We may not pay dividends if a default or event of default under our new credit facility has occurred and is continuing or would occur as a consequence of such payment.

Pre-dividend free cash flow is defined in our credit facility as Adjusted EBITDA minus the sum of (i) net interest expense paid in cash, (ii) net cash taxes, (iii) capital expenditures, subject to certain limitations per the credit facility and reduced by the amount of any asset sale, insurance or condemnation proceeds which we are permitted to retain in our business and any capital expenditures made with the proceeds of previously generated surplus cash (iv) all scheduled debt repayments, (v) cash restructuring and growth program costs subject to certain limitations per the credit facility and (vi) cash payments of withholding taxes from proceeds of the repurchase, redemption or retention of our common stock relating to equity incentive awards. For the purposes of the definition of pre-dividend free cash flow, the amount of capital expenditures deducted may not exceed \$44.0 million in 2005 in the aggregate, \$48.6 million in 2006 in the aggregate, \$52.2 million in 2007 in the aggregate, \$47.8 million in 2008 in the aggregate, \$44.0 million in 2009 in the aggregate, \$50.0 million in 2010 in the aggregate and \$50.0 million in 2011 in the aggregate and consolidated cash restructuring and growth program costs shall not exceed \$7.1 million in 2005 in the aggregate, \$1.0 million in 2006 in the aggregate, \$5.0 million in 2007 in the aggregate and \$5.0 million in the aggregate in any year thereafter.

Table of Contents

The amount of cash required to pay the quarterly dividend declared for June 15, 2007 at the \$0.1125 per share level depends on the number of shares outstanding and the level of participation in the DRIP. Approximately \$2.5 million of cash would be required to pay this dividend based upon 44,434,325 shares of common stock outstanding as of April 1, 2007 and an assumed participation rate of 50% in the DRIP for this dividend. We expect that the number of our shares outstanding will increase as a result of participation in the DRIP. The number of shares of our common stock issued in connection with the DRIP will depend on the dividends declared by us, the level of participation in the DRIP and the trading price of our common stock applied in calculating the shares issued pursuant to the DRIP. See *Dividend Policy* above. More cash would be required to pay quarterly dividends at the \$0.1125 per share level in succeeding quarters of 2007 if the number of our shares of common stock outstanding increases and the participation in the DRIP were at the 50% level for each of these dividends. We generated \$47.4 million of pre-dividend free cash flow for the twelve month period ended March 31, 2007. If we achieved this level of pre-dividend free cash flow for the twelve month period ended June 30, 2007, the pre-dividend free cash flow based limitation on our quarterly dividends would, before the application of the other limitations on dividends described above (including the \$0.1125 per share quarterly dividend limitation and Authorized Dividend Amount limitation), limit the quarterly dividend that could be paid in the third quarter of 2007 to \$5.3 million (not including dividends applied to newly-issued or treasury shares of our common stock pursuant to a dividend reinvestment plan). The Apax entities have made no commitment to participate in the DRIP beyond 2008.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses. Actual results could differ from those estimates. We have formal accounting policies in place including those that address critical and complex accounting areas. Note 3 to the condensed consolidated financial statements included elsewhere in this Quarterly Report identifies the significant accounting policies used in preparation of the consolidated financial statements. The most significant areas involving management judgments and estimates are described below.

Derivatives and Hedging We account for our derivative instruments in accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS No. 133). SFAS No. 133 requires companies to record derivatives on their balance sheets as either assets or liabilities measured at their fair value. All changes in the fair value of derivatives are recognized currently in earnings unless specific hedge criteria are met, which requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting.

There are two types of hedges into which we enter: hedges of fair value exposure and hedges of cash flow exposure. Hedges of fair value exposure are entered into in order to hedge the fair value of a recognized asset or liability, or a firm commitment. Hedges of cash flow exposure are entered into in order to hedge a forecasted transaction or the variability of cash flows to be paid related to a recognized liability. On the date the derivative contract is executed, the Company designates the derivative as either a fair value or a cash flow hedge. Changes in derivative fair values that are designated as fair value hedges are recognized in earnings as offsets to the changes in fair value of the related hedged assets, liabilities and firm commitments. Changes in the derivative fair values that are designated as cash flow hedges which meet the criteria for hedge accounting are recorded in other comprehensive loss. However, we currently record interest rate swap derivatives which are cash flow hedges in earnings because, although these cash flow hedges otherwise would have qualified for hedge accounting under SFAS No. 133, hedge accounting under SFAS No. 133 was not allowed, as discussed in Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements, because we inappropriately applied the *short cut* method to evaluate these interest rate swaps for hedge accounting purposes from the date of inception.

Contingencies. We are subject to various claims and contingencies associated with lawsuits, insurance, tax, environmental and other issues arising out of the normal course of business. Our consolidated financial statements reflect the treatment of claims and contingencies based on management's view of the expected outcome. We consult with legal counsel on those issues related to litigation with respect to matters in the ordinary course of business. If the likelihood of an adverse outcome is probable and the amount is estimable, we accrue a liability in accordance with SFAS No. 5, *Accounting for Contingencies*. While we believe that the current level of reserves is adequate, the adequacy of these reserves may change in the future due to new developments in particular

Table of Contents

matters. We have expensed \$3.1 million (net of a \$0.2 million settlement from a potentially responsible party), \$0.9 million and \$3.8 million in 2006, 2005 and 2004, respectively, for environmental costs related to contamination at two former manufacturing sites which were closed under our restructuring programs. Management believes that both sites have been remediated and no further remediation costs are expected to be incurred.

Income Taxes. We utilize the asset and liability method for accounting for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates and statutes that will be in effect when the differences are expected to reverse.

We reduce our deferred tax assets by a valuation allowance if, based upon the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Relevant evidence, both positive and negative, is considered in determining the need for a valuation allowance. Information evaluated includes our financial position and results of operations for the current and preceding years as well as an evaluation of currently available information about future years. In light of our accumulated loss position in certain tax jurisdictions at December 31, 2006, and the uncertainty of profitability in future periods, we recorded valuation allowances for deferred tax assets primarily related to net operating loss carryforwards in the United States, United Kingdom and Sweden.

In addition, we operate within multiple taxing jurisdictions and could be subject to audit in these jurisdictions. These audits can involve complex issues and rely on estimates and assumptions. These audits may require an extended period of time to resolve and may cover multiple years. Although the Company believes that the estimates and assumptions are reasonable, the final determination of tax audits and any related litigation could be different than that which is reflected in historical income tax provisions and recorded assets and liabilities.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FAS No. 109. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The Company adopted FIN 48 on January 1, 2007 and, accordingly, recorded a cumulative effect increase of \$3,323 to accumulated deficit, an increase of \$627 to income taxes payable and an increase of \$2,696 to deferred and long term taxes for uncertain tax positions upon adoption. Management cannot provide a reasonably reliable estimate of the period of related future payments for which settlement is expected to occur beyond the next twelve months.

NON-GAAP LIQUIDITY MEASURES

We use EBITDA and Adjusted EBITDA as supplementary non-GAAP liquidity measures to assist us in evaluating our liquidity and financial performance, specifically our ability to service indebtedness and to fund ongoing capital expenditures and dividends. Our credit facility includes covenants based on Adjusted EBITDA. If our Adjusted EBITDA declines below certain levels, we will violate covenants resulting in a default condition under the credit facility or be required to prepay the credit facility or we will be prohibited from paying dividends. Neither EBITDA nor Adjusted EBITDA should be considered in isolation or as a substitute for net cash provided by operating activities (as determined in accordance with GAAP) or income (loss) from operations (as determined in accordance with GAAP).

EBITDA is defined as net income (loss) before interest expense, income tax provision (benefit) and depreciation and amortization. Adjusted EBITDA is defined in our credit facility and is EBITDA plus (i) expenses or losses incurred on or prior to the completion of our initial public offering in connection with proposed or completed debt or equity financing transactions, including expenses or losses related to the early retirement or extinguishment of debt and any bonuses paid in connection with such financing transactions, (ii) unrealized foreign exchange (gain) loss on indebtedness, net, (iii) restructuring or related impairment costs and costs for programs

Table of Contents

intended to increase productivity and economic efficiency or our market share capacity, reduce cost structure, improve equipment utilization or provide additional regional capacity to better serve growth markets (not to exceed \$11.0 million in the aggregate for 2005, \$4.0 million in the aggregate for 2006, \$12.0 million in the aggregate for 2007 and \$5.0 million in the aggregate in each year thereafter), (iv) reserves for inventory in connection with plant closings, (v) stock-based and other non-cash compensation charges, charges from forgiveness of loans made to employees in connection with the purchase of equity and any tax gross-up payments made in respect of such loan forgiveness in connection with or prior to the completion of our initial public offering, (vi) certain transaction costs, including costs incurred in connection with our initial public offering and the related debt financing and the legal reorganization of Brazilian subsidiaries, (vii) costs associated with payments to management prior to the completion of our initial public offering in connection with the termination of incentive plans, (viii) non-cash charges resulting from the application of purchase accounting, (ix) any fees, expenses or charges deducted in computing net income (loss) which have been determined by management, which determination is reasonably acceptable to the administrative agent under our credit facility, to be non-recurring by virtue of changes in our method of operations pursuant to our cost reduction programs, (x) non-cash losses (net of non-cash gains) resulting from marking-to-market hedging obligations, (xi) non-cash expenses resulting from the granting of stock options, restricted stock or restricted stock unit awards under equity compensation programs solely with respect to our common stock and (xii) expenses not exceeding \$5 million per year incurred as a result of the repurchase, redemption or retention of our own common stock earned under equity compensation programs solely in order to make withholding tax payments. Adjusted EBITDA, as defined in the credit facility and calculated below, may not be comparable to similarly titled measurements used by other companies. The following table provides a reconciliation from net cash provided by operating activities, which is the most directly comparable GAAP financial measure, to EBITDA and Adjusted EBITDA.

The information in the table below has been restated to reflect adjustments to our consolidated financial statements and other financial information for the quarters ended March 31, 2007 and 2006 in connection with the restatement described in Note 2 of the Notes to Unaudited Condensed Consolidated Financial Statements included in this quarterly report. While this restatement did not impact total Adjusted EBITDA for the relevant periods, certain individual line items within Adjusted EBITDA have been restated.

<i>(in thousands)</i>	Three Months Ended March 31,	
	2007 (As restated)	2006 (As restated)
Net cash provided by operating activities	\$ 15,254	\$ 3,714
Interest expense, net	12,187	6,216
Net change in operating assets and liabilities	1,165	23,162
Income tax provision	1,401	4,948
Stock-based compensation	(535)	(778)
Deferred financing cost amortization	(918)	(923)
Deferred taxes	1,123	(5,185)
Asset impairment	(389)	
Gain (loss) on disposition of property and equipment	(78)	22
Unrealized foreign exchange loss on indebtedness, net	(19)	(392)
Change in fair value of interest rate swaps	(1,563)	3,795
EBITDA	27,628	34,579
Unrealized foreign exchange loss on indebtedness, net	19	392
Restructuring expenses	3,744	222
Non-cash impairment charges (A)	389	
Growth program costs (B)	617	
Inventory write-offs under restructuring programs	14	
Non-cash compensation and related expenses	535	778
Non-recurring expenses resulting from cost reduction programs (C)	(102)	1,444
Adjusted EBITDA	\$ 32,844	\$ 37,415

Table of Contents

- (A) In accordance with the definition of Adjusted EBITDA in our credit facility, non-cash impairment charges resulting from application of Statement of Financial Accounting Standards Nos. 142 and 144 have been added back to Adjusted EBITDA.
- (B) In accordance with the definition of Adjusted EBITDA in our credit facility, as amended on May 2, 2007, growth programs are those intended to increase productivity and economic efficiency or the market share capacity of the Company, reduce cost structure, improve equipment utilization or provide additional regional capacity to better serve growth markets. These growth program costs for the three months ended March 31, 2007 include expenses incurred for the Company's lean manufacturing initiatives, expansion into Vietnam and other such programs. Growth program costs were not added back to net income in calculating Adjusted EBITDA for the three months ended March 31, 2006 based upon the credit facility as in effect at that time.
- (C) In accordance with the definition of Adjusted EBITDA in our credit facility, certain fees, expenses and charges deducted in computing net income determined by us to be non-recurring, which determination was accepted by the administrative agent under the facility, by virtue of changes in our method of operations pursuant to our cost reduction programs have been added back to Adjusted EBITDA for the three months ended March 31, 2007 and March 31, 2006. These fees, expenses and charges are presented in the following table:

<i>(in thousands)</i>	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Environmental charges in connection with facilities closures pursuant to cost reduction programs (1)	\$ (200)	\$
Certain operating costs incurred in connection with the transition of production operations from closed facilities to other facilities (2)	98	1,444
Total	\$ (102)	\$ 1,444

- (1) For the three months ended March 31, 2007, reflects the reversal of amounts accrued in prior periods.
- (2) For the three months ended March 31, 2007, the amount includes added operating costs related to facility closures in Italy. For the three months ended March 31, 2006, the amount includes added operating costs related to facility closures in North America.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Hedging. We have foreign currency cash flow and earnings exposure with respect to specific sale transactions denominated in currencies other than the functional currency of the unit incurring the costs associated with such transactions. To mitigate the risks related to this exposure, we utilize forward currency contracts in certain circumstances, to lock in exchange rates with the objective that the gain or loss on the forward contracts will approximate the loss or gain on the transaction or transactions being hedged. We determine whether to enter into hedging arrangements based upon the size of the underlying transaction or transactions, an assessment of the risk of adverse movements in the applicable currencies and the availability of a cost-effective hedging strategy. In South America, substantially all of our sales are indexed to U.S. Dollars, but the associated costs are recorded in the local currencies of the operating units. Generally, we do not hedge this U.S. Dollar exposure as it would not be cost effective due to the relatively inefficient foreign exchange markets for local currencies in that region. To the extent we do not engage in hedging or such hedging is not effective, changes in the relative value of currencies can affect our profitability.

As of March 31, 2007, we had open foreign currency exchange contracts maturing through February 2008 with total net notional amounts of approximately \$15.5 million. At March 31, 2007, we prepared an analysis to determine the sensitivity of our forward foreign exchange contracts to changes in exchange rates. A hypothetical adverse exchange rate movement of 10% against our forward foreign exchange contracts would have resulted in a potential net loss in fair value of these contracts of approximately \$1.5 million. All such losses on these forward foreign exchange contracts would be substantially offset by gains on the underlying transactions that we had hedged.

Table of Contents

For additional information about the risks associated with fluctuations in currency exchange rates, see Management's Discussion and Analysis of Financial Condition and Results of Operations Foreign Exchange.

Interest Rate Hedging. Our senior credit facility has a variable interest rate. We entered into interest rate swap contracts effective June 30, 2005 pursuant to which we pay fixed rates on US Dollar notional amounts while receiving the applicable floating LIBOR rates. In connection with the restatement discussed in Note 2 of the Notes to Unaudited Condensed Consolidated Financial Statements, the interest rate swaps do not qualify for hedge accounting under SFAS No. 133 and the change in their fair value is subject to mark to market accounting through earnings. Although these interest rate swaps are subject to mark to market accounting through earnings, the interest rate swap contracts effectively fix, from a cash flow hedge perspective, the interest rate on approximately 90% of the term loan portion of the credit facility through June 30, 2008. The mark to market accounting through earnings has no effect on cash flows from operating, investing or financing activities nor has the effectiveness of the swaps as cash flow hedging instruments been affected by these changes in accounting treatment. As of March 31, 2007, the weighted average interest rate on the effectively fixed portion of the term loan facility was 6.12%; the weighted average interest rate on the portion of the term loan facility not effectively fixed by interest rate swap contracts, based on the 90-day LIBOR, was 7.21%. In February 2007, the applicable margin for LIBOR term loans, LIBOR revolving loans, Euribor loans and CDOR loans under our senior credit facility increased from 2.50% to 2.75% as a result of Moody's downgrade of its rating of our senior indebtedness. We estimate that a 1% increase in the LIBOR rate would increase our interest expense on the term debt by approximately \$0.7 million on an annual basis through June 30, 2008, the period covered by the interest rate swap agreements. To the extent that we do enter into a hedging arrangement that effectively fixes the interest rate on a portion of our senior debt after these contracts expire, the effectively fixed rate may be significantly higher than the effectively fixed rate as of March 31, 2007. If we do not enter into new interest rate hedging arrangements, when these contracts expire the interest rate on all of the debt covered by our senior credit facility will fluctuate based on LIBOR and other variable interest rates. To the extent these interest rates increase, our interest expense will increase, in which event, we may have difficulty making interest payments and funding our other costs and our ability to comply with the financial covenants in our credit facility may be adversely affected.

ITEM 4. CONTROLS AND PROCEDURES

As disclosed in this amended quarterly report on Form 10-Q/A, we have restated our previously issued consolidated balance sheet as of March 31, 2007 and the consolidated statements of operations and cash flows for each of the three month periods ended March 31, 2007 and 2006. In addition, the Company filed an amendment to its Annual Report on Form 10-K/A for the year ended December 31, 2006 to amend and restate consolidated balance sheets as of December 31, 2006 and 2005 and the consolidated statements of operations, stockholders' equity (deficit), and cash flows for the years 2006 and 2005 and the Company's unaudited quarterly financial statements during these years, commencing with the quarter ended June 30, 2005. The restatements correct an error in those financial statements relating to our derivative accounting under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133).

During the third quarter of 2007, we identified that our application of the "short cut" method to evaluate interest rate swaps for hedge accounting purposes from the date of inception, June 2005, was not appropriate. We had accounted for these interest rate swaps as hedging instruments in accordance with SFAS No. 133, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities-an amendment of FASB Statement No. 133 and SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities. The fair value of these interest rate swap agreements was adjusted quarterly with the changes recorded as deferred gains or losses in the consolidated balance sheet with the offset recorded in accumulated other comprehensive loss, net of tax. It has been determined that the swaps do not qualify as hedging instruments because we inappropriately applied the "short cut" method to evaluate these interest rate swaps for hedge accounting purposes from the date of inception. Accordingly, we will recognize the change in the fair value as a component of earnings for the applicable periods. Following our discovery of the errors in the application and documentation of hedge accounting under SFAS No. 133, we initiated a comprehensive review of all of our determinations and documentation related to hedge accounting under the "short cut" method for our interest rate swaps, as well as our related processes and procedures.

Table of Contents

Evaluation of Disclosure Controls and Procedures

In connection with the aforementioned restatement of our financial statements, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we reevaluated, as of March 31, 2007, the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Act). Based upon that reevaluation, as a result of a material weakness in internal control over financial reporting with respect to hedge accounting for interest rate swaps, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were not effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Act is (i) recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms; and (ii) accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosures. In connection with the Original Filing and prior to our discovery of the error relating to hedge accounting for interest rate swaps, our principal executive officer and principal financial officer had concluded that our disclosure controls and procedures were effective as of March 31, 2007 to a reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. As disclosed in our annual report for the year ended December 31, 2006 on Form 10-K/A filed with the Securities and Exchange Commission on August 23, 2007, we determined that as of December 31, 2006 there was a material weakness in our internal controls over financial reporting with respect to hedge accounting for interest rate swaps. We have determined that this material weakness still existed as of March 31, 2007.

Remediation of Material Weakness

In light of the material weakness described above, we have restated our financial statements for the affected periods. To remediate the material weakness and enhance our internal control over financial reporting, management has implemented the following changes:

Improved the education and understanding of hedge accounting requirements in accordance with generally accepted accounting principles for all relevant personnel involved in derivatives transactions.

Updated our procedures to now require the use of an outside expert to evaluate the documentation and accounting for any significant derivative instrument for which we are seeking hedge accounting under SFAS No. 133.

We believe that, as of the date of this filing, we have fully remediated the material weakness in our internal control over financial reporting with respect to accounting for interest rate swaps described above.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On June 7, 2006, a purported class action complaint was filed in the United States District Court for the District of Massachusetts on behalf of a putative class of investors who purchased shares pursuant or traceable to our initial public offering on or about May 16, 2005 through November 15, 2005 against us, our Chief Executive Officer and our Chief Financial Officer. We were served with the complaint on June 8, 2006. The complaint concerns our initial public offering of common stock and alleges violations of Sections 11 and 12(a)(2) and liability under Section 15 of the Securities Act of 1933. The plaintiff seeks rescission rights, attorneys' fees and other costs and unspecified damages on behalf of a purported class of purchasers of our common stock pursuant and/or traceable to the Company's IPO on or about May 16, 2005 through November 15, 2005. We believe that the complaint is without merit and intend to defend the litigation vigorously.

We are from time to time involved in various legal proceedings that arise in the ordinary course of our business. We believe that none of our pending litigation will, individually or in the aggregate, have a material adverse effect on our financial condition, cash flows or results of operations.

ITEM 1A. RISK FACTORS

The risk factors included in the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2006 have not materially changed, except that information included in such risk factors relating to our dividend policy, our senior credit facility, including restrictions imposed on the payment of dividends by our credit facility, and the commitment of certain shareholders to participate in a dividend reinvestment plan has been updated herein to reflect the change in our dividend policy, the amendment to our credit facility and the extension of the commitment of certain shareholders to participate in a dividend reinvestment plan. See

Table of Contents

Management's Discussion and Analysis of Financial Condition and Results of Operations Dividend Policy and Management's Discussion and Analysis of Financial Condition and Results of Operations Credit Facility.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

Restrictions on Payment of Dividends

For a description on restrictions imposed by Delaware law and our credit agreement on our payment of dividends, see Management's Discussion and Analysis of Financial Condition and Results of Operations Dividend Policy and Management's Discussion and Analysis of Financial Condition and Results of Operations Credit Agreement.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

ITEM 5. OTHER INFORMATION.

Not applicable.

ITEM 6. EXHIBITS

See the exhibit index following the signature page to this quarterly report.

Table of Contents

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.

XERIUM TECHNOLOGIES, INC.
(Registrant)

Date: August 23, 2007

By: /s/ Michael P. O Donnell
Michael P. O Donnell
Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description of Exhibits
10.1	Form of 2007 Corporate Award under the 2006 Cash Incentive Bonus Plan*
10.2	Form of Performance Based Restricted Stock Units Agreement (based upon a 2007 performance metric) under the 2005 Equity Incentive Plan*
31.1	Certification Statement of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification Statement of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Statement of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification Statement of the Chief financial Officer pursuant to Section 906 Of the Sarbanes-Oxley Act of 2002.

* Incorporated by reference to the same numbered exhibit to the Company's current report on Form 8-K filed on March 30, 2007.