

ALBANY INTERNATIONAL CORP /DE/  
Form 10-Q  
August 08, 2006

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

Form 10-Q

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

For the quarterly period ended: June 30, 2006

OR

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

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

Commission file number: 0-16214

**ALBANY INTERNATIONAL CORP.**

(Exact name of registrant as specified in its charter)

Delaware

14-0462060

(State or other jurisdiction of  
incorporation or organization)

(IRS Employer Identification No.)

1373 Broadway, Albany, New York

12204

(Address of principal executive offices)

(Zip Code)

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

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

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

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Large accelerated filer  x

Accelerated filer  o

Non-accelerated filer  o

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

The registrant had 25,846,321 shares of Class A Common Stock and 3,236,098 shares of Class B Common Stock outstanding as of June 30, 2006.

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

| Three Months Ended<br>June 30,               |            |   | Six Months Ended<br>June 30, |            |
|--|------------|---|------------------------------|------------|
| 2006   | 2005       |   | 2006                         | 2005       |
| \$ 261,630                                   | \$ 247,406 | Net sales   | \$ 512,853                   | \$ 488,470 |
| 157,621                                      | 146,231    | Cost of goods sold                                | 304,868                      | 288,960    |
| 104,009                                      | 101,175    | Gross profit                                      | 207,985                      | 199,510    |
| 75,064                                       | 69,139     | Selling, technical, general and research expenses | 149,626                      | 137,680    |
| 28,945                                       | 32,036     | Operating income                                  | 58,359                       | 61,830     |
| 2,712  | 3,125      | Interest expense, net                             | 4,591                        | 6,814      |
| (137)  | 263        | Other (income)/expense, net                       | 772                          | 1,581      |
| 26,370                                       | 28,648     | Income before income taxes                        | 52,996                       | 53,435     |
| 7,749  | 8,595      | Income tax expense                                | 15,737                       | 14,643     |
| 18,621                                       | 20,053     | Income before associated companies                | 37,259                       | 38,792     |
| 66   | 298        | Equity in earnings of associated companies        | 243                          | 468        |
| 18,687                                       | 20,351     | Net income  | 37,502                       | 39,260     |
| 511,156                                      | 450,432    | Retained earnings, beginning of period            | 495,018                      | 434,057    |
| (2,945)                                      | (2,548)    | Dividends declared                                | (5,622)                      | (5,082)    |
| \$ 526,898                                   | \$ 468,235 | Retained earnings, end of period                  | \$ 526,898                   | \$ 468,235 |
| Earnings per share:                          |            |   |                              |            |
| \$ 0.63                                      | \$ 0.64    | Basic   | \$ 1.23                      | \$ 1.24    |
| \$ 0.62                                      | \$ 0.63    | Diluted   | \$ 1.21                      | \$ 1.22    |
| Shares used in computing earnings per share: |            |   |                              |            |
| 29,554                                       | 31,770     | Basic   | 30,481                       | 31,653     |
| 30,094                                       | 32,374     | Diluted   | 31,019                       | 32,304     |
| \$ 0.10                                      | \$ 0.08    | Dividends per share                               | \$ 0.19                      | \$ 0.16    |

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

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

|  | (unaudited)<br>June 30,<br>2006 | December 31,<br>2005 |
|--|---------------------------------|----------------------|
| <b>ASSETS</b>  |                                 |                      |
| Cash and cash equivalents  | \$ 103,575                      | \$ 72,771            |
| Accounts receivable, net   | 146,681                         | 132,247              |
| Note receivable  | 18,332                          | 17,827               |
| Inventories  | 220,528                         | 194,398              |
| Deferred taxes   | 19,239                          | 22,012               |
| Prepaid expenses   | 9,154                           | 7,892                |
| <b>Total current assets</b>  | <b>517,509</b>                  | <b>447,147</b>       |
| Property, plant and equipment, net   | 361,788                         | 335,446              |
| Investments in associated companies  | 6,968                           | 6,403                |
| Intangibles  | 15,242                          | 12,076               |
| Goodwill   | 168,351                         | 153,001              |
| Deferred taxes   | 77,124                          | 75,875               |
| Cash surrender value of life insurance policies  | 39,486                          | 37,778               |
| Other assets   | 28,719                          | 19,321               |
| <b>Total assets</b>  | <b>\$ 1,215,187</b>             | <b>\$ 1,087,047</b>  |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                                 |                      |
| Notes and loans payable  | \$ 6,705                        | \$ 6,151             |
| Accounts payable   | 44,497                          | 36,775               |
| Accrued liabilities  | 129,418                         | 116,395              |
| Current maturities of long-term debt   | 11,157                          | 1,009                |
| Income taxes payable and deferred  | 11,465                          | 14,793               |
| <b>Total current liabilities</b>   | <b>203,242</b>                  | <b>175,123</b>       |
| Long-term debt   | 331,857                         | 162,597              |
| Other noncurrent liabilities   | 151,351                         | 144,905              |
| Deferred taxes and other credits   | 31,659                          | 29,504               |
| <b>Total liabilities</b>   | <b>718,109</b>                  | <b>512,129</b>       |
| Commitments and Contingencies  |                                 |                      |
| <b>SHAREHOLDERS EQUITY</b>   |                                 |                      |
| Preferred stock, par value \$5.00 per share; authorized 2,000,000 shares; none issued  |                                 |                      |
| Class A Common Stock, par value \$.001 per share; authorized 100,000,000 shares; issued 34,387,512 in 2006 and 34,176,010 in 2005              | 34                              | 34                   |
| Class B Common Stock, par value \$.001 per share; authorized 25,000,000 shares; issued and outstanding 3,236,098 in 2006 and 3,236,476 in 2005 | 3                               | 3                    |
| Additional paid in capital   | 312,218                         | 319,372              |
| Retained earnings  | 526,898                         | 495,018              |
| Accumulated items of other comprehensive income:   |                                 |                      |
| Translation adjustments  | (42,469)                        | (71,205)             |
| Pension liability adjustment   | (40,340)                        | (40,340)             |
|  | 756,344                         | 702,882              |

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|  |              |              |
|--|--------------|--------------|
| Less treasury stock (Class A), at cost (8,541,191 shares in 2006 and 5,050,159 shares in 2005) | 259,266      | 127,964      |
| Total shareholders' equity   | 497,078      | 574,918      |
| Total liabilities and shareholders' equity   | \$ 1,215,187 | \$ 1,087,047 |

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

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

|   | Six Months Ended<br>June 30, |                 |
|---|------------------------------|-----------------|
|   | 2006                         | 2005            |
| <b>OPERATING ACTIVITIES</b>   |                              |                 |
| Net income  | \$ 37,502                    | \$ 39,260       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |                 |
| Equity in earnings of associated companies  | (243)                        | (468)           |
| Depreciation  | 26,936                       | 26,317          |
| Amortization  | 1,961                        | 1,989           |
| Provision for deferred income taxes, other credits and long-term liabilities      | 5,024                        | 5,412           |
| Provision for write-off of equipment  | 321                          | 1,262           |
| Increase in cash surrender value of life insurance                                | (1,708)                      | (1,596)         |
| Unrealized currency transaction gains and losses                                  | 1,436                        | (1,867)         |
| Shares contributed to ESOP  | 4,183                        | 3,364           |
| Stock option expense  | 770                          |                 |
| Tax benefit of options exercised  | (529)                        | 2,050           |
| Changes in operating assets and liabilities, net of business acquisition:         |                              |                 |
| Accounts receivable   | (7,976)                      | (3,663)         |
| Note receivable   | (505)                        | (913)           |
| Inventories   | (20,055)                     | (14,097)        |
| Prepaid expenses  | (999)                        | (425)           |
| Accounts payable  | (3,048)                      | (3,101)         |
| Accrued liabilities   | 8,834                        | 1,404           |
| Income taxes payable  | (2,551)                      | (5,209)         |
| Other, net  | (3,562)                      | 107             |
| <b>Net cash provided by operating activities</b>                                  | <b>45,791</b>                | <b>49,826</b>   |
| <b>INVESTING ACTIVITIES</b>   |                              |                 |
| Purchases of property, plant and equipment  | (32,352)                     | (18,478)        |
| Purchased software  | (147)                        | (1,647)         |
| Proceeds from sale of assets  |                              | 5,067           |
| Acquisitions, net of cash acquired  | (8,112)                      |                 |
| <b>Net cash used in investing activities</b>                                      | <b>(40,611)</b>              | <b>(15,058)</b> |
| <b>FINANCING ACTIVITIES</b>   |                              |                 |
| Proceeds from borrowings  | 192,996                      | 15,586          |
| Principal payments on debt  | (15,677)                     | (23,362)        |
| Purchase of treasury shares   | (131,499)                    | (1,576)         |
| Purchase of call options on common stock  | (47,688)                     |                 |
| Sale of common stock warrants   | 32,961                       |                 |
| Proceeds from options exercised   | 1,926                        | 5,936           |
| Tax benefit of options exercised  | 529                          |                 |
| Debt issuance costs   | (5,434)                      |                 |
| Dividends paid  | (5,658)                      | (5,044)         |
| <b>Net cash provided by/(used in) financing activities</b>                        | <b>22,456</b>                | <b>(8,460)</b>  |
| <b>Effect of exchange rate changes on cash flows</b>                              | <b>3,168</b>                 | <b>(7,919)</b>  |

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|  |            |           |
|--|------------|-----------|
| Increase in cash and cash equivalents          | 30,804     | 18,389    |
| Cash and cash equivalents at beginning of year | 72,771     | 58,982    |
| Cash and cash equivalents at end of period     | \$ 103,575 | \$ 77,371 |

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

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ALBANY INTERNATIONAL CORP.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. Management Opinion**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary for a fair presentation of results for such periods. The results for any interim period are not necessarily indicative of results for the full year. The preparation of financial statements for interim periods does not require all of the disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. These consolidated financial statements should be read in conjunction with financial statements and notes thereto for the year ended December 31, 2005.

As more fully discussed in Note 11, the Company adopted Financial Accounting Standard No. 123 (Revised) Share-Based Payment (FAS No. 123R) effective January 1, 2006. The Company adopted the modified prospective transition method provided under FAS No. 123R and, accordingly, has not retroactively adjusted results of prior periods.

**2. Inventories**

Inventories consist of the following:

| (in thousands)            | June 30,<br>2006 | December 31,<br>2005 |
|---------------------------|------------------|----------------------|
| Finished goods            | \$ 122,526       | \$ 105,800           |
| Work in process           | 55,842           | 55,039               |
| Raw material and supplies | 42,160           | 33,559               |
| Total inventories         | \$ 220,528       | \$ 194,398           |

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

**3. Goodwill and other Intangible Assets**

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

The Company performs the test for goodwill impairment during the second quarter of each year. As a result of the test performed in the second quarter of 2006, no impairment provision was required. Goodwill and other long-lived assets are reviewed for impairment whenever events, such as significant changes in the business climate, plant closures, changes in product offerings, or other circumstances indicate that the carrying amount may not be recoverable.

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

The changes in intangible assets and goodwill from December 31, 2005 to June 30, 2006, were as follows:

| (in thousands)                      | Balance at<br>December 31,<br>2005 | Increases | Amortization | Currency<br>translation | Balance at<br>June 30,<br>2006 |
|-------------------------------------|------------------------------------|-----------|--------------|-------------------------|--------------------------------|
| <b>Amortized intangible assets:</b> |                                    |           |              |                         |                                |
| Trade names                         | \$ 2,658                           | \$ 70     | (\$288)      | 75                      | 2,515                          |
| Patents                             | 2,756                              |           | (237)        | 98                      | 2,617                          |
| Customer contracts                  |                                    | 3,630     | (182)        |                         | 3,448                          |
| Deferred pension costs              | 6,662                              |           |              |                         | 6,662                          |
| <br>                                |                                    |           |              |                         |                                |
| Total amortized intangible assets   | \$ 12,076                          | \$ 3,700  | (\$707)      | \$ 173                  | \$ 15,242                      |

| (in thousands) | Balance at<br>December 31, 2005 | Increases | Currency<br>translation | Balance at<br>June 30,<br>2006 |
|----------------|---------------------------------|-----------|-------------------------|--------------------------------|
| Goodwill       | \$ 153,001                      | \$ 7,531  | \$ 7,819                | \$ 168,351                     |

The increase in goodwill relates to the acquisition of Texas Composite Inc. (TCI) and the purchase of certain assets of Aztex, Inc. TCI and Aztex are aerospace composite manufacturing companies. These acquisitions have been integrated into Albany Engineered Composites, a business of the Applied Technologies segment.

The Company paid \$6.7 million in January 2006, and expects to pay \$8.0 million in the fourth quarter of 2006 for the purchase of TCI. The purchase price was allocated as follows: \$7.1 million to property, plant and equipment, \$4.9 million to goodwill, \$3.7 million to intangibles, \$4.0 million to other assets, and \$5.0 million to liabilities. The Company has not completed its purchase price allocation for deferred taxes that relate to the TCI acquisition.

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The Company has not completed its purchase price allocation related to the Aztex transaction, principally due to an ongoing valuation analysis of intangible assets.

As of June 30, 2006, goodwill included \$115.9 million in the Paper Machine Clothing segment, \$23.5 million in the Applied Technologies segment, and \$29.0 million in the Albany Door Systems segment.

Estimated amortization expense of intangibles for the years ending December 31, 2006 through 2010, is as follows:

| <b>Year</b> | <b>Annual<br/>amortization<br/>(in thousands)</b> |
|-------------|---|
| 2006        | \$ 1,600  |
| 2007        | 1,500   |
| 2008        | 1,500   |
| 2009        | 1,400   |
| 2010        | 1,300   |
|             | \$ 7,300  |

**4. Other Expense, Net**

Other expense, net consists of the following:

| (in thousands)                       | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |                 |
|--------------------------------------|--------------------------------|---------------|------------------------------|-----------------|
|                                      | 2006                           | 2005          | 2006                         | 2005            |
| Currency transactions                | (\$ 1,520)                     | (\$ 314)      | (\$ 2,283)                   | (\$ 1,362)      |
| Debt costs                           | 447                            | 314           | 928                          | 640             |
| Securitization program               | 889                            | 702           | 1,681                        | 1,555           |
| License expense/(income)             | 166                            | (145)         | 112                          | 404             |
| Settlement of legal claims           |                                | (6)           | 240                          | 229             |
| Other miscellaneous (income)/expense | (119)                          | (288)         | 94                           | 115             |
| <b>Total</b>                         | <b>(\$ 137)</b>                | <b>\$ 263</b> | <b>\$ 772</b>                | <b>\$ 1,581</b> |

The Company has a program whereby it may sell, without recourse, certain North American accounts receivable to a Qualified Special Purpose Entity (QSPE), as defined under Financial Accounting Standard, No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (FAS No. 140). The QSPE is a wholly owned subsidiary of the Company and, in accordance with FAS No. 140, its financial statements are not consolidated with the financial statements of the Company.

The QSPE finances a portion of the accounts receivable purchased by selling an undivided ownership interest in the pool of purchased receivables to an unrelated third party for cash. The balance of the purchase price is financed by the Company, in exchange for a note receivable. In addition to financing a portion of the purchase price, the Company performs certain administration functions for the QSPE, including collecting the accounts receivable, in exchange for a fee. Eligible accounts receivable are sold at a discount to the QSPE on an ongoing basis at the discretion of the Company and the amount is subject to change. The Company does not retain an interest in the accounts receivable sold. The eligibility of accounts receivable is based on certain criteria agreed to by the Company and the unrelated third party. The discount rate is determined by the average time the accounts receivable are outstanding, current interest rates, and estimated credit losses.

The amount of receivables sold as of June 30, 2006 was approximately \$61.0 million. The Company received \$40.3 million in cash and a note receivable that has a balance of \$18.3 million in exchange for the accounts receivable sold. The discount is included in Other expense, net, and was \$1.7 million and \$1.6 million for the six months ending June 30, 2006 and 2005, respectively.

The QSPE receives cash from an unrelated third party in exchange for an undivided ownership interest in the accounts receivable. As of June 30, 2006, the QSPE had assets of \$19.1 million consisting primarily of the \$61.0 million of accounts receivable sold to it by the Company, net of the \$40.3 million interest sold to the unrelated third party, and an allowance for doubtful accounts. As of June 30, 2006, the liabilities of the QSPE were \$18.4 million consisting principally of the note payable to the Company, and equity was \$0.7 million.

**5. Earnings Per Share**

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

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

| (in thousands, except market price data)   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
|  | 2006                           | 2005      | 2006                         | 2005      |
| Net income available to common shareholders                                      | \$ 18,687                      | \$ 20,351 | \$ 37,502                    | \$ 39,260 |
| <b>Weighted average number of shares:</b>  |                                |           |                              |           |
| Weighted average number of shares used in calculating basic earnings per share   | 29,554                         | 31,770    | 30,481                       | 31,653    |
| <b>Effect of dilutive stock-based compensation plans:</b>                        |                                |           |                              |           |
| Stock options  | 491                            | 604       | 489                          | 651       |
| Long-term incentive plan   | 49                             |           | 49                           |           |
| Weighted average number of shares used in calculating diluted earnings per share | 30,094                         | 32,374    | 31,019                       | 32,304    |
| Average market price of common stock used for calculation of dilutive shares     | \$ 39.68                       | \$ 31.54  | \$ 38.38                     | \$ 32.14  |
| <b>Earnings per share:</b>   |                                |           |                              |           |
| Basic  | \$ 0.63                        | \$ 0.64   | \$ 1.23                      | \$ 1.24   |
| Diluted  | \$ 0.62                        | \$ 0.63   | \$ 1.21                      | \$ 1.22   |

There were no option shares that were excluded from the computation of diluted earnings per share in any of the periods presented. As of June 30, 2006, there was no dilution resulting from convertible debt instrument, purchased call option, and warrant that are described in Note 13.

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

|                   | <b>Class A<br/>Shares</b> | <b>Class B<br/>Shares</b> | <b>Less: Treasury<br/>Shares</b> | <b>Net shares<br/>Outstanding</b> |
|-------------------|---------------------------|---------------------------|----------------------------------|-----------------------------------|
| December 31, 2005 | 34,176,010                | 3,236,476                 | (5,050,159)                      | 32,362,327                        |
| March 31, 2006    | 34,307,097                | 3,236,098                 | (7,791,439)                      | 29,751,756                        |
| June 30, 2006     | 34,387,512                | 3,236,098                 | (8,541,191)                      | 29,082,419                        |

**6. Comprehensive Income**

Comprehensive income consists of the following:

| (in thousands)  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |             |
|---|--------------------------------|------------|------------------------------|-------------|
|   | 2006                           | 2005       | 2006                         | 2005        |
| Net income  | \$ 18,687                      | \$ 20,351  | \$ 37,502                    | \$ 39,260   |
| Other comprehensive income/(loss), before tax:                          |                                |            |                              |             |
| Foreign currency translation adjustments                                | 22,019                         | (29,119)   | 28,736                       | (54,915)    |
| Current period change in fair value of interest rate swaps              |                                | 1,808      |                              | 4,146       |
| Income taxes related to the change in fair value of interest rate swaps |                                | (705)      |                              | (1,617)     |
| Other comprehensive income/(loss), net of tax                           | 22,019                         | (28,016)   | 28,736                       | (52,386)    |
| Comprehensive income/(loss)   | \$ 40,706                      | (\$ 7,665) | \$ 66,238                    | (\$ 13,126) |



**7. Changes in Stockholders' Equity**

The following table summarizes changes in Stockholders' Equity:

| (in thousands)                           | Class A<br>Common<br>Stock | Class B<br>Common<br>Stock | Additional<br>paid in<br>capital | Retained<br>earnings | Accumulated<br>items of other<br>comprehensive<br>income | Treasury<br>stock | Total<br>Shareholders<br>Equity |
|--|----------------------------|----------------------------|----------------------------------|----------------------|--|-------------------|---------------------------------|
| December 31, 2005                        | \$ 34                      | \$ 3                       | \$ 319,372                       | \$ 495,018           | (\$ 111,545)   | (\$ 127,964)      | \$ 574,918                      |
| Net income                               |                            |                            |                                  | 37,502               |  |                   | 37,502                          |
| Shares contributed to ESOP               |                            |                            | 4,183                            |                      |  |                   | 4,183                           |
| Purchase of treasury shares              |                            |                            |                                  |                      |  | (131,499)         | (131,499)                       |
| Purchase of call options on common stock |                            |                            | (47,688)                         |                      |  |                   | (47,688)                        |
| Sale of common stock warrants            |                            |                            | 32,961                           |                      |  |                   | 32,961                          |
| Proceeds from options exercised          |                            |                            | 1,926                            |                      |  |                   | 1,926                           |
| Dividends declared                       |                            |                            |                                  | (5,622)              |  |                   | (5,622)                         |
| Stock option expense                     |                            |                            | 770                              |                      |  |                   | 770                             |
| Tax benefit of options exercised         |                            |                            | 529                              |                      |  |                   | 529                             |
| Cummulative translation adjustment/other |                            |                            | 165                              |                      | 28,736   | 197               | 29,098                          |
| June 30, 2006                            | \$ 34                      | \$ 3                       | \$ 312,218                       | \$ 526,898           | (\$ 82,809)  | (\$ 259,266)      | \$ 497,078                      |

**8. Operating Segment Data**

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

| (in thousands)                            | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2006                           | 2005       | 2006                         | 2005       |
| <b>Net Sales</b>                          |                                |            |                              |            |
| Paper Machine Clothing                    | \$ 194,461                     | \$ 185,265 | \$ 378,357                   | \$ 364,842 |
| Applied Technologies                      | 37,765                         | 34,485     | 75,607                       | 66,646     |
| Albany Door Systems                       | 29,404                         | 27,656     | 58,889                       | 56,982     |
| Consolidated total                        | \$ 261,630                     | \$ 247,406 | \$ 512,853                   | \$ 488,470 |
| <b>Operating Income</b>                   |                                |            |                              |            |
| Paper Machine Clothing                    | \$ 40,232                      | \$ 42,065  | \$ 80,788                    | \$ 83,969  |
| Applied Technologies                      | 5,107                          | 6,007      | 11,255                       | 11,461     |
| Albany Door Systems                       | 1,214                          | 624        | 3,499                        | 2,390      |
| Research expense                          | (7,997)                        | (7,114)    | (16,536)                     | (14,214)   |
| Unallocated expenses                      | (9,611)                        | (9,546)    | (20,647)                     | (21,776)   |
| Operating income before reconciling items | 28,945                         | 32,036     | 58,359                       | 61,830     |
| <b>Reconciling items:</b>                 |                                |            |                              |            |
| Interest expense, net                     | (2,712)                        | (3,125)    | (4,591)                      | (6,814)    |
| Other income/(expense), net               | 137                            | (263)      | (772)                        | (1,581)    |
| Consolidated income before income taxes   | \$ 26,370                      | \$ 28,648  | \$ 52,996                    | \$ 53,435  |

There were no material changes in the total assets of the reportable segments during the six months ended June 30, 2006.

**9. Income Taxes**

The effective income tax rate was 29.4 percent for the second quarter of 2006, compared to 30.0 percent for the same period of 2005. For the first six months of 2006, the effective income tax rate was 29.7 percent, compared to 27.4 percent for the same period of 2005, which included the favorable resolution of certain income tax contingencies. The Company currently anticipates its consolidated tax rate in 2006 will not exceed 30 percent before any discrete items, although there can be no assurance that this will not change.

## 10. Contingencies

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

Albany was defending against 20,246 claims as of August 4, 2006. This compares with 20,726 such claims as of April 21, 2006, 24,451 claims as of December 31, 2005, 24,406 claims as of October 21, 2005, 29,411 claims as of December 31, 2004, 28,838 claims as of December 31, 2003, 22,593 claims as of December 31, 2002, 7,347 claims as of December 31, 2001, 1,997 claims as of December 31, 2000, and 2,276 claims as of December 31, 1999. These suits allege a variety of lung and other diseases based on alleged exposure to products previously manufactured by Albany.

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

As of August 4, 2006, approximately 13,641 of the claims pending against Albany are pending in Mississippi, in either State or Federal courts. This compares to 19,166 claims as of July 22, 2005, 24,865 claims as of July 23, 2004, and approximately 24,646 claims as of August 1, 2003.

A Mississippi Supreme Court decision rendered in 2004 resulted in the dismissal of a number of claims pending against Albany in Mississippi and may continue to impact the remaining claims. In that decision, the Mississippi Supreme Court ruled on the practice of filing multi-plaintiff asbestos cases against numerous defendants. As a result, State courts in counties throughout Mississippi began to issue orders severing the individual claims of plaintiffs in mass joinder asbestos cases. Once severed, the plaintiffs were ordered to file amended complaints with more detailed information regarding their allegations of asbestos exposure to establish proper jurisdiction and venue, with the stated intention that any improperly filed claim would be dismissed or transferred. As a consequence, a number of plaintiffs voluntarily dismissed their claims and others were dismissed by Court order. In cases where plaintiffs filed amended complaints, their cases were transferred to the proper counties within Mississippi. In approximately 2,582 cases the plaintiffs arranged for the removal of their cases to Federal court, either with or without filing amended complaints. As of August 4, 2006, approximately 7,466 of the claims against Albany pending in Mississippi are now in Federal court, either through removal or original jurisdiction.

Those Federal Court claims are before the Federal Multidistrict Litigation (MDL) Panel for asbestos cases. A number of procedural challenges have been made at the MDL, but the Company cannot predict the outcomes of those challenges. The Company does expect that a small number of the remaining claims pending in Mississippi State courts could yet be dismissed, or transferred as the Mississippi Supreme Court ruling continues to be implemented, though not at the rates previously seen. At that point the only claimants remaining in Mississippi State courts will be those who are residents of, or who allege exposure to asbestos in, that State, and whose amended complaints satisfy the requirement for specific information regarding their exposure claims. The Company expects that only a portion of these remaining claimants will be able to demonstrate time spent in a paper mill to which Albany supplied asbestos-containing products during a period in which Albany s asbestos-containing products were in use. Based on past experience, communications from

certain plaintiffs' counsel and the advice of the Company's Mississippi counsel, the Company expects the percentage of claimants with paper mill exposure in the Mississippi proceedings to be considerably lower than the total number of claims previously asserted. However, due to the fact that the effects of the mandate of the Mississippi Supreme Court are taking time to be fully realized, the Company does not believe a meaningful estimate can be made regarding the expected reduction in claims or the range of possible loss with respect to the remaining claims.

It is the position of Albany and the other paper machine clothing defendants that there was insufficient exposure to asbestos from any paper machine clothing products to cause asbestos-related injury to any plaintiff. Furthermore, asbestos contained in Albany's synthetic products was encapsulated in a resin-coated yarn woven into the interior of the fabric, further reducing the likelihood of fiber release. While the Company believes it has meritorious defenses to these claims, it has settled certain of these cases for amounts it considers reasonable given the facts and circumstances of each case. The Company's insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of August 4, 2006, the Company had resolved, by means of settlement or dismissal, 19,648 claims. The total cost of resolving all claims was \$6,671,000. Of this amount, \$6,636,000, or 99%, was paid by the Company's insurance carrier. The Company has approximately \$130 million in confirmed insurance coverage that should be available with respect to current and future asbestos claims, as well as additional insurance coverage that it should be able to access.

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

Brandon Drying Fabrics, Inc. ( Brandon ), a subsidiary of Geschmay Corp., is also a separate defendant in many of the asbestos cases in which Albany is named as a defendant. Brandon was defending against 9,399 claims as of August 4, 2006. This compares with 9,753 such claims as of April 21, 2006, 9,566 claims as of December 31, 2005, 9,608 claims as of October 21, 2005, 9,985 claims as of December 31, 2004, 10,242 claims as of December 31, 2003, 11,802 claims as of December 31, 2002, 8,759 claims as of December 31, 2001, 3,598 claims as of December 31, 2000, and 1,887 claims as of December 31, 1999. The Company acquired Geschmay Corp., formerly known as Wangner Systems Corporation, in 1999. Brandon is a wholly-owned subsidiary of Geschmay Corp. In 1978, Brandon acquired certain assets from Abney Mills ( Abney ), a South Carolina textile manufacturer. Among the assets acquired by Brandon from Abney were assets of Abney's wholly-owned subsidiary, Brandon Sales, Inc. which, among other things, had sold dryer fabrics containing asbestos made by its parent, Abney. It is believed that Abney ceased production of asbestos-containing fabrics prior to the 1978 transaction. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. Under the terms of the Assets Purchase Agreement between Brandon and Abney, Abney agreed to indemnify, defend, and hold Brandon harmless from any actions or claims on account of products manufactured by Abney and its related corporations prior to the date of the sale, whether or not the product was sold subsequent to the date of the sale. It appears that Abney has since been dissolved. Nevertheless, a representative of Abney has been notified of the pendency of these actions and demand has been made that it assume the defense of these actions. Because Brandon did not manufacture asbestos-containing products, and because it does not believe that it was the legal successor to, or otherwise responsible for obligations of, Abney with respect to products manufactured by Abney, it believes it has strong defenses to the claims that have been asserted against it. In some instances, plaintiffs have voluntarily dismissed claims against it, while in others it has entered into what it considers to be reasonable settlements. As of August 4, 2006, Brandon has resolved, by means of settlement or dismissal, 7,945 claims for a total of \$152,499. Brandon's insurance carriers initially agreed to pay 88.2% of the total indemnification and defense costs related to these proceedings, subject to the standard reservation of rights. The remaining 11.8% of the costs had been borne directly by Brandon. During 2004, Brandon's insurance carriers agreed to cover 100% of indemnification and defense costs, subject to policy limits and the

standard reservation of rights, and to reimburse Brandon for all indemnity and defense costs paid directly by Brandon related to these proceedings.

#### **Mount Vernon**

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

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

Legislation has again been introduced in the United States Senate that is intended to address asbestos litigation by creating a privately funded trust to provide compensation to persons injured as the result of exposure to asbestos. The Fairness In Asbestos Injury Resolution Act Of 2006 ( Fair Act ) was introduced by Senators Leahy and Specter on May 25, 2006. If enacted into law, the Company would be required to make payments of up to \$1, 000,000 per year for up to 30 years to the privately funded, publicly administered trust fund. The payments would not be covered by any of the Company s insurance policies. The Company cannot predict whether the Fair Act, or any asbestos legislation, will ultimately be enacted into law.

## 11. Stock Options

Effective January 1, 2006, the Company began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Financial Accounting Standard No. 123 (Revised) Share-Based Payment (FAS No. 123R), as interpreted by SEC Staff Accounting Bulletin No. 107. The Company adopted the modified prospective transition method provided under FAS No. 123R, and, accordingly, has not retroactively adjusted results of prior periods. Under this transition method, compensation cost associated with stock options recognized in 2006 includes amortization related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FAS No. 123. For the six months ended June 30, 2006, the Company recognized approximately \$0.8 million in stock-based compensation expense, all of which was recorded in Selling, technical, general and research expenses. Adoption of FAS 123R had the effect of reducing net income by \$0.02 per share for the first six months of 2006. No stock-based compensation cost was recognized prior to January 1, 2006.

During 1988, 1992 and 1998, the shareholders approved stock option plans for key employees. The 1988 and 1992 plans, under which options can no longer be granted, each provided for the granting of up to 2,000,000 shares of Class A Common Stock. The 1998 plan provides for the granting of up to 5,000,000 shares of Class A Common Stock. In addition, in 1997 the Board of Directors granted one option outside these plans for 250,000 shares of Class A Common Stock. Options are normally exercisable in five cumulative annual amounts beginning 12 months after date of grant. Option exercise prices were normally equal to and were not permitted to be less than the market value on the date of grant. The option granted by the Board in 1997 is not exercisable unless the Company's share price reaches \$48 per share and exercise is then limited to 10% of the total number of shares multiplied by the number of full years of employment elapsed since the grant date. During 2000, the Board of Directors approved an amendment to increase the period after retirement to exercise options from 5 years to 10 years. This amendment, however, does not change the original termination date of each option. Unexercised options generally terminate twenty years after the date of grant for all plans.

There have been no stock options granted since November 2002. For options granted, the fair value of each option granted was estimated on the grant date using the Black-Scholes option-pricing model. No adjustments were made for certain factors that are generally recognized to reduce the value of option contracts because such impact was not considered material. These factors include limited transferability, a 20% per year vesting schedule, a share price threshold with vesting based on years of employment, and the risk of forfeiture of the non-vested portion if employment were terminated. The expected life of the options was based on employee groups and ranged from 11 to 20 years. Prior to 2006, the Company applied Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for the stock option plans and, accordingly no compensation cost was recognized.

Prior to the adoption of FAS 123R, the Company presented all tax benefits for deductions resulting from the exercise of stock options and disqualifying dispositions as operating cash flows in the Consolidated Statement of Cash Flows. FAS 123R requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow. Total cash flow will remain unchanged from what would have been reported under prior accounting rules.

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If compensation cost of the Company's stock-based compensation plans had been determined consistent with FAS No. 123 for years prior to 2006, net income and earnings per share would have been adjusted to the following pro forma amounts:

| (in thousands, except per share amounts)  | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2006                           | 2005      | 2006                         | 2005      |
| Net income, as reported   | \$ 18,687                      | \$ 20,351 | \$ 37,502                    | \$ 39,260 |
| <b>Deduct:</b>  |                                |           |                              |           |
| Total stock-based employee compensation expense determined under fair value based method for all awards, net of taxes |                                | (368)     |                              | (736)     |
| Net income, pro forma   | \$ 18,687                      | \$ 19,983 | \$ 37,502                    | \$ 38,524 |
| <b>Basic net income per share:</b>  |                                |           |                              |           |
| As reported   | \$ 0.63                        | \$ 0.64   | \$ 1.23                      | \$ 1.24   |
| Pro forma   | 0.63                           | 0.63      | 1.23                         | 1.22      |
| <b>Diluted net income per share:</b>  |                                |           |                              |           |
| As reported   | \$ 0.62                        | \$ 0.63   | \$ 1.21                      | \$ 1.22   |
| Pro forma   | 0.62                           | 0.62      | 1.21                         | 1.19      |

A summary of option activity as of December 31, 2005 and year to date changes is presented below:

|                                  | Option shares | Weighted Average<br>Exercise price | Remaining<br>life | Aggregate<br>Intrinsic<br>value (000 s) |
|----------------------------------|---------------|------------------------------------|-------------------|---|
| Outstanding at December 31, 2005 | 1,453,120     | \$ 20.26                           |                   | \$ 29,499                               |
| Exercised                        | (100,150)     | 19.23                              |                   | 2,136                                   |
| Canceled                         | (18,950)      | 20.56                              |                   | 379                                     |
| Outstanding at June 30, 2006     | 1,334,020     | 20.33                              | 11.2              | \$ 26,984                               |
| Exercisable at June 30, 2006     | 932,420       | 18.89                              | 10.4              | \$ 20,204                               |

As of June 30, 2006, there were 515,455 shares available for future option grants.



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A summary of the Company's nonvested option shares as of December 31, 2005 and year to date changes is presented below:

|                                | Option<br>shares | Weighted Average<br>Exercise price |
|--------------------------------|------------------|------------------------------------|
| Nonvested at December 31, 2005 | 233,700          | \$ 21.64                           |
| Vested during period           | (13,150)         | 20.56                              |
| Canceled                       | (18,950)         | 20.56                              |
| Nonvested at June 30, 2006     | 201,600          | \$ 21.81                           |

The following is a summary of the status of options outstanding at June 30, 2006:

| Exercise Price Range | Vested    | Nonvested | Outstanding Options                                     |  | Exercisable Options |  |
|----------------------|-----------|-----------|---|--|---------------------|--|
|                      |           |           | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Number              | Weighted<br>Average<br>Exercise<br>Price |
| \$10.56              | 88,020    |           | 12.3  | \$ 10.56                                 | 88,020              | \$ 10.56                                 |
| \$15.00 - \$15.69    | 95,900    |           | 10.3  | 15.51                                    | 95,900              | 15.51                                    |
| \$16.25 - \$16.75    | 53,100    |           | 4.9   | 16.46                                    | 53,100              | 16.46                                    |
| \$18.63 - \$18.75    | 59,200    |           | 7.4   | 18.73                                    | 59,200              | 18.73                                    |
| \$19.38              | 85,900    |           | 10.3  | 19.38                                    | 85,900              | 19.38                                    |
| \$19.75              | 73,900    |           | 10.2  | 19.75                                    | 73,900              | 19.75                                    |
| \$20.45 - \$20.63    | 296,250   | 151,600   | 13.7  | 20.55                                    | 296,250             | 20.53                                    |
| \$22.25              | 180,150   |           | 8.6   | 22.25                                    | 180,150             | 22.25                                    |
| \$25.56              | 200,000   | 50,000    | 11.4  | 25.56                                    |                     |  |
|                      | 1,132,420 | 201,600   | 11.2  | \$ 20.33                                 | 932,420             | \$ 18.89                                 |

As of June 30, 2006, the aggregate intrinsic value of vested and nonvested options was \$22.9 million and \$4.1 million, respectively.

As of June 30, 2006, there was \$3.3 million of total unrecognized compensation cost related to stock option grants. The Company expects approximately \$1.6 million of compensation cost to be recognized in 2006, \$0.8 million in 2007, and \$160,000 per year from 2008 to 2017.

In 2005, shareholders approved the Albany International 2005 Incentive Plan. The plan provides key members of management with incentive compensation based on achieving certain performance targets. The incentive compensation award is paid out over three years, partly in cash and partly in shares of Class A Common Stock. In March 2006, cash payments totaling \$1.2 million were made under this plan. Shares that are expected to be paid out are included in the calculation of diluted earnings per share. If a person terminates employment prior to the award becoming fully vested, the person will forfeit a portion of the incentive compensation award. In accordance with FASB Interpretation No. 28,

Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, expense associated with this plan is recognized over the vesting period which includes the year for which performance targets are measured and the two subsequent years.

**12. Pensions and Other Benefits**

The Company sponsors defined benefit pension plans in various countries. The amount of contributions to the plans is based on several factors including the funding rules in each country. The Company expects to contribute approximately \$26.5 million to its pension plans in 2006. The Company also provides certain medical, dental and life insurance benefits ( Other Benefits ) for retired United States employees that meet program qualifications. The Company currently funds this plan as claims are paid.

The components of net periodic benefit cost for the three months ended June 30, 2006 and 2005 are, as follows:

| (in thousands)                 | Pension Plans |          | Other Benefits |          |
|--------------------------------|---------------|----------|----------------|----------|
|                                | 2006          | 2005     | 2006           | 2005     |
| Service cost                   | \$ 1,761      | \$ 1,735 | \$ 556         | \$ 1,221 |
| Interest cost                  | 4,471         | 4,652    | 1,366          | 2,474    |
| Expected return on plan assets | (4,405)       | (4,245)  |                |          |
| Amortization:                  |               |          |                |          |
| Transition obligation          | 27            | 6        |                |          |
| Prior service cost/(credit)    | 237           | 257      | (1,138)        | (236)    |
| Net actuarial loss             | 1,361         | 1,355    | 980            | 1,417    |
| Net periodic benefit costs     | \$ 3,452      | \$ 3,760 | \$ 1,764       | \$ 4,876 |

The components of net periodic benefit cost for the six months ended June 30, 2006 and 2005 are, as follows:

| (in thousands)                 | Pension Plans |          | Other Benefits |          |
|--------------------------------|---------------|----------|----------------|----------|
|                                | 2006          | 2005     | 2006           | 2005     |
| Service cost                   | \$ 3,522      | \$ 3,470 | \$ 1,308       | \$ 2,016 |
| Interest cost                  | 8,942         | 9,303    | 2,919          | 4,296    |
| Expected return on plan assets | (8,810)       | (8,491)  |                |          |
| Amortization:                  |               |          |                |          |
| Transition obligation          | 54            | 13       |                |          |
| Prior service cost/(credit)    | 474           | 515      | (2,276)        | (473)    |
| Net actuarial loss             | 2,722         | 2,709    | 2,183          | 2,211    |
| Net periodic benefit costs     | \$ 6,904      | \$ 7,519 | \$ 4,134       | \$ 8,050 |

**13. Long Term Debt**

Long term debt consists of the following:

| (in thousands)  | June 30,<br>2006  | December 31,<br>2005 |
|---|-------------------|----------------------|
| Convertible notes issued in March 2006 with fixed interest rates of 2.25%, due in year 2026   | \$ 180,000        |                      |
| Private placement with a fixed interest rate of 5.34%, due in years 2013 through 2017   | 150,000           | 150,000              |
| Various notes and mortgages relative to operations principally outside the United States, at an average rate of 5.76% in 2006 and 5.91% in 2005 due in varying amounts through 2021 | 1,900             | 2,312                |
| Industrial revenue financings at an average interest rate of 6.97% in 2006 and 6.89% in 2005, due in varying amounts through 2009   | 11,114            | 11,294               |
| <b>Long term debt</b>   | <b>343,014</b>    | <b>163,606</b>       |
| Less: current portion   | (11,157)          | (1,009)              |
| <b>Long term debt, net of current portion</b>   | <b>\$ 331,857</b> | <b>\$ 162,597</b>    |

The weighted average rate for all debt decreased from 5.93% on December 31, 2005 to 3.73% on June 30, 2006.

In March 2006, the Company issued \$180 million principal amount of 2.25% convertible notes. The notes are convertible upon the occurrence of specified events and at any time on or after February 15, 2013, into cash up to the principal amount of notes converted and shares of the Company's Class A common stock with respect to the remainder, if any, of the Company's conversion obligation at an initial conversion rate of 22.462 shares per \$1,000 principal amount of notes (equivalent to an initial conversion price of \$44.52 per share of Class A common stock).

In connection with the offering, the Company has entered into convertible note hedge and warrant transactions with respect to its Class A common stock at a net cost of \$14.7 million. These transactions are intended to reduce the potential dilution upon conversion of the notes by providing the Company with the option, subject to certain exceptions, to acquire shares which offset the delivery of newly issued shares upon conversion of the notes.

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

In addition, the amount paid for the call option and the premium received for the warrant were recorded as additional paid-in capital in the accompanying consolidated balance sheet and are not accounted for as derivatives (which would be marked to market each reporting period). Incremental net shares for the convertible note feature and the warrant agreement will be included in future diluted earnings per share calculations for those periods in which the Company's average common stock price exceeds \$44.52 per share in the case of the Senior Notes and \$52.25 per share in the case of the warrants. The purchased call option is anti-dilutive and is excluded from the diluted earnings per share calculation.

On April 14, 2006, the Company entered into a new \$460 million five-year revolving credit agreement, which is currently undrawn. The agreement replaced a similar \$460 million revolving credit facility. Under the terms of the new agreement, commitment fees on the unused portion of the facility were reduced from 0.25 percent to 0.09 percent and the term was extended from 2009 to 2011. The applicable interest rate for borrowings under the new agreement, as well as under the old agreement, is LIBOR plus a spread, based on the Company's leverage ratio at the time of borrowing. Spreads under the new agreement are 15 to 50 basis points lower than under the old agreement. The new agreement includes covenants similar to the old agreement, which could limit the Company's ability to purchase Common Stock, pay dividends, or acquire other companies or dispose of its assets. The Company is also required to maintain a leverage ratio of not greater than 3.50 to 1.00 and a minimum interest coverage of at least 3.00 to 1.00. As of June 30, 2006, the Company's leverage ratio under the agreement was 1.43 to 1.00 and the interest coverage ratio was 15.71 to 1.00. The Company may purchase its Common Stock or pay dividends to the extent its leverage ratio remains at or below 2.50 to 1.00, and may make acquisitions provided its leverage ratio would not exceed 3.00 to 1.00 after giving pro forma effect to the acquisition.

#### 14. Recent Accounting Pronouncements

In November 2004, the FASB issued FAS No. 151, *Inventory Costs*, an amendment of ARB No. 43, Chapter 4. This Standard requires that items such as idle facility expense and excess spoilage be recognized as current period charges. Under ARB No. 43, such costs were considered inventoriable costs unless they were considered so abnormal as to require immediate expensing. The Company was required to adopt the Standard on January 1, 2006 and it did not have any effect on its financial statements.

In December 2004, the FASB issued FAS No. 123 (Revised) *Share-Based Payment* (FAS No. 123R). This Standard establishes accounting guidelines for transactions in which an entity exchanges its equity instruments for goods or services. The Standard focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. In April 2005, the Securities and Exchange Commission amended Regulation S-X to amend the date for compliance with FAS No. 123R, *Share-Based Payment* to fiscal years beginning on or after June 15, 2005. FAS 123R also requires that certain tax benefits resulting from stock options be classified in the Statement of Cash Flows as financing activities, instead of operating activities. The Company adopted the provisions of this Standard on January 1, 2006 and used the modified prospective transition method. Accordingly, the Company will recognize share-based compensation expense over the requisite service period of the awards. The Company expects that the adoption of this Standard will result in additional compensation expense for unvested options that were granted prior to 2003 of approximately \$1.6 million in 2006, \$0.8 million in 2007, and \$0.2 million per year from 2008 to 2017.

In May 2005, the FASB issued FAS No. 154, *Accounting Changes and Error Corrections* a replacement of APB Opinion No. 20 and FAS Statement No. 3. This Standard requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Standard also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in nondiscretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. In addition, this Standard requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. The Company adopted the Standard on January 1, 2006 and it did not have any effect on its financial statements.

In March 2005, the FASB issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, an Interpretation of FAS No. 143. This interpretation provides additional guidance as to when companies should record the fair value of a liability for a conditional asset retirement obligation when there is uncertainty about the timing and/or method of settlement of the obligation. The Company obtained documentation from each of its locations in order to determine whether there were any asset retirement obligations that required accrual or disclosure. The Company adopted the Standard on December 31, 2005 and it did not have any effect on its financial statements.

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

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

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an Interpretation of FAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation is effective for fiscal years beginning after December 15, 2006, and the Company is currently evaluating what impact it will have on its financial statements.

### **15. Subsequent event**

On August 3, 2006, the Company announced a reduction in manufacturing capacity in North America. The Company intends to discontinue dryer fabric manufacturing operations at its facility in Quebec, Canada, and to shut down seaming capacity at its Menasha, Wisconsin forming fabric operation. The actions are the result of shifting paper machine clothing demand in the Americas, and the continuing closure of paper and paperboard machines in North America, especially Canada.

The Company estimates that it will incur termination and severance charges of approximately \$2.0 million and other cash charges of approximately \$0.5 million in connection with these actions. These charges will be reflected in third-quarter results, with the bulk of the cash payments to be made during the third quarter. In addition, the Company expects to incur additional charges of from \$2.0 to \$2.5 million related to the relocation or retirement of equipment at the affected locations. The timing and nature of these charges (i.e., cash or non-cash; operating or restructuring/non-operating) has not been determined, pending final determination by the Company of the ultimate disposition of each item.

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

**For the Three and Six Month Periods Ended June 30, 2006**

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

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

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

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

Goodwill and other long-lived assets are reviewed for impairment whenever events such as significant changes in the business climate, plant closures, changes in product offerings, or other circumstances indicate that the carrying amount may not be recoverable. The Company performs a test for goodwill impairment at least annually. The determination of whether these assets are impaired involves significant judgments based on short and long-term projections of future performance. Changes in strategy and/or market conditions may result in adjustments to recorded asset balances.

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

The Company has pension and postretirement benefit costs and liabilities that are developed from actuarial valuations. Inherent in these valuations are key assumptions, including discount rates and expected return on plan assets, which are updated on an annual basis. The Company is required to consider current market conditions, including changes in interest rates, in making these assumptions. Changes in the related pension and postretirement benefit costs or credits may occur in the future due to changes in the assumptions. The amount of annual pension plan funding and annual expense is subject to many variables, including the investment return on pension plan assets and interest rates. Assumptions used for determining pension plan

liabilities and expenses are evaluated and updated at least annually. Discount rate assumptions are based on the population of plan participants and a mixture of high-quality fixed income investments for which the average maturity approximates the average remaining service period of plan participants. The assumption for expected return on plan assets is based on historical and expected returns on various categories of plan assets. The actual return on assets in the U.S. pension plan for 2005 was greater than the assumption. As of September 30, 2005, the measurement date for pension plans, the largest portion of pension plan assets (45% for the U.S. plan and 72% for non-U.S. plans) was invested in equities. For the U.S. pension plan mortality assumption, the Company uses the 1983 Group Annuity Mortality assumption updated to 1993. The Company has studied its actual mortality data for a recent six year period and found it to be consistent with that mortality table. Weakness in investment returns and low interest rates, or deviations in results from other assumptions, could result in the Company making equal or greater pension plan contributions in future years, as compared to 2005. The Company expects pension plan contributions to be approximately \$26.5 million in 2006, compared to actual contributions for 2005 of \$16.9 million.

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

The Company has a trade accounts receivable program whereby it sells, without recourse, certain North American accounts receivable to a qualified special purpose entity (QSPE), as defined under Financial Accounting Standard No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (FAS No. 140). The QSPE is a wholly owned subsidiary of the Company and, in accordance with FAS No. 140, its financial statements are not consolidated with the financial statements of the Company. The securitization program can be terminated at any time, with thirty days notice, by the Company or the unrelated third party. If the securitization program were terminated, the Company would not be required to repay cash received from the sale of accounts receivable, but no additional receivables would be sold under the program. Accounts receivable would increase as new sales were made, and the note receivable would decrease as the sold accounts receivable were collected. The Company might need to borrow from its existing credit facilities or use existing cash to fund operations until cash flow from accounts receivable returned to normal levels.

The QSPE receives cash from an unrelated third party in exchange for an undivided ownership interest in the accounts receivable. As of June 30, 2006, the QSPE had assets of \$19.1 million consisting primarily of the \$61.0 million of accounts receivable sold to it by the Company, net of the \$40.3 million interest sold to the unrelated third party, and an allowance for doubtful accounts. As of June 30, 2006, the liabilities of the QSPE were \$18.4 million consisting principally of the note payable to the Company, and equity was \$0.7 million.

The Company has contingent liabilities for litigation, claims and assessments that result from the ordinary course of business. These matters are more fully described in Note 10 to the Consolidated Financial Statements.

#### Overview

The Company is engaged in three business segments: Paper Machine Clothing, Applied Technologies and Albany Door Systems.

The Company's largest segment is Paper Machine Clothing, which includes paper machine clothing and process belts (PMC), which are technologically sophisticated consumable products designed, manufactured



and marketed for each section of the paper machine. The design and material composition of clothing and belts can have a considerable effect on the quality of paper products produced and the efficiency of paper machines on which they are used. Paper machine clothing and belts have finite lives and must be replaced on a regular basis. The Company invests in research and development to maintain what it believes to be its position as the technology leader in the marketplace, and to continually improve the production processes and deliver increased value to customers. The Company's operations are strategically located in the major paper-producing regions of the world.

The Applied Technologies segment includes the businesses that apply the Company's core competencies in advanced textiles and materials to other industries including specialty materials and composite structures for aircraft and other applications (Albany Engineered Composites); fabrics, wires, and belting products for the nonwovens and pulp industries (Albany Engineered Fabrics); specialty filtration products for wet and dry applications (Albany Filtration Technologies); industrial belts for Tannery, Textile and Corrugator applications (Albany Industrial Process Belts); and insulation for personal outerwear and home furnishings (PrimaLoft®).

Albany Door Systems produces and services high-performance doors, which are primarily marketed to industrial and commercial enterprises requiring interior or external doors that involve either frequent openings or environmental contrasts between the two areas separated by the doors. High-performance doors open and close very rapidly, and may utilize electrical systems that assure automatic opening and closing under circumstances desired by customers. Although the Company's high-performance doors are marketed globally, its largest manufacturing operations are in Europe and North America.

#### Industry Trends

The Paper Machine Clothing segment has experienced significant change since 1999 as consolidation and restructuring impacted the global paper and paperboard industry and reduced the number of major paper machine clothing competitors.

Albany International is the paper machine clothing market leader, with a worldwide market share of approximately 30% for the year 2005. The market shares of each of the next largest competitors were approximately half that of Albany International's market share for the year 2005.

As part of the Company's long-term strategy to provide value to customers and to improve returns to shareholders, the Company has rationalized production capacity by closing and consolidating manufacturing facilities in North America and Europe, and announced that production capacity will be increased in Asia to meet that fast growing market.

According to published data, world paper and paperboard production volumes have grown at an annual rate of approximately 2.7% over the last ten years ending in 2005. Of the thousands of paper machines operating in the world, the Company estimates that approximately 5,000 machines represent the target market for the Company's paper machine clothing products. During the three year period ending December 2005, more than 150 paper machines in North America and Europe were shut down. These machine closures were partially offset by the start-up of approximately 45 new paper machines located around the world during the same period. Increases in paper production have a positive impact on demand for paper machine clothing, while the shutdown of paper machines, combined with increases in the efficiency of the remaining paper machines and the useful life of paper machine clothing, has a negative impact on demand. The Company anticipates continued growth for the long term in world paper and paperboard production. However, demand can be negatively affected in the shorter term by paper industry consolidation and rationalization.

Technological advances in paper machine clothing, while contributing to the papermaking efficiency of customers, have in some cases lengthened the useful life of the Company's products and reduced the number

of pieces required to produce the same volume of paper. While the Company is often able to charge higher prices for its products as a result of these improvements, increased prices may not always be sufficient to offset completely a decrease in the number of fabrics sold.

Although Paper Machine Clothing segment sales were higher in 2005 as compared to 2004, the Company's net sales of Paper Machine Clothing decreased in each of the three previous fiscal years after adjusting for currency translation effects. The trend toward a decrease in the ratio of PMC consumed to paper produced and the recent period of consolidation and rationalization may be significant contributors to the decline in sales for 2002, 2003 and 2004. The Company's strategy for dealing with these trends is to continue to focus on providing solutions for customers through new products and services, improving the Company's product mix and price structure, while at the same time identifying additional cost-saving opportunities and growing sales in other industries.

#### Challenges, Risks and Opportunities

The Paper Machine Clothing segment of the business is very competitive. Some competitors tend to compete more on the basis of price, while others, including the Company, attempt to compete more on the basis of technical performance of products and services. During the past three years, the Company has spent an average of 3% of its consolidated net sales on research and development, and expects to spend similar amounts in future periods. Failure to maintain or increase the product and service value delivered to customers in future periods could have a material impact on sales in this segment.

Some competitors in this segment have the ability to bundle sales of PMC with other papermaking equipment. This can result in additional discounts in their paper machine clothing.

The basic papermaking process, while it has undergone dramatic increases in efficiency and speed, has always relied on paper machine clothing. In the event that a paper machine builder or other person were able to develop a commercially viable manner of paper manufacture that did not require paper machine clothing, sales of the Company's products in this segment could be expected to decline significantly.

The Applied Technologies segment has experienced significant growth in net sales during the last two to three years, due to the introduction of new products and growth in demand and application of previously existing products. While opportunities for continued growth remain excellent, there can be no assurances that the growth in sales enjoyed during the last two to three years will continue.

Albany Door Systems derives most of its revenue from the sale of high-performance doors. The purchase of these doors is normally a capital expenditure item for customers and, as such, market opportunities tend to fluctuate with industrial capital spending. The majority of the segment's revenues are derived from sales and manufacturing outside of the United States, which can cause the reported financial results to be more sensitive to changes in currency rates than the other segments of the Company.

#### Foreign Currency

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

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currencies affect revenues and profits as the results are translated into U.S. dollars in the consolidated financial statements.

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

### Results of Operations:

*Total Company three months ended June 30, 2006*

Net sales were \$261.6 million for the three months ended June 30, 2006 as compared to \$247.4 million for the three months ended June 30, 2005. Changes in currency translation rates had the effect of increasing net sales by \$2.9 million. Excluding the effect of changes in currency translation rates, net sales increased 4.6 percent as compared to the same period last year.

Second-quarter 2006 results reflected the continuation of the trends of the past several quarters. The highlights were record net sales, driven by continued top-line strength in PMC and growth in the emerging businesses, and the formal agreements in the aerospace composites business with Snecma and Messier-Dowty. These agreements validate the significant growth potential for Albany Engineered Composites.

The following table presents 2006 and 2005 net sales by segment and the effect of changes in currency translation rates:

| (in thousands)         | Three months ended<br>June 30, |            | Percent<br>change | Increase in 2006 sales<br>due to changes in<br>currency translation rates | Percent change<br>Excluding currency<br>rate effect |
|------------------------|--------------------------------|------------|-------------------|---|---|
|                        | 2006                           | 2005       |                   |   |   |
| Paper Machine Clothing | \$ 194,461                     | \$ 185,265 | 5.0%              | \$ 2,545  | 3.6%  |
| Applied Technologies   | 37,765                         | 34,485     | 9.5%              | 241   | 8.8%  |
| Albany Door Systems    | 29,404                         | 27,656     | 6.3%              | 82  | 6.0%  |
| Consolidated total     | \$ 261,630                     | \$ 247,406 | 5.7%              | \$ 2,868  | 4.6%  |

Gross profit was 39.8 percent of net sales in the second quarter of 2006, compared to 40.9 percent for the same period of 2005. The decrease in the second quarter compared to the same period last year is due principally to the costs associated with the integration of Texas Composite Inc. (TCI) and the ramp-up of manufacturing to meet the TCI order backlog. Higher petroleum prices increased the cost of materials by approximately \$9 million, compared to the second quarter of 2005. The adverse impact of these material cost increases on gross profit percentages was offset by a combination of revenue growth, price improvements, and efficiency gains.

Selling, technical, general, and research expenses increased from 27.9 percent of net sales in the second quarter of 2005 to 28.7 percent for the same period of 2006. The increase is due mainly to the implementation of incentive compensation programs, and the effect of changes in currency translation rates on accounts receivable and other balances held in currencies other than the local currency.

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In the first quarter of 2006, the Company adopted the provisions of FAS 123R, Share-Based Payment, for its stock option plans. The Company has not granted options since 2002, but must record compensation expense for the value of options that vest after 2005. Included in compensation expense for the second quarter of 2006 was \$0.4 million related to stock options. No comparable expense was recorded for the same period of 2005. The Company anticipates that the full-year 2006 expense related to stock options will be \$1.6 million.

Operating income was \$28.9 million in the second quarter of 2006, compared to \$32.0 million in the same period of 2005. The decline in operating income was attributable to the decline in gross profit percentage and increased selling, technical, general and research expenses. Following is a table of operating income by segment:

| (in thousands)                            | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2006                           | 2005      | 2006                         | 2005      |
| <b>Operating Income</b>                   |                                |           |                              |           |
| Paper Machine Clothing                    | \$ 40,232                      | \$ 42,065 | \$ 80,788                    | \$ 83,969 |
| Applied Technologies                      | 5,107                          | 6,007     | 11,255                       | 11,461    |
| Albany Door Systems                       | 1,214                          | 624       | 3,499                        | 2,390     |
| Research expense                          | (7,997)                        | (7,114)   | (16,536)                     | (14,214)  |
| Unallocated expenses                      | (9,611)                        | (9,546)   | (20,647)                     | (21,776)  |
| Operating income before reconciling items | 28,945                         | 32,036    | 58,359                       | 61,830    |
| <b>Reconciling items:</b>                 |                                |           |                              |           |
| Interest expense, net                     | (2,712)                        | (3,125)   | (4,591)                      | (6,814)   |
| Other income/(expense), net               | 137                            | (263)     | (772)                        | (1,581)   |
| Consolidated income before income taxes   | \$ 26,370                      | \$ 28,648 | \$ 52,996                    | \$ 53,435 |

Research expenses increased \$0.9 million as compared to the second quarter of 2005, principally due to higher research supplies and professional fees related to intellectual property. Unallocated expenses, which consist primarily of corporate headquarters expenses, increased \$0.1 million compared to the second quarter of 2005.

Interest expense, net, was \$2.7 million for the second quarter of 2006, compared to \$3.1 million for the second quarter of 2005. The decrease is due principally to lower average interest rates in 2006. The Company's average interest rate in 2005 was affected by interest rate swaps that matured during 2005.

The effective income tax rate was 29.4 percent for the second quarter of 2006, compared to 30.0 percent for the same period of 2005.

Basic earnings per share were \$0.63 for the second quarter of 2006, compared to \$0.64 for the same period of 2005. In addition to the factors described above, earnings were positively impacted by approximately \$0.04 per share due to fewer average shares outstanding, which resulted from share buybacks.

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*Total Company six months ended June 30, 2006*

Net sales were \$512.9 million for the six months ended June 30, 2006 as compared to \$488.5 million for the six months ended June 30, 2005. Changes in currency translation rates had the effect of decreasing net sales by \$3.0 million. Excluding the effect of changes in currency translation rates, net sales increased 5.6 percent as compared to the same period last year.

The following table presents 2006 and 2005 net sales by segment and the effect of changes in currency translation rates:

| (in thousands)         | Six months ended<br>June 30, |            | Percent<br>change | (Decrease) in 2006 sales<br>due to changes in<br>currency translation rates | Percent change<br>Excluding currency<br>rate effect |
|------------------------|------------------------------|------------|-------------------|---|---|
|                        | 2006                         | 2005       |                   |   |   |
| Paper Machine Clothing | \$ 378,357                   | \$ 364,842 | 3.7%              | (\$ 698)  | 3.9%  |
| Applied Technologies   | 75,607                       | 66,646     | 13.4%             | (313)   | 13.9%   |
| Albany Door Systems    | 58,889                       | 56,982     | 3.3%              | (2,034)   | 6.9%  |
| Consolidated total     | \$ 512,853                   | \$ 488,470 | 5.0%              | (\$ 3,045)  | 5.6%  |

Gross profit was 40.6 percent of net sales for the first six months of 2006, compared to 40.8 percent for the same period of 2005. The decrease in 2006 was due to costs associated with the integration of TCI and effects of higher petroleum prices, which were partially offset by a combination of revenue growth, price improvements, and efficiency gains.

Selling, technical, general, and research expenses were 29.2 percent of net sales for the first six months of 2006, compared with 28.2 percent for the same period of 2005. The increase is due mainly to the implementation of the previously discussed incentive compensation programs, severance payments, and the effect of changes in currency translation rates on accounts receivable and other balances held in currencies other than the local currency.

Operating income was \$58.4 million for the first six months of 2006, compared with \$61.8 million for the same period of 2005. The decline in operating income was attributable to increased selling, technical, general and research expenses.

Research expenses increased \$2.3 million as compared to the first six months of 2005, principally due to higher professional fees related to intellectual property, and higher compensation. Unallocated expenses, which consist primarily of corporate headquarters expenses, decreased \$1.1 million compared to the first six months of 2005 principally due the result of timing differences recorded at Corporate headquarters that are charged out to the business segments.

Interest expense, net, was \$4.6 million for the first six months of 2006, compared to \$6.8 million for the same period of 2005. The decrease is due principally to lower average interest rates in 2006. The Company's average interest rate in 2005 was affected by interest rate swaps that matured during 2005.

The effective income tax rate was 29.7 percent for the first six months of 2006, compared to 27.4 percent for the same period of 2005, which included the favorable resolution of certain income tax contingencies.

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Basic earnings per share were \$1.23 for the first six months of 2006, compared to \$1.24 for the same period of 2005. In addition to the factors described above, earnings were positively impacted by approximately \$0.05 per share due to fewer average shares outstanding, which resulted from share buybacks.

### *Paper Machine Clothing Segment three months ended June 30, 2006*

Second-quarter net sales of PMC increased 5.0 percent compared to the same period last year. Excluding the effects of changes in currency translation rates, net sales for the quarter increased 3.6 percent. Compared to the second quarter of 2005, net sales benefited from volume increases, product upgrades, and price improvements in some regions.

Paper and paperboard manufacturers in Canada and Europe continued their restructuring activities. During the first six months of 2006, Canadian papermakers shut down or announced plans to shut down a total of 12 paper machines, while European papermakers shut down 30 paper machines and announced plans to remove an additional 20 machines from production.

Gross profit as a percentage of net sales for the Paper Machine Clothing segment was 44.0% for the second quarter of 2006 compared to 43.8% for the same period of 2005. Gross margin in PMC was negatively affected by higher material costs as a result of higher petroleum prices, which were offset by the benefits of increased sales and efficiency improvements. Operating income decreased to \$40.2 million compared to \$42.1 million for the second quarter of 2005, principally due to an increase of \$3.6 million for Selling, technical, and general expenses. Approximately half of that increase was due to the effect of changes in currency translation rates on accounts receivable and other balances held in currencies other than the local currency.

### *Paper Machine Clothing Segment six months ended June 30, 2006*

Year to date net sales of PMC increased 3.7 percent compared to the same period last year. Excluding the effects of changes in currency translation rates, net sales increased 3.9 percent. Compared to the first half of 2005, net sales benefited from volume increases, product upgrades, and price improvements in some regions.

Gross profit as a percentage of net sales for the Paper Machine Clothing segment was 44.0% for the first six months of 2006 and 2005. Gross margin in PMC was negatively affected by higher material costs as a result of higher petroleum prices, which were offset by the benefits of increased sales and efficiency improvements. Operating income decreased to \$80.8 million compared to \$84.0 million for the first six months of 2005, principally due to an increase of \$6.5 million for Selling, technical, and general expenses. Approximately \$2.3 million of that increase was due to the effect of changes in currency translation rates on accounts receivable and other balances held in currencies other than the local currency.

### *Applied Technologies Segment three months ended June 30, 2006*

Second-quarter Applied Technologies net sales increased 9.5 percent compared to the same period last year and 8.8 percent excluding the effect of changes in currency translation rates. The segment benefited from strong second-quarter performance in PrimaLoft, Engineered Fabrics, and Industrial Process Belts.

Gross profit as a percentage of net sales for the Applied Technologies segment was 33.3% for the second quarter of 2006 compared to 36.4% for the same period of 2005. Gross margin percentages in Albany Engineered Composites declined as a result of costs associated with integrating the first-quarter 2006

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acquisition of Texas Composite Inc. and increases in manufacturing capacity to satisfy growth in the order backlog.

During the quarter, Albany Engineered Composites entered into two long-term, exclusive agreements with leaders in jet engines and aircraft landing gear. First, Snecma has agreed to develop and commercialize advanced composite fan blades for future jet engines utilizing Albany's unique technology. Snecma is a world-leader in aircraft and space engines. In civil aviation in particular, Snecma and General Electric team up to produce the best-selling family of CFM56 aircraft engines. Similarly, Messier-Dowty, a world-leader in landing gear, has agreed to develop and build advanced composite landing gear components that will utilize Albany's technology.

Operating income decreased to \$5.1 million compared to \$6.0 million for the second quarter of 2005. In comparison to the second quarter of 2005, Selling, technical and general expenses increased \$0.9 million due to increases in several cost categories.

### *Applied Technologies Segment six months ended June 30, 2006*

Year to date Applied Technologies net sales increased 13.4 percent compared to the same period last year and 13.9 percent excluding the effect of changes in currency translation rates. The segment benefited from strong performance in PrimaLoft and Engineered Fabrics.

Gross profit as a percentage of net sales for the Applied Technologies segment was 33.6% for the first six months of 2006 compared to 36.4% for the same period of 2005. Operating income decreased to 11.3 million compared to \$11.5 million for the first six months of 2005.

### *Albany Door Systems Segment three months ended June 30, 2006*

Second-quarter Door Systems net sales increased 6.3 percent compared to the second quarter of 2005, and increased 6.0 percent excluding the effect of changes in currency translation rates. Increased sales in Europe and Australia, both in new products and in the after-market business, were responsible for the year-on-year improvements.

Gross profit as a percentage of net sales was 33.0% for the second quarter of 2006 compared to 32.3% for the same period of 2005. Operating income increased to \$1.2 million compared to \$0.6 for the second quarter of 2005. The increases were due to higher sales.

### *Albany Door Systems Segment six months ended June 30, 2006*

Year to date Door Systems net sales increased 3.3 percent compared with the same period of 2005, and increased 6.9 percent excluding the effect of changes in currency translation rates. Increased sales in Europe and Australia, both in new products and in the after-market business, were responsible for the year-on-year improvements.

Gross profit as a percentage of net sales was 34.6% for the first six months of 2006 compared to 33.7% for the same period of 2005. Operating income increased to \$3.5 million compared to \$2.4 for the first six months of 2005. The increases were due to higher sales.

**Liquidity and Capital Resources:**

The Company finances its business activities primarily with cash generated from operations and borrowings, primarily under \$180 million of convertible bonds issued in March 2006, \$150 million of long-term indebtedness to Prudential Securities issued in October 2005, and its revolving credit agreement as described in Note 13 of Notes to Consolidated Financial Statements. Company subsidiaries outside of the United States may also maintain working capital lines with local banks, but borrowings under such local facilities tend not to be significant.

Net cash provided by operating activities was \$45.8 million in comparison with \$49.8 million for the first six months of 2005. Excluding the effects of the Texas Composite acquisition and changes in currency translation rates, inventories increased \$20.1 million during the first six months of 2006, and accounts receivable increased \$6.5 million, in comparison to increases during the same period of 2005 of \$14.1 million and \$5.5 million, respectively. Increases in inventories and accounts receivable during the first six months of each year are common and reflect seasonality of certain geographic markets.

Capital spending during the second quarter of 2006 was \$12.6 million and was \$32.4 million for the first six months of 2006. The Company remains on track with its previously announced capital spending plans, which call for \$90-100 million of spending in 2006. Year to date depreciation was \$26.9 million and amortization was \$2.0 million, and are expected to be approximately \$54 million and \$4 million, respectively, for the full year.

In the first quarter of 2006, \$6.7 million of cash was invested in the first payment for shares of Texas Composite Inc. The second and final payment of approximately \$8 million for the remaining shares is expected to be made in the fourth quarter of 2006.

During the second quarter of 2006, the Company purchased an additional 758,720 shares of its Class A Common Stock at an average price of \$40.06 per share. For the first half of 2006, the Company acquired 3.5 million shares of its stock at an average price of \$37.57 per share, or a total cost of \$131.5 million.

In connection with the \$180 million of convertible bonds issued in March 2006, the Company entered into convertible note hedge and warrant transactions with respect to its Class A common stock at a net cost of \$14.7 million. These transactions are intended to reduce the potential dilution upon conversion of the notes by providing the Company with the option, subject to certain exceptions, to acquire shares which offset the delivery of newly issued shares upon conversion of the notes.

The Company anticipates that it will make a contribution of \$20 million to its United States pension plan during the third quarter of 2006, in comparison to a contribution of \$10 million in the third quarter of 2005.

The Company has a program to sell a portion of its North American accounts receivable. This program is described in detail in Note 4 of Notes to Consolidated Financial Statements. This form of financing results in a lower current incremental cost of financing than the lowest rate on the Company's revolving credit agreement, and it broadens the Company's sources of financing. In exchange for the accounts receivable sold, the Company receives cash and a note. The note is subject to monthly fluctuation based on the amount of receivables sold and bears interest at variable rates. As of June 30, 2006, the interest rate was 5.82% per annum. As described above under Critical Accounting Policies and Assumptions, in the event that the receivables program were terminated, the Company would not be required to repay any amounts received, but would also not realize any cash proceeds from the collection of additional receivables sold under the program prior to termination. Accounts receivable as reflected in the Consolidated Balance Sheets would increase as new sales were made, and, after the QSPE's obligations to the third party were satisfied, the note receivable would decrease as sold receivables were collected. These factors would result in a decrease in reported cash flow from operations beginning in the period of termination and continuing in subsequent periods until the sold



receivables were collected. The Company might need to borrow from its existing credit facilities or use available cash to make up the difference in cash generated from accounts receivable until collections from new accounts not sold under the program begin to be received.

The Company currently anticipates its consolidated tax rate in 2006 will not exceed 30% before any discrete items, although there can be no assurance that this will not change.

As discussed under *Industry Trends*, the paper industry has undergone major consolidation and capacity rationalization in recent years. Although PMC sales in 2005 improved over 2004, there can be no assurances that paper industry consolidation and rationalization is complete. If paper industry consolidation and rationalization continue, it could have a negative impact on net sales as well as on cash flow from operations. The Company will continue to focus on improving the performance of its products in order to increase market share and improve its product mix and price structure, while at the same time exploring additional cost-saving opportunities. In any event, although historical cash flows may not, for all of these reasons, necessarily be indicative of future cash flows, the Company expects to continue to be able to generate substantial cash from sales of its products and services in future periods.

For the three months ended June 30, 2006 and 2005, dividends declared were \$0.10 and \$0.08 per share, respectively, bringing the year to date dividends to \$0.19 and \$0.16 per share, respectively. Dividends have been declared each quarter since the fourth quarter of 2001. Decisions with respect to whether a dividend will be paid, and the amount of the dividend, are made by the Board of Directors each quarter. To the extent the Board declares cash dividends in the future, the Company would expect to pay such dividends out of operating cash flow. Future cash dividends will be dependent on debt covenants and on the Board's assessment of the Company's ability to generate sufficient cash flows.

**Outlook:**

In PMC, the Company was able to offset inflation in the second quarter of 2006 and almost all of the increase in materials cost through increased revenue, driven in part by new products, and through internal efficiencies. In the emerging businesses, the Company continued to balance positive short-term performance with the measures necessary to build the foundation for long-term, sustainable growth. Earnings in the second quarter of 2006 were negatively affected by integration costs at Texas Composite Inc. and ramp-up of their manufacturing capacity to meet a strong order backlog. Management remains confident that the acquisition will be accretive in 2007.

Looking forward, the Company's long-term strategy remains on track, and if anything, ahead of schedule: the emerging businesses continue on their path to sustainable growth; the PMC investments in Asia and Latin America are progressing well; and the Company is increasingly optimistic about its PMC products and R&D pipeline. And, while there is always the risk that petroleum price increases will undermine these efforts, management expects that company-wide internal improvement initiatives will have positive impacts on margins beginning late in the fourth quarter of 2006.

On the other hand, management does see a notable change in the business environment that could affect earnings in the short term, including the continuing consolidation in the paper industry in Canada and Europe. In addition, some competitors in Europe are aggressively reducing PMC prices. The combination of the financial pressures on the paper industry and the discounting by competitors leads management to the conclusion that it would be prudent to expect a slowdown in PMC revenue growth in the near term.

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Because of the downward pressure on PMC revenue, management is accelerating its internal efforts to improve margins. These accelerated efforts will have a negative impact on earnings in the third quarter of 2006. Management is hopeful that by year-end 2006, the resulting margin improvements will offset the impact on earnings from any slowdown in PMC revenue growth. The Company remains bullish about the PMC industry and confident that its value generating activities in general, and investments in the growth markets of Asia and Latin America in particular, will have enduring, positive impacts on the PMC business and returns to shareholders.

On August 3, 2006, the Company announced a reduction in manufacturing capacity in North America. The Company intends to discontinue dryer fabric manufacturing operations at its facility in Quebec, Canada, and to shut down seaming capacity at its Menasha, Wisconsin forming fabric operation. The actions are the result of shifting paper machine clothing demand in the Americas, and the continuing closure of paper and paperboard machines in North America, especially Canada.

The Company estimates that it will incur termination and severance charges of approximately \$2.0 million and other cash charges of approximately \$0.5 million in connection with these actions. These charges will be reflected in third-quarter results, with the bulk of the cash payments to be made during the third quarter. In addition, the Company expects to incur additional charges of from \$2.0 to \$2.5 million related to the relocation or retirement of equipment at the affected locations. The timing and nature of these charges (i.e., cash or non-cash; operating or restructuring/non-operating) has not been determined, pending final determination by the Company of the ultimate disposition of each item.

### **Non-GAAP Measures**

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

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

### **Recent Accounting Pronouncements**

In November 2004, the FASB issued FAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. This Standard requires that items such as idle facility expense and excess spoilage be recognized as current period charges. Under ARB No. 43, such costs were considered inventoriable costs unless they were considered so abnormal as to require immediate expensing. The Company was required to adopt the Standard on January 1, 2006 and it did not have any effect on its financial statements.

In December 2004, the FASB issued FAS No. 123 (Revised) Share-Based Payment (FAS No. 123R). This Standard establishes accounting guidelines for transactions in which an entity exchanges its equity instruments for goods or services. The Standard focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. In April 2005, the Securities and Exchange Commission amended Regulation S-X to amend the date for compliance with FAS No. 123R, Share-Based Payment to fiscal years beginning on or after June 15, 2005. FAS 123R also requires that certain tax benefits resulting from stock options be classified in the Statement of Cash Flows as financing activities, instead of operating activities. The Company adopted the provisions of this Standard on January 1, 2006 and used the

modified prospective transition method. Accordingly, the Company will recognize share-based compensation expense over the requisite service period of the awards. The Company expects that the adoption of this Standard will result in additional compensation expense for unvested options that were granted prior to 2003 of approximately \$1.6 million in 2006, \$0.8 million in 2007, and \$0.2 million per year from 2008 to 2017.

In May 2005, the FASB issued FAS No. 154, Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FAS Statement No. 3. This Standard requires retrospective application to prior periods – financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Standard also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in nondiscretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. In addition, this Standard requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. The Company adopted the Standard on January 1, 2006 and it did not have any effect on its financial statements.

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an Interpretation of FAS No. 143. This interpretation provides additional guidance as to when companies should record the fair value of a liability for a conditional asset retirement obligation when there is uncertainty about the timing and/or method of settlement of the obligation. The Company obtained documentation from each of its locations in order to determine whether there were any asset retirement obligations that required accrual or disclosure. The Company adopted the Standard on December 31, 2005 and it did not have any effect on its financial statements.

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

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

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation is effective for fiscal years beginning after December 15, 2006, and the Company is currently evaluating what impact it will have on its financial statements.

### Forward-looking statements

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

There are a number of risks, uncertainties and other important factors that could cause actual results to differ materially from the forward-looking statements, including, but not limited to: changes in conditions in the industry in which the Company's Paper Machine Clothing segment competes or in the papermaking industry in general could change; failure to remain competitive in the industry in which the Company's Paper Machine Clothing segment competes; material and petroleum-related costs could increase more or faster than anticipated; failure to receive, or a delay in receiving, the benefits from the Company's capital expenditures and investments; the strategies described in this report to address certain business or operational matters could fail to be effective, or their effectiveness could be delayed; other risks and uncertainties detailed from time to time in the Company's filings with the SEC.

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

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

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

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

**Item 4. Controls and Procedures**

(a) Disclosure controls and procedures.

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

(b) Changes in internal control over financial reporting.

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

**PART II OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

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

Albany was defending against 20,246 claims as of August 4, 2006. This compares with 20,726 such claims as of April 21, 2006, 24,451 claims as of December 31, 2005, 24,406 claims as of October 21, 2005, 29,411 claims as of December 31, 2004, 28,838 claims as of December 31, 2003, 22,593 claims as of December 31, 2002, 7,347 claims as of December 31, 2001, 1,997 claims as of December 31, 2000, and 2,276 claims as of December 31, 1999. These suits allege a variety of lung and other diseases based on alleged exposure to products previously manufactured by Albany.

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

As of August 4, 2006, approximately 13,641 of the claims pending against Albany are pending in Mississippi, in either State or Federal courts. This compares to 19,166 claims as of July 22, 2005, 24,865 claims as of July 23, 2004, and approximately 24,646 claims as of August 1, 2003.

A Mississippi Supreme Court decision rendered in 2004 resulted in the dismissal of a number of claims pending against Albany in Mississippi and may continue to impact the remaining claims. In that decision, the Mississippi Supreme Court ruled on the practice of filing multi-plaintiff asbestos cases against numerous defendants. As a result, State courts in counties throughout Mississippi began to issue orders severing the individual claims of plaintiffs in mass joinder asbestos cases. Once severed, the plaintiffs were ordered to file amended complaints with more detailed information regarding their allegations of asbestos exposure to establish proper jurisdiction and venue, with the stated intention that any improperly filed claim would be dismissed or transferred. As a consequence, a number of plaintiffs voluntarily dismissed their claims and others were dismissed by Court order. In cases where plaintiffs filed amended complaints, their cases were transferred to the proper counties within Mississippi. In approximately 2,582 cases the plaintiffs arranged for the removal of their cases to Federal court, either with or without filing amended complaints. As of August 4, 2006, approximately 7,466 of the claims against Albany pending in Mississippi are now in Federal court, either through removal or original jurisdiction.

Those Federal Court claims are before the Federal Multidistrict Litigation (MDL) Panel for asbestos cases. A number of procedural challenges have been made at the MDL, but the Company cannot predict the outcomes of those challenges. The Company does expect that a small number of the remaining claims pending in Mississippi State courts could yet be dismissed, or transferred as the Mississippi Supreme Court ruling continues to be implemented, though not at the rates previously seen. At that point the only claimants remaining in Mississippi State courts will be those who are residents of, or who allege exposure to asbestos in, that State, and whose amended complaints satisfy the requirement for specific information regarding their exposure claims. The Company expects that only a portion of these remaining claimants will be able to

demonstrate time spent in a paper mill to which Albany supplied asbestos-containing products during a period in which Albany's asbestos-containing products were in use. Based on past experience, communications from certain plaintiffs' counsel and the advice of the Company's Mississippi counsel, the Company expects the percentage of claimants with paper mill exposure in the Mississippi proceedings to be considerably lower than the total number of claims previously asserted. However, due to the fact that the effects of the mandate of the Mississippi Supreme Court are taking time to be fully realized, the Company does not believe a meaningful estimate can be made regarding the expected reduction in claims or the range of possible loss with respect to the remaining claims.

It is the position of Albany and the other paper machine clothing defendants that there was insufficient exposure to asbestos from any paper machine clothing products to cause asbestos-related injury to any plaintiff. Furthermore, asbestos contained in Albany's synthetic products was encapsulated in a resin-coated yarn woven into the interior of the fabric, further reducing the likelihood of fiber release. While the Company believes it has meritorious defenses to these claims, it has settled certain of these cases for amounts it considers reasonable given the facts and circumstances of each case. The Company's insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of August 4, 2006, the Company had resolved, by means of settlement or dismissal, 19,648 claims. The total cost of resolving all claims was \$6,671,000. Of this amount, \$6,636,000, or 99%, was paid by the Company's insurance carrier. The Company has approximately \$130 million in confirmed insurance coverage that should be available with respect to current and future asbestos claims, as well as additional insurance coverage that it should be able to access.

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

Brandon Drying Fabrics, Inc. ( Brandon ), a subsidiary of Geschmay Corp., is also a separate defendant in many of the asbestos cases in which Albany is named as a defendant. Brandon was defending against 9,399 claims as of August 4, 2006. This compares with 9,753 such claims as of April 21, 2006, 9,566 claims as of December 31, 2005, 9,608 claims as of October 21, 2005, 9,985 claims as of December 31, 2004, 10,242 claims as of December 31, 2003, 11,802 claims as of December 31, 2002, 8,759 claims as of December 31, 2001, 3,598 claims as of December 31, 2000, and 1,887 claims as of December 31, 1999. The Company acquired Geschmay Corp., formerly known as Wangner Systems Corporation, in 1999. Brandon is a wholly-owned subsidiary of Geschmay Corp. In 1978, Brandon acquired certain assets from Abney Mills ( Abney ), a South Carolina textile manufacturer. Among the assets acquired by Brandon from Abney were assets of Abney's wholly-owned subsidiary, Brandon Sales, Inc. which, among other things, had sold dryer fabrics containing asbestos made by its parent, Abney. It is believed that Abney ceased production of asbestos-containing fabrics prior to the 1978 transaction. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. Under the terms of the Assets Purchase Agreement between Brandon and Abney, Abney agreed to indemnify, defend, and hold Brandon harmless from any actions or claims on account of products manufactured by Abney and its related corporations prior to the date of the sale, whether or not the product was sold subsequent to the date of the sale. It appears that Abney has since been dissolved. Nevertheless, a representative of Abney has been notified of the pendency of these actions and demand has been made that it assume the defense of these actions. Because Brandon did not manufacture asbestos-containing products, and because it does not believe that it was the legal successor to, or otherwise responsible for obligations of, Abney with respect to products manufactured by Abney, it believes it has strong defenses to the claims that have been asserted against it. In some instances, plaintiffs have voluntarily dismissed claims against it, while in others it has entered into what it considers to be reasonable settlements. As of August 4, 2006, Brandon has resolved, by means of settlement or dismissal, 7,945 claims for a total of \$152,499. Brandon's insurance carriers initially agreed to pay 88.2% of the total indemnification and defense costs related to these proceedings, subject to the standard reservation of rights. The remaining 11.8% of the costs had been borne directly by Brandon. During 2004, Brandon's

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

#### **Mount Vernon**

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

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

Legislation has again been introduced in the United States Senate that is intended to address asbestos litigation by creating a privately funded trust to provide compensation to persons injured as the result of exposure to asbestos. The Fairness In Asbestos Injury Resolution Act Of 2006 ( Fair Act ) was introduced by Senators Leahy and Specter on May 25, 2006. If enacted into law, the Company would be required to make payments of up to \$1, 000,000 per year for up to 30 years to the privately funded, publicly administered trust fund. The payments would not be covered by any of the Company s insurance policies. The Company cannot predict whether the Fair Act, or any asbestos legislation, will ultimately be enacted into law.



**Item 1A. Risk Factors.**

There have been no material changes in risks since December 31, 2005. For discussion of risk factors, refer to Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

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

In December 2005, the Board of Directors increased the number of shares of the Company's Class A Common Stock that could be purchased to 3,500,000. The Board's action authorized management to purchase shares from time to time, in the open market or otherwise, whenever it believes the available price makes such purchase advantageous to the Company's shareholders.

In May 2006, the Company announced that it had adopted a written trading plan under Rule 10b5-1 of the Securities Exchange Act of 1934 to facilitate the repurchase of its Class A Common Stock. During May and June 2006, the Company purchased a total of 758,720 shares under the Rule 10b5-1 plan. Although the 10b-5 plan expires on October 25, 2006, management is not authorized to purchase any additional shares of its Class A Common Stock.

| Period                | Total number of shares purchased | Average price paid | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|-----------------------|----------------------------------|--------------------|--|--|
| January 1 to 31, 2006 | 663,700                          | \$ 36.20           | 0  | 0  |
| March 1 to 31, 2006   | 2,077,580                        | 37.10              | 0  | 0  |
| May 1 to 31, 2006     | 358,700                          | 39.72              | 358,700  | 0  |
| June 1 to 30, 2006    | 400,020                          | 40.37              | 400,020  | 0  |

**Item 3. Defaults Upon Senior Securities**

None

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

None

At the annual meeting of shareholders held May 12, 2006, the only items subject to a vote of security holders were the election of nine directors and the approval of the Directors Annual Retainer Plan.

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

| Nominee                  | Number of Votes For |            | Number of Votes Withheld |         | Broker Nonvotes |         |
|--------------------------|---------------------|------------|--------------------------|---------|-----------------|---------|
|                          | Class A             | Class B    | Class A                  | Class B | Class A         | Class B |
| Frank R. Schmeler        | 14,434,613          | 32,359,940 | 10,086,857               |         |                 |         |
| Joseph G. Morone         | 13,498,598          | 32,359,940 | 11,022,872               |         |                 |         |
| Thomas R. Beecher Jr.    | 13,185,985          | 32,359,940 | 11,335,485               |         |                 |         |
| Christine L. Standish    | 9,953,466           | 32,359,940 | 14,568,005               |         |                 |         |
| Erland E. Kailbourne     | 21,561,631          | 32,359,940 | 2,959,840                |         |                 |         |
| John C. Standish         | 13,188,189          | 32,359,940 | 11,333,881               |         |                 |         |
| Juhani Pakkala           | 21,803,825          | 32,359,940 | 2,717,645                |         |                 |         |
| Paula H. J. Cholmondeley | 21,404,363          | 32,359,940 | 3,117,107                |         |                 |         |
| John F. Cassidy, Jr.     | 22,437,353          | 32,359,940 | 2,084,117                |         |                 |         |

In the vote taken at the 2006 Annual Meeting on the resolution to approve the Directors Annual Retainer Plan, the number of votes cast for, the number cast against, and the number of votes abstaining with respect to such resolution were as follows:

| Number of Votes For |            | Number of Votes Against |         | Number of Votes Abstaining |         | Broker Nonvotes |         |
|---------------------|------------|-------------------------|---------|----------------------------|---------|-----------------|---------|
| Class A             | Class B    | Class A                 | Class B | Class A                    | Class B | Class A         | Class B |
| 21,125,401          | 32,359,940 | 811,904                 |         | 360,614                    |         | 2,223,550       |         |

**Item 5. Other Information**

None

**Item 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 31.1               | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act.  |
| 31.2               | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act.  |
| 32.1               | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) |
| 99.1               | Quantitative and qualitative disclosures about market risks as reported at December 31, 2005.   |

**SIGNATURES**

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

ALBANY INTERNATIONAL CORP.

(Registrant)

Date: August 7, 2006

By /s/ Michael C. Nahl

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