

ALBANY INTERNATIONAL CORP /DE/  
Form 10-Q  
November 10, 2008

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: September 30, 2008

OR

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

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

Commission file number: 1-10026

ALBANY INTERNATIONAL CORP.

(Exact name of registrant as specified in its charter)

Delaware

14-0462060

(State or other jurisdiction of

(IRS Employer Identification No.)

incorporation or organization)

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, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer [  ]

Accelerated filer

[  ]

Non-accelerated filer [  ] Smaller reporting company [  ]

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

Yes [  ] No [  ]

The registrant had 26,646,292 shares of Class A Common Stock and 3,236,098 shares of Class B Common Stock outstanding as of September 30, 2008.

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ALBANY INTERNATIONAL CORP.

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ALBANY INTERNATIONAL CORP.  
CONSOLIDATED STATEMENTS OF  
OPERATIONS

(in thousands except per share data)  
(unaudited)

| Three Months Ended |           |  | Nine Months Ended |           |
|--------------------|-----------|--|-------------------|-----------|
| September 30,      |           |  | September 30,     |           |
| 2008               | 2007      |  | 2008              | 2007      |
| \$266,922          | \$264,960 | Net sales  | \$837,331         | \$772,253 |
| 177,772            | 173,583   | Cost of goods sold   | 550,053           | 489,700   |
| 89,150             | 91,377    | Gross profit   | 287,278           | 282,553   |
| 78,297             | 76,823    | Selling, technical, general and research expenses            | 247,625           | 231,850   |
| 6,731              | 13,512    | Restructuring and other, net                                 | 13,825            | 28,233    |
| 4,122              | 1,042     | Operating income   | 25,828            | 22,470    |
| 4,520              | 3,782     | Interest expense, net  | 13,602            | 10,666    |
| (706)              | 1,409     | Other (income)/expense, net                                  | 1,175             | 1,622     |
| 308                | (4,149)   | Income/(loss) from continuing operations before income taxes | 11,051            | 10,182    |
| 5,805              | 81        | Income tax expense   | 12,082            | 971       |

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|          |           |  |          |         |
|----------|-----------|--|----------|---------|
| (5,497)  | (4,230)   | (Loss)/income before associated companies              | (1,031)  | 9,211   |
| 159      | (195)     | Equity in income/(losses) of associated companies      | (86)     | (430)   |
| (5,338)  | (4,425)   | (Loss)/income from continuing operations               | (1,117)  | 8,781   |
|          |           | Discontinued operations:                               |          |         |
| (404)    | 658       | (Loss)/income from operations of discontinued business | (91)     | 1,255   |
| 6,134    | -         | Gain on sale of discontinued business                  | 6,134    | -       |
| (368)    | 104       | Income tax (benefit)/expense                           | (238)    | 197     |
| 6,098    | 554       | Income from discontinued operations                    | 6,281    | 1,058   |
| \$760    | (\$3,871) | Net income/(loss)                                      | \$5,164  | \$9,839 |
|          |           | (Loss)/income from continuing operations:              |          |         |
| (\$0.17) | (\$0.15)  | Basic  | (\$0.04) | \$0.30  |
| (\$0.17) | (\$0.15)  | Diluted  | (\$0.04) | \$0.30  |
|          |           | Income from discontinued operations:                   |          |         |
| \$0.20   | \$0.02    | Basic  | \$0.21   | \$0.03  |
| \$0.20   | \$0.02    | Diluted  | \$0.21   | \$0.03  |
|          |           | Net income/(loss) per share:                           |          |         |
| \$0.03   | (\$0.13)  | Basic  | \$0.17   | \$0.33  |
| \$0.03   | (\$0.13)  | Diluted  | \$0.17   | \$0.33  |
|          |           | Shares used in computing (losses)/earnings per share:  |          |         |
| 29,857   | 29,492    | Basic  | 29,743   | 29,380  |
| 29,857   | 29,492    | Diluted  | 29,743   | 29,790  |
| \$0.12   | \$0.11    | Dividends per share                                    | \$0.35   | \$0.32  |

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

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

|   | (unaudited)<br>September 30,<br>2008 | December 31,<br>2007 |
|---|--------------------------------------|----------------------|
| <b>ASSETS</b>                                   |                                      |                      |
| Cash and cash equivalents                       | \$93,962                             | \$73,305             |
| Accounts receivable, net                        | 232,842                              | 232,440              |
| Inventories                                     | 226,224                              | 247,043              |
| Income taxes receivable and deferred            | 25,070                               | 26,734               |
| Prepaid expenses and other current assets       | 22,712                               | 22,832               |
| Total current assets                            | 600,810                              | 602,354              |
| <br>  |                                      |                      |
| Property, plant and equipment, net              | 576,642                              | 525,853              |
| Investments in associated companies             | 4,204                                | 5,373                |
| Intangibles                                     | 9,448                                | 11,217               |
| Goodwill  | 194,184                              | 194,660              |
| Deferred taxes                                  | 87,393                               | 100,604              |
| Cash surrender value of life insurance policies | 46,494                               | 43,701               |
| Other assets                                    | 41,958                               | 43,215               |
| Total assets                                    | \$1,561,133                          | \$1,526,977          |
| <br>  |                                      |                      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>     |                                      |                      |
| Notes and loans payable                         | \$19,551                             | \$32,030             |
| Accounts payable                                | 53,828                               | 82,157               |
| Accrued liabilities                             | 137,149                              | 120,267              |
| Current maturities of long-term debt            | 10                                   | 1,146                |
| Income taxes payable and deferred               | 5,988                                | 2,970                |
| Total current liabilities                       | 216,526                              | 238,570              |
| <br>  |                                      |                      |
| Long-term debt                                  | 526,276                              | 446,433              |
| Other noncurrent liabilities                    | 146,016                              | 188,621              |
| Deferred taxes and other credits                | 58,895                               | 53,682               |
| Total liabilities                               | 947,713                              | 927,306              |
| <br>  |                                      |                      |
| Commitments and Contingencies                   | -                                    | -                    |

**SHAREHOLDERS' EQUITY**

|   |             |             |
|---|-------------|-------------|
| Preferred stock, par value \$5.00 per share;<br>authorized 2,000,000 shares; none issued  | -           | -           |
| Class A Common Stock, par value \$.001 per<br>share;<br>authorized 100,000,000 shares; issued<br>35,169,431 in 2008 and 34,819,384 in 2007. | 35          | 35          |
| Class B Common Stock, par value \$.001 per<br>share;<br>authorized 25,000,000 shares; issued and<br>outstanding 3,236,098 in 2008 and 2007  | 3           | 3           |
| Additional paid in capital  | 335,658     | 326,608     |
| Retained earnings   | 538,968     | 544,228     |
| Accumulated items of other comprehensive<br>income:   |             |             |
| Translation adjustments   | 29,384      | 42,208      |
| Pension liability adjustment  | (31,757)    | (55,953)    |
| Derivative valuation adjustment   | -           | 1,565       |
|   | 872,291     | 858,694     |
| Less treasury stock (Class A), at cost (8,523,139<br>shares<br>in 2008 and 8,530,066 in 2007)   | 258,871     | 259,023     |
| Total shareholders' equity  | 613,420     | 599,671     |
| Total liabilities and shareholders' equity  | \$1,561,133 | \$1,526,977 |

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

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

|                      |                                    |      |
|----------------------|------------------------------------|------|
|                      | Nine Months Ended<br>September 30, |      |
|                      | 2008                               | 2007 |
| OPERATING ACTIVITIES |                                    |      |

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|   |           |           |
|---|-----------|-----------|
| Net income  | \$5,164   | \$9,839   |
| Adjustments to reconcile net income to net cash provided by operating activities:           |           |           |
| Equity in losses of associated companies  | 86        | 430       |
| Depreciation  | 43,618    | 43,020    |
| Amortization  | 4,553     | 3,605     |
| Provision for deferred income taxes, other credits and long-term liabilities                | 1,610     | (2,925)   |
| Provision for write-off of equipment  | 1,793     | 3,452     |
| Increase in cash surrender value of life insurance  | (1,806)   | (2,146)   |
| Unrealized currency transaction gains and losses  | (2,401)   | (273)     |
| Gain on disposition of discontinued operations  | (6,134)   | -         |
| Shares contributed to ESOP  | 4,593     | 4,065     |
| Stock option expense  | 126       | 602       |
| Tax benefit of options exercised  | (811)     | (1,088)   |
| Issuance of shares under long-term incentive plan   | 624       | 937       |
| Changes in operating assets and liabilities, net of business acquisitions and divestitures: |           |           |
| Accounts receivable   | (8,126)   | (16,895)  |
| Inventories   | (2,706)   | (18,804)  |
| Income taxes prepaid and receivable   | -         | (16,076)  |
| Prepaid expenses  | (101)     | (4,570)   |
| Accounts payable  | (26,826)  | 922       |
| Accrued liabilities   | 17,719    | 33,449    |
| Income taxes payable  | 3,710     | 1,667     |
| Other, net  | (2,816)   | 61        |
| Net cash provided by operating activities   | 31,869    | 39,272    |
| INVESTING ACTIVITIES  |           |           |
| Purchases of property, plant and equipment  | (104,958) | (90,684)  |
| Proceeds from sale of discontinued operations, net of cash transferred                      | 42,268    | -         |
| Purchased software  | (10,027)  | (11,687)  |
| Acquisitions, net of cash acquired  | -         | (9,592)   |
| Cash received from life insurance policy terminations                                       | -         | 1,470     |
| Premiums paid for life insurance policies   | (987)     | (988)     |
| Gain on cross currency swap   | 8,090     | -         |
| Net cash (used in) investing activities   | (65,614)  | (111,481) |
| FINANCING ACTIVITIES  |           |           |



|  |          |          |
|--|----------|----------|
| Proceeds from borrowings                         | 87,010   | 83,697   |
| Principal payments on debt                       | (21,884) | (28,104) |
| Proceeds from options exercised                  | 2,813    | 2,958    |
| Tax benefit of options exercised                 | 811      | 1,088    |
| Dividends paid                                   | (10,094) | (9,088)  |
| Net cash provided by financing activities        | 58,656   | 50,551   |
| Effect of exchange rate changes on cash flows    | (4,254)  | 188      |
| Increase/(decrease) in cash and cash equivalents | 20,657   | (21,470) |
| Cash and cash equivalents at beginning of year   | 73,305   | 68,237   |
| Cash and cash equivalents at end of period       | \$93,962 | \$46,767 |

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

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ALBANY INTERNATIONAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of only normal, recurring adjustments, necessary for a fair presentation of results for such periods. The results for any interim period are not necessarily indicative of results for the full year. The preparation of financial statements for interim periods does not require all of the disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. These consolidated financial statements should be read in conjunction with financial statements and notes thereto for the year ended December 31, 2007.

**Reclassification:**

In the third quarter of 2008, the Company reclassified software so that it is now reflected as a component of Property, plant, and equipment, net, on the Consolidated Balance Sheets for the periods ended September 30, 2008 and December 31, 2007. In previous financial reports, software was included in the caption Other assets in the Consolidated Balance Sheets. The accompanying balance sheet of December 31, 2007 includes a reclassification of \$26,313,000 from Other assets to Property, plant, and equipment, net, in order to conform to the current year presentation.

## 2. Reportable Segment Data

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

| (in thousands)          | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                         | 2008                                | 2007      | 2008                               | 2007      |
| <b>Net Sales</b>        |                                     |           |                                    |           |
| Paper Machine Clothing  | \$179,449                           | \$189,077 | \$561,941                          | \$552,107 |
| Albany Door Systems     | 46,268                              | 37,363    | 140,245                            | 105,181   |
| Engineered Fabrics      | 24,117                              | 25,219    | 79,482                             | 76,592    |
| Engineered Composites   | 12,000                              | 9,341     | 37,065                             | 24,259    |
| PrimaLoft® Products     | 5,088                               | 3,960     | 18,598                             | 14,114    |
| Consolidated total      | \$266,922                           | \$264,960 | \$837,331                          | \$772,253 |
| <b>Operating Income</b> |                                     |           |                                    |           |
| Paper Machine Clothing  | \$19,246                            | \$15,886  | \$65,221                           | \$66,020  |
| Albany Door Systems     | 3,231                               | (99)      | 10,389                             | (556)     |
| Engineered Fabrics      | 4,060                               | 4,429     | 13,206                             | 13,282    |
| Engineered Composites   | (3,342)                             | (1,309)   | (5,393)                            | (3,621)   |
| PrimaLoft® Products     | 646                                 | 304       | 3,409                              | 2,391     |
| Research expense        | (6,004)                             | (5,892)   | (20,163)                           | (16,609)  |
| Unallocated expenses    | (13,715)                            | (12,277)  | (40,841)                           | (38,437)  |

|   |       |       |        |        |
|---|-------|-------|--------|--------|
| Operating income before reconciling items | 4,122 | 1,042 | 25,828 | 22,470 |
|---|-------|-------|--------|--------|

**Reconciling items:**

|  |       |           |          |          |
|--|-------|-----------|----------|----------|
| Interest expense, net  | 4,520 | 3,782     | 13,602   | 10,666   |
| Other (income)/expense, net                                  | (706) | 1,409     | 1,175    | 1,622    |
| Income/(loss) from continuing operations before income taxes | \$308 | (\$4,149) | \$11,051 | \$10,182 |

The Company has incurred restructuring and other performance improvement costs in connection with significant restructuring of manufacturing facilities and administrative processes. The tables below present the amount of cost incurred by reportable segment.

| (in thousands)               | Three Months Ended<br>September 30, 2008 |  |          | Nine Months Ended<br>September 30, 2008 |  |          |
|------------------------------|--|--|----------|---|--|----------|
|                              | Restructuring<br>and other               | Costs related to<br>Idle capacity and<br>Performance<br>improvement<br>initiatives | Total    | Restructuring<br>and other              | Costs related to<br>Idle capacity and<br>Performance<br>improvement<br>initiatives | Total    |
| Paper Machine Clothing       | \$6,761                                  | \$6,537  | \$13,298 | \$13,792                                | \$19,500   | \$33,292 |
| Albany Door Systems          | 227                                      | -  | 227      | 549                                     | 2,000  | 2,549    |
| Albany Engineered Composites | 366                                      | -  | 366      | 366                                     | -  | 366      |
| Research expenses            | (192)                                    | -  | (192)    | 1,636                                   | -  | 1,636    |
| Unallocated                  | (431)                                    | 4,166  | 3,735    | (2,518)                                 | 14,800   | 12,282   |
| Consolidated total           | \$6,731                                  | \$10,703   | \$17,434 | \$13,825                                | \$34,500   | \$48,329 |

Costs related to idle capacity and performance improvement initiatives were reported in the statement of income as follows:

|  |          |        |
|--|----------|--------|
| Cost of goods sold                       | \$5,975  | \$16,8 |
| Selling, technical, general and research | 4,728    | 17,7   |
| Total                                    | \$10,703 | \$34,5 |

| (in thousands)            | Three Months Ended<br>September 30, 2007 |  |          | Nine Months Ended<br>September 30, 2007 |  |          |
|---------------------------|--|--|----------|---|--|----------|
|                           | Restructuring<br>and other               | Costs related to<br>Idle capacity and<br>Performance<br>improvement<br>initiatives | Total    | Restructuring<br>and other              | Costs related to<br>Idle capacity and<br>Performance<br>improvement<br>initiatives | Total    |
| Paper Machine Clothing    | \$13,204                                 | \$4,991  | \$18,195 | \$23,091                                | \$6,999  | \$29,990 |
| Albany Door Systems       | -  | 1,085  | 1,085    | 2,224                                   | 1,085  | 3,309    |
| Albany Engineered Fabrics | -  | 452  | 452      | -                                       | 452  | 452      |
| Research                  | 308                                      | -  | 308      | 308                                     | -  | 308      |
| Unallocated               | -  | 2,328  | 2,328    | 2,610                                   | 6,994  | 9,322    |
| Consolidated total        | \$13,512                                 | \$8,856  | \$22,368 | \$28,233                                | \$15,530   | \$43,763 |

Costs related to idle capacity and performance improvement initiatives were reported in the statement of income as follows:

|  |         |          |
|--|---------|----------|
| Cost of goods sold                       | \$3,886 | \$4,939  |
| Selling, technical, general and research | 4,970   | 10,591   |
| Total                                    | \$8,856 | \$15,530 |

There were no material changes in the total assets of the reportable segments during the three months ended September 30, 2008.

### 3. 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 \$9,600,000 to its pension plans in 2008, compared to \$20,800,000 in 2007. The Company also provides certain medical, dental and life insurance benefits ( Other Postretirement 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 nine months ended September 30, 2008 and 2007 are, as follows:

| (in thousands)                 | Pension Plans |          | Other Postretirement Benefits |         |
|--------------------------------|---------------|----------|-------------------------------|---------|
|                                | 2008          | 2007     | 2008                          | 2007    |
| Service cost                   | \$6,501       | \$5,569  | \$1,446                       | \$1,923 |
| Interest cost                  | 19,359        | 15,872   | 4,464                         | 4,620   |
| Expected return on plan assets | (15,585)      | (16,293) | -                             | -       |
| Amortization:                  |               |          |                               |         |
| Transition obligation          | -             | 24       | -                             | -       |
| Prior service cost/(credit)    | 582           | 661      | (3,093)                       | (3,156) |
| Net actuarial loss             | 1,857         | 3,838    | 2,585                         | 2,673   |
| Curtailement loss/(gain)       | 676           | -        | (3,155)                       | -       |
| Net periodic benefit costs     | \$13,390      | \$9,671  | \$2,247                       | \$6,060 |

Effective September 1, 2008, the Company made a change to its cost sharing arrangement of the Other Postretirement Benefits program. Under this change, the Company will not increase its nominal contribution for health care costs, thereby eliminating the portion of the liability related to the expected future increases in medical costs. The impact of this change was a reduction in the Other Postretirement Benefits liability of \$43,500,000, an increase to the pension equity adjustment of \$26,500,000, and a decrease to noncurrent deferred tax assets of \$17,000,000. Additionally, the monthly net periodic benefit cost was reduced approximately \$585,000 beginning September 1, 2008.

The curtailment loss/(gain) includes a gain of \$462,000 recognized in the third quarter and \$3,155,000 for the first nine months of 2008, and is related to restructuring activities in North America.

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

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#### 4. Restructuring

The Company has ongoing restructuring activities principally related to the reduction of manufacturing capacity in North America and reorganization of certain administrative functions.

The following table summarizes charges reported in the Statement of Operations under *Restructuring and other* for the first nine months of 2008:

| (in thousands)               | Total restructuring<br>costs incurred | Termination and<br>other costs | Benefit plan<br>curtailment |
|------------------------------|---------------------------------------|--------------------------------|-----------------------------|
| Paper Machine Clothing       | \$ 13,792                             | \$ 13,342                      | \$ 450                      |
| Albany Door Systems          | 549                                   | 549                            | -                           |
| Albany Engineered Composites | 366                                   | 366                            | -                           |
| Research expenses            | 1,636                                 | 1,636                          | -                           |
| Corporate headquarters       | (2,518)                               | (51)                           | (2,467)                     |
| <b>Total</b>                 | <b>\$ 13,825</b>                      | <b>\$ 15,842</b>               | <b>\$ (2,017)</b>           |

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

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

| (in thousands)            | Restructuring<br>charges accrued<br>December 31, 2007 | Restructuring<br>accruals in<br>2008 | Payments          | Currency<br>translation<br>/other | Restructuring<br>charges accrued<br>September 30, 2008 |
|---------------------------|---|--------------------------------------|-------------------|-----------------------------------|--|
| Termination costs         | \$10,408  | \$13,962                             | (\$12,895)        | \$102                             | \$11,577   |
| Other restructuring costs | 301   | -                                    | (113)             | -                                 | 188  |
| <b>Total</b>              | <b>\$10,709</b>                                       | <b>\$13,962</b>                      | <b>(\$13,008)</b> | <b>\$102</b>                      | <b>\$11,765</b>  |

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## 5. Other (income)/expense, net

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

Three Months Ended  
September 30,

Nine Months Ended  
September 30,

| (in thousands)              | 2008      | 2007    | 2008      | 2007    |
|-----------------------------|-----------|---------|-----------|---------|
| Currency transactions       | (\$1,548) | \$104   | (\$1,222) | (\$589) |
| Debt costs                  | 524       | 537     | 1,627     | 1,436   |
| Other miscellaneous expense | 318       | 768     | 770       | 775     |
| Total                       | (\$706)   | \$1,409 | \$1,175   | \$1,622 |

## 6. Discontinued Operations

In July 2008, the Company closed on the sale of its Filtration Technologies business, the principal operations of which are in Gosford, Australia, and Zhangjiagang, China. At closing, the Company received approximately \$45,000,000, which resulted in a pre-tax gain of \$6,134,000.

In evaluating the financial statement presentation, the Company concluded that the business met the definition of a discontinued operation, as defined in Statement of Financial Accounting Standards No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* (FAS No. 144) and, accordingly, the results of operations of this business have been reclassified for all periods presented, and are reported separately as income from discontinued operations. As permitted by FAS No. 144, the consolidated statements of cash flows, up to the date of sale, were combined with cash flows from continuing operations. The cash received from the sale, net of cash transferred, is included as cash flows from investing activities in the cash flow statement.

The results of operations for 2008 reflect activity only up to the closing date of July 25, 2008.



The table below summarizes financial results of the discontinued operation:

| (in thousands)   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2008                                | 2007     | 2008                               | 2007     |
| Net sales  | \$3,316                             | \$11,292 | \$23,383                           | \$29,006 |
| (Loss)/income from operations of discontinued business | (404)                               | 658      | (91)                               | 1,255    |
| Gain on sale of discontinued business                  | 6,134                               | -        | 6,134                              | -        |
| Income tax (benefit)/expense                           | (368)                               | 104      | (238)                              | 197      |

No remaining assets are held for sale relative to the Filtration Technologies business.

## 7. Income Taxes

The following tables present components of income tax expense for the three and nine month periods ending September 30, 2008 and 2007:

| (in thousands) | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|----------------|-------------------------------------|------|------------------------------------|------|
|                | 2008                                | 2007 | 2008                               | 2007 |

|   |         |           |          |         |
|---|---------|-----------|----------|---------|
| Income tax based on income from continuing operations before income taxes and estimated tax rate of 18% in 2008 and 26% in 2007 | \$55    | (\$1,079) | \$1,989  | \$2,647 |
| Impact of change in estimated tax rate  | (215)   | -         | -        | -       |
| Discrete tax expense/(benefit):   |         |           |          |         |
| Change in postretirement benefit plan   | 3,579   | -         | 3,579    | -       |
| Enacted legislation change  | -       | 1,944     | -        | 1,944   |
| Adjustments to prior period tax liabilities   | 356     | (750)     | 1,441    | (3,454) |
| Provision for/resolution of tax audits  | (363)   | (135)     | 2,496    | (180)   |
| Provision for/adjustment to valuation allowance   | 351     | -         | 351      | -       |
| Other discrete tax adjustments  | 336     | 101       | 520      | 14      |
| Out-of-period tax adjustment  | 1,706   | -         | 1,706    | -       |
| Total income tax expense on continuing operations   | \$5,805 | \$81      | \$12,082 | \$971   |

Income tax expense in 2008 includes an out-of-period adjustment to correct an equivalent favorable discrete tax adjustment of \$1,706,000 recorded in the second quarter of 2007. The corrected item has no impact on cash flows for any period presented. The Company does not believe that the corrected item is or was material to any previously issued annual or quarterly financial statements. As a result, the Company has not restated its previously issued annual or quarterly financial statements.

The Company is currently under audit in the U.S. and non-U.S. taxing jurisdictions. The Company records reserves for the outcome of these uncertainties in accordance with FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FAS No. 109. It is reasonably possible that a change in the reserve for these uncertainties could occur in the next twelve months. However, it is not possible to estimate a range at this time.

## 8. 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.

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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 |           | Nine Months Ended |         |
|--|--------------------|-----------|-------------------|---------|
|  | September 30,      |           | September 30,     |         |
|  | 2008               | 2007      | 2008              | 2007    |
| Net income/(loss) available to common shareholders   | \$760              | (\$3,871) | \$5,164           | \$9,839 |
| <b>Weighted average number of shares:</b>  |                    |           |                   |         |
| Weighted average number of shares used in calculating basic earnings per share   | 29,857             | 29,492    | 29,743            | 29,380  |
| <b>Effect of dilutive stock-based compensation plans:</b>  |                    |           |                   |         |
| Stock options  | -                  | -         | -                 | 389     |
| Long-term incentive plan   | -                  | -         | -                 | 21      |
| Weighted average number of shares used in calculating diluted earnings per share   | 29,857             | 29,492    | 29,743            | 29,790  |
| Effect of stock-based compensation plans that were not included in the computation of diluted earnings per share because to do so would have been antidilutive | 224                | 398       | 278               | -       |
| Average market price of common stock used for calculation of dilutive shares   | \$30.06            | \$39.11   | \$33.02           | \$37.16 |
| <b>Net income/(loss) per share:</b>  |                    |           |                   |         |
| Basic  | \$0.03             | (\$0.13)  | \$0.17            | \$0.33  |
| Diluted  | \$0.03             | (\$0.13)  | \$0.17            | \$0.33  |

As of September 30, 2008 and 2007, there was no dilution resulting from the convertible debt instrument, purchased call option, and warrant that are described in Note 11.

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

|                    | Class A<br>Shares | Class B<br>Shares | Less: Treasury<br>Shares | Net shares<br>Outstanding |
|--------------------|-------------------|-------------------|--------------------------|---------------------------|
| December 31, 2007  | 34,865,744        | 3,236,098         | (8,530,066)              | 29,571,776                |
| March 31, 2008     | 34,974,850        | 3,236,098         | (8,530,066)              | 29,680,882                |
| June 30, 2008      | 35,131,455        | 3,236,098         | (8,523,139)              | 29,844,414                |
| September 30, 2008 | 35,169,431        | 3,236,098         | (8,523,139)              | 29,882,390                |

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## 9. Inventories

Inventories consist of the following:

| (in thousands)  | September 30,<br>2008 | December 31,<br>2007 |
|-----------------|-----------------------|----------------------|
| Finished goods  | \$104,747             | \$119,141            |
| Work in process | 66,757                | 67,374               |

|                           |           |           |
|---------------------------|-----------|-----------|
| Raw material and supplies | 54,720    | 60,528    |
| Total inventories         | \$226,224 | \$247,043 |

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.

## 10. 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 2008, 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, customer contracts and technology assets that have finite lives. For purposes of applying FAS No. 142, the Company has determined that the reporting units are the Americas and Europe/Asia Pacific businesses within the Paper Machine Clothing segment, the Albany Doors segment, the Engineered Fabrics segment, and the Engineered Composites segment. Fair values of the reporting units and the related implied fair values of their respective goodwill were established using public company analysis and discounted cash flows.

The changes in intangible assets and goodwill from December 31, 2007 to September 30, 2008, were as follows:

| (in thousands)                      | Balance at<br>December 31, 2007 | Amortization | Currency<br>translation | Balance at<br>September 30, 2008 |
|-------------------------------------|---------------------------------|--------------|-------------------------|----------------------------------|
| <b>Amortized intangible assets:</b> |                                 |              |                         |                                  |
| Patents                             | \$2,091                         | (\$434)      | \$1                     | \$1,658                          |
| Trade names                         | 2,044                           | (599)        | 1                       | 1,446                            |
| Customer contracts                  | 6,693                           | (709)        | -                       | 5,984                            |
| Technology                          | 389                             | (29)         | -                       | 360                              |
| Total amortized intangible assets   | \$11,217                        | (\$1,771)    | \$2                     | \$9,448                          |

**Unamortized intangible assets:**

|          |           |      |         |           |
|----------|-----------|------|---------|-----------|
| Goodwill | \$194,660 | \$ - | (\$476) | \$194,184 |
|----------|-----------|------|---------|-----------|

As of September 30, 2008, goodwill included \$132,620,000 in the Paper Machine Clothing segment, \$37,042,000 in the Albany Door Systems segment, \$18,560,000 in the Engineered Fabrics segment, and \$5,962,000 in the Engineered Composites segment.

Estimated amortization expense of intangibles for the years ending December 31, 2008 through 2012 is as follows:

| Year | Annual amortization<br>(in thousands) |
|------|---------------------------------------|
| 2008 | \$2,600                               |
| 2009 | 2,500                                 |

|      |         |
|------|---------|
| 2010 | 1,800   |
| 2011 | 1,400   |
| 2012 | 900     |
|      | \$9,200 |

## 11. Financial Instruments

### Long term debt consists of the following:

| (in thousands)  | September 30,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| Convertible notes issued in March 2006 with fixed interest rates of 2.25%, due in year 2026   | \$180,000             | \$180,000            |
| Private placement with a fixed interest rate of 5.34%, due in years 2013 through 2017   | 150,000               | 150,000              |
| April 2006 credit agreement with borrowings outstanding at an average interest rate of 4.71% in 2008 and 5.88% in 2007  | 196,000               | 116,000              |
| Various notes and mortgages relative to operations principally outside the United States, at an average rate of 4.64% in 2008 and 5.80% in 2007 due in varying amounts through 2021 | 286                   | 1,015                |
| Industrial revenue financings at an average interest rate of 1.75% in 2007, due in varying amounts through 2009   | -                     | 564                  |

|  |           |           |
|--|-----------|-----------|
| Long term debt                         | 526,286   | 447,579   |
| Less: current portion                  | (10)      | (1,146)   |
| Long term debt, net of current portion | \$526,276 | \$446,433 |

The weighted average rate for all debt was 4.07% as of September 30, 2008 and 4.06% as of December 31, 2007.

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

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basis. The fair value of the note agreement was approximately \$142,558,000, which was measured using active market interest rates.

In March 2006, the Company issued \$180,000,000 principal amount of 2.25% convertible notes. The notes are convertible upon the occurrence of specified events and at any time on or after February 15, 2013, into cash up to the principal amount of notes converted and shares of the Company s Class A common stock with respect to the remainder, if any, of the Company s conversion obligation at a conversion rate of 22.5351 shares per \$1,000 principal amount of notes (equivalent to a conversion price of \$44.38 per share of Class A common stock). The fair value of the convertible notes was approximately \$145,350,000, which was measured using quoted prices in active markets.

Holders may convert their notes at any time on or after February 15, 2013. Before February 15, 2013, a holder may convert notes during the five-business day period immediately after any period of five consecutive trading days in which the trading price per note for each of such five days was less than 103% of the product of the last reported sale price of the Company s Class A common stock and the conversion rate on such day. Additionally, holders may convert prior to February 15, 2013 if the Company elects to distribute to all or substantially all of its Class A shareholders (a) rights or warrants to purchase shares of Class A common stock for less than their trading value, or (b) assets, debt



securities or rights to purchase securities, which distribution has a per-share value exceeding 15% of the current trading value of the Class A common stock.

Converting holders are entitled to receive, upon conversion of their notes, (1) an amount in cash equal to the lesser of the principal amount of the note and the note's conversion value, and (2) if the conversion value of the note exceeds the principal amount, shares of the Company's Class A common stock in respect of the excess conversion value. The conversion rate of the notes (subject to adjustment upon the occurrence of certain events) is 22.5351 shares per \$1,000 principal amount of notes (equivalent to a conversion price of \$44.38 per share of Class A common stock). The exact amount payable upon conversion would be determined in accordance with the terms of the indenture pursuant to which the notes were issued and will be based on a daily conversion value calculated on a proportionate basis by reference to the volume-weighted average price of the Company's Class A common stock for each day during a twenty-five day period relating to the conversion.

The notes are not redeemable before March 15, 2013. On or after March 15, 2013, the Company may, at its option, redeem for cash all or part of the notes for a price equal to 100% of the principal amount of the notes to be purchased, plus any accrued and unpaid interest, including any additional interest, up to but excluding the redemption date.

On each of March 15, 2013 and March 15, 2021, holders may require the Company to purchase all or a portion of their notes at a purchase price equal to 100% of the principal amount of the notes to be purchased, plus any accrued and unpaid interest, including any additional interest, to but excluding the purchase date. Holders also have the right to require the Company to repurchase notes upon the occurrence of certain fundamental events, including, without limitation, (1) a person or group, other than the Standish family, becoming beneficial owner of shares of common stock carrying more than 50% of the voting power of our common stock, (2) consummation of an exchange offer, tender offer or similar event whereby our Class A common stock is converted into cash, securities or other property, or any sale, lease or other transfer of all or substantially all of our consolidated assets, (3) approval by our stockholders of a plan or proposal of liquidation or dissolution, or (4) the delisting of our Class A common stock under certain circumstances.

In connection with the sale of the notes, the Company entered into hedge and warrant transactions with respect to its Class A common stock. 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 in an amount equal to the number of shares which the Company would be required to deliver upon

conversion of the notes. These transactions had the economic effect to the Company of increasing the conversion price of the Notes to \$52.25 per share.

Pursuant to the hedge transactions, if the Company delivers notice to the counterparties of any conversion of the Notes on or prior to March 15, 2013, the counterparties are in the aggregate obligated to deliver to the Company the number of shares of Class A common stock that the Company is obligated to deliver to the holders of the notes with respect to such conversion, exclusive of any shares deliverable by the Company by reason of any additional (or make whole ) premium relating to the notes or by reason of any election by the Company to unilaterally increase the conversion rate. The note hedge and warrant transactions had a net cost of \$14,700,000.

Pursuant to the warrant transactions, the Company sold a total of 4,123,986 warrants, each exercisable to buy a single share of Class A common stock at an initial strike price of \$52.25 per share. The warrants are American-style warrants (exercisable at any time), and expire over a period of sixty trading days beginning on September 15, 2013. If the warrants are exercised when they expire, the Company may choose either net cash or net share settlement. If the warrants are exercised before they expire, they must be net share settled. If the Company elects to net cash settle the warrants, the Company will pay cash in an amount equal to, for each exercise of warrants, (i) the number of warrants exercised multiplied by (ii) the excess of the volume weighted average price of the Company's Class A common stock on the expiration date of such warrants (the "Settlement Price") over the strike price. Under net share settlement, the Company will deliver to the warrant holders a number of shares of the Company's Class A common stock equal to, for each exercise of warrants, (x) the amount payable upon net cash settlement divided by (y) the Settlement Price.

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 \$44.38 per share in the case of the Senior Notes and \$51.98 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 \$460,000,000 five-year revolving credit agreement (the Credit Agreement), under which \$196,000,000 was outstanding as of September 30, 2008. The applicable interest rate for borrowings under the agreement is LIBOR plus a spread, based on the Company's leverage ratio at the time of borrowing. The agreement includes covenants that could limit the Company's ability to purchase Common Stock, pay dividends, acquire other companies or dispose of its assets.

Reflecting, in each case, the effect of subsequent amendments to each agreement, the Company is required to maintain a leverage ratio of not greater than 3.50 to 1.00 under the Credit Agreement, and a leverage ratio of not greater than 3.00 to 1.00 (or 3.50 to 1.00 for a period of six fiscal quarters following a material acquisition, as defined) under the Prudential Agreement. The Company is also required to maintain minimum interest coverage of 3.00 to 1.00 under each agreement. As of September 30, 2008, the Company's leverage

ratio under the agreement was 2.62 to 1.00 and the interest coverage ratio was 7.72 to 1.00. The Company may purchase its Common Stock or pay dividends to the extent its leverage ratio remains at or below 3.00 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. The Company's ability to borrow additional amounts under the credit agreement is conditional upon the absence of any defaults, as well as the absence of any material adverse change. Based on the maximum leverage ratio and the Company's consolidated EBITDA (as defined in the agreement), and without modification to any other credit agreements as of September 30, 2008, the Company would have been able to borrow an additional \$58,584,000 under its loan agreements.

On December 10, 2007, the Company and Bank of America entered into a US dollar-to-euro cross-currency and interest rate swap agreement with a notional value of \$150,000,000. The Company designated the swap to be an effective hedge of its euro net asset exposure relating to European operations. Under the swap agreement, the Company notionally exchanged \$150,000,000 at a fixed interest rate of 5.34% for euro 101,951,000 at a fixed interest rate of 5.28%. The exchange was executed at an exchange rate of 1.4713 US dollars per euro. The majority of the cash flows in the swap agreement were aligned with the Company's principal and interest payment obligations on its \$150,000,000, Prudential Agreement. The final maturity of the swap matched the final maturity of the Prudential Agreement. This cross-currency and interest rate swap was terminated on September 8, 2008. In consideration of the early termination of the swap, \$8,090,000 was paid to Albany International by Bank of America. The Company's swap agreement qualified as a hedge of net investments in foreign operations under the provisions of FAS No. 133, Accounting for Derivative Instruments and Hedging Activities. The \$8,090,000 cash settlement resulted in a \$4,783,000 increase to shareholders' equity, net of tax, in the Translation adjustments caption, and an increase of \$3,307,000 to Deferred tax liability.

**Fair Value Measurements include the following:**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 157 ( SFAS No. 157 ), Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 emphasizes that fair value is a market-based measurement, not an

entity-specific measurement, and states that a fair value measurement should be determined based on assumptions that market participants would use in pricing an asset or liability. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2 ( FSP No. 157-2 ), Effective Date of FASB Statement No. 157. FSP No. 157-2 amended SFAS No. 157 to defer the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, at least annually, including goodwill and trademarks. On January 1, 2008, the Company adopted the provisions of SFAS No. 157 that were not deferred by FSP No. 157-2. The adoption of these provisions of SFAS No. 157 did not have a material impact on the Company's consolidated financial statements. In accordance with FSP No. 157-2, the Company is required to adopt the remaining provisions of SFAS No. 157 on March 1, 2009. The Company does not expect the adoption of the remaining provisions of SFAS No. 157 in connection with its nonfinancial assets and nonfinancial liabilities to have a material impact on the Company's consolidated financial statements.

SFAS No. 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. The hierarchy is broken down into three general levels: Level 1 inputs are quoted prices in active markets for identical assets or liabilities; Level 2 inputs include data points that are observable such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical assets or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) such as interest

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rates and yield curves that are observable for the asset and liability, either directly or indirectly; Level 3 inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

The following table presents the fair value hierarchy for the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2008:

| (in thousands)                | Total Carrying<br>Value at<br>September 30, 2008 | Quoted prices<br>in active markets<br>(Level 1) | Significant other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable inputs<br>(Level 3) |
|-------------------------------|--|---|--|---|
| <i>Assets:</i>                |  |   |  |   |
| Cash and cash equivalents     | \$ 93,962  | \$ 93,962                                       | \$ -   | \$ -  |
| Available for sale securities | 859  | 859   | -  | -   |

|   |         |         |   |   |
|---|---------|---------|---|---|
| Cash surrender value of life insurance policies | 46,494  | 46,494  | - | - |
| <i>Liabilities:</i>                             |         |         |   |   |
| Foreign currency contracts                      | 2,105   | 2,105   | - | - |
| Fixed rate debt                                 | 526,276 | 526,276 | - | - |

Available for sale securities represent shares of common stock that are traded in an active market exchange. The shares are measured at fair value using closing stock prices and are recorded in the Consolidated Balance Sheets as Other assets.

Foreign currency contracts consist of foreign exchange forward contracts that are valued using market-based inputs obtained from independent pricing sources. The contracts are measured using market foreign exchange prices and are recorded in the Consolidated Balance Sheets as Accrued liabilities.

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## 12. Contingencies

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

Albany was defending against 18,385 claims as of October 27, 2008. This compares with 18,462 such claims as of July 25, 2008, 18,529 claims as of May 2, 2008, 18,789 claims as of February 1, 2008, 18,791 claims as of October 19, 2007, 18,813 claims as of July 27, 2007, 19,120 claims as of April 27, 2007, 19,388 claims as of February 16, 2007, 19,416 claims as of December 31, 2006, 24,451 claims as of December 31, 2005, 29,411 claims as of December 31, 2004, 28,838 claims as of December 31, 2003, 22,593 claims as of December 31, 2002, 7,347 claims as of December 31, 2001, 1,997 claims as of December 31, 2000, and 2,276 claims as of December 31, 1999. These suits allege a variety of lung and other diseases based on alleged exposure to products previously manufactured by Albany. The following table sets forth the number of claims filed, the number of claims settled, dismissed or otherwise resolved, and the average settlement amount during the periods presented:

| <i>Year ended<br/>December 31,</i> | <i>Opening<br/>Number<br/>of claims</i> | <i>Claims<br/>Dismissed,<br/>Settled or<br/>Resolved</i> | <i>New<br/>Claims</i> | <i>Closing<br/>Number<br/>of Claims</i> | <i>Amounts Paid<br/>(thousands) to<br/>Settle or Resolve<br/>(\$\$)</i> |
|------------------------------------|---|--|-----------------------|---|---|
| <i>2005</i>                        | <i>29,411</i>                           | <i>6,257</i>   | <i>1,297</i>          | <i>24,451</i>                           | <i>504</i>  |
| <i>2006</i>                        | <i>24,451</i>                           | <i>6,841</i>   | <i>1,806</i>          | <i>19,416</i>                           | <i>3,879</i>  |
| <i>2007</i>                        | <i>19,416</i>                           | <i>808</i>   | <i>190</i>            | <i>18,798</i>                           | <i>15</i>   |
| <i>2008 to date</i>                | <i>18,798</i>                           | <i>523</i>   | <i>110</i>            | <i>18,385</i>                           | <i>52</i>   |

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

As of October 27, 2008, approximately 12,436 of the claims pending against Albany were pending in Mississippi. Of these, approximately 11,871 are in federal court, at the multidistrict litigation panel ( MDL ), either through removal or original jurisdiction. (In addition to the 11,871 Mississippi claims pending against the Company at the MDL, there are approximately 888 claims pending against the Company at the MDL removed from various United States District Courts in other states.)

As of October 27, 2008, the remaining 5,949 claims pending against Albany were pending in states other than Mississippi. Pleadings and discovery responses in those cases in which work histories have been provided indicate claimants with paper mill exposure in less than 26% 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. For these reasons, the Company expects the percentage of these remaining claimants able to demonstrate time spent in

a paper mill to which Albany supplied asbestos-containing products during a period in which Albany's asbestos-containing products were in use to be considerably lower than the total

number of pending claims. In addition, over half of these remaining non-Mississippi claims have not provided any disease information. Detailed exposure and disease information sufficient meaningfully to estimate a range of possible loss of a particular claim is typically not available until late in the discovery process, and often not until a trial date is imminent and a settlement demand has been received. For these reasons, the Company does not believe a meaningful estimate can be made regarding the range of possible loss with respect to these remaining claims.

On May 31, 2007 the MDL issued an administrative order that required each MDL plaintiff to provide detailed information regarding, among other things, the alleged asbestos-related medical diagnoses. The order does not require exposure information with this initial filing. The first set of plaintiffs were required to submit their filings with the Court by August 1, 2007, with deadlines for additional sets of plaintiffs monthly thereafter until December 1, 2007, but the process is continuing with defendants reviewing the submissions for compliance.

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

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

It is the position of Albany and the other paper machine clothing defendants that there was insufficient exposure to asbestos from any paper machine clothing products to cause asbestos-related injury to any plaintiff. Furthermore, asbestos contained in Albany's synthetic products was encapsulated in a resin-coated yarn woven into the interior of the fabric, further reducing the likelihood of fiber release. While the Company believes it has meritorious defenses to these claims, it has settled certain of these cases for amounts it considers reasonable given the facts and circumstances of each case. The Company's insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of October 27, 2008, the Company had resolved, by means of settlement or dismissal, 22,046 claims. The total cost of resolving all claims was \$6,758,000. Of this amount, \$6,713,000, or 99%, was paid by the Company's insurance carrier. The Company has approximately \$130 million in confirmed insurance coverage that

should be available with respect to current and future asbestos claims, as well as additional insurance coverage that it should be able to access.

### Brandon Drying Fabrics, Inc.

Brandon Drying Fabrics, Inc. ( Brandon ), a subsidiary of Geschmay Corp., which is a subsidiary of the Company, is also a separate defendant in many of the asbestos cases in which Albany is named as a defendant. Brandon was defending against 8,664 claims as of October 27, 2008. This compares with 8,672 such claims as of July 25, 2008, 8,689 claims as of May 2, 2008, 8,741 claims as of February 1, 2008 and October 19, 2007, 9,023 claims as of July 27, 2007, 9,089 claims as of April 27, 2007, 9,189 claims as of February 16, 2007, 9,114 claims as of December 31, 2006, 9,566 claims as of December 31, 2005, 9,985 claims as of December 31, 2004, 10,242 claims as of December 31, 2003, 11,802 claims as of December 31, 2002, 8,759 claims as of December 31, 2001, 3,598 claims as of December 31, 2000, and 1,887 claims as of

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December 31, 1999. The following table sets forth the number of claims filed, the number of claims settled, dismissed or otherwise resolved, and the average settlement amount during the periods presented:

| <i>Year ended<br/>December 31,</i> | <i>Opening<br/>Number of<br/>claims</i> | <i>Claims<br/>Dismissed,<br/>Settled or<br/>Resolved</i> | <i>New<br/>Claims</i> | <i>Closing<br/>Number of<br/>Claims</i> | <i>Amounts Paid<br/>(thousands) to<br/>Settle or Resolve<br/>(\$\$)</i> |
|------------------------------------|---|--|-----------------------|---|---|
| 2005                               | 9,985                                   | 642  | 223                   | 9,566                                   | 0   |
| 2006                               | 9,566                                   | 1182   | 730                   | 9,114                                   | 0   |
| 2007                               | 9,114                                   | 462  | 88                    | 8,740                                   | 0   |
| 2008 to date                       | 8,740                                   | 86   | 10                    | 8,664                                   | 0   |

The Company acquired Geschmay Corp., formerly known as Wangner Systems Corporation, in 1999. Brandon is a wholly-owned subsidiary of Geschmay Corp. In 1978, Brandon acquired certain assets from Abney Mills ( Abney ), a South Carolina textile manufacturer. Among the assets acquired by Brandon from Abney were assets of Abney s wholly-owned subsidiary, Brandon Sales, Inc. which had sold, among other things, dryer fabrics containing asbestos made by its parent, Abney. It is believed that Abney ceased production of asbestos-containing fabrics prior to the 1978 transaction. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. Under the terms of the Assets Purchase Agreement between Brandon and Abney, Abney agreed to indemnify, defend, and hold Brandon harmless from any actions or claims on account of products manufactured by Abney and its related corporations prior to the date of the sale, whether or not the product was sold subsequent to the date of the sale. It appears that Abney has since been dissolved. Nevertheless, a



representative of Abney has been notified of the pendency of these actions and demand has been made that it assume the defense of these actions. Because Brandon did not manufacture asbestos-containing products, and because it does not believe that it was the legal successor to, or otherwise responsible for obligations of Abney with respect to products manufactured by Abney, it believes it has strong defenses to the claims that have been asserted against it. In some instances, plaintiffs have voluntarily dismissed claims against it, while in others it has entered into what it considers to be reasonable settlements. As of October 27, 2008, Brandon has resolved, by means of settlement or dismissal, 8,911 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.

As of October 27, 2008, 6,821 (or approximately 79%) of the claims pending against Brandon were pending in Mississippi. For the same reasons set forth above with respect to Albany's Mississippi and other claims, as well as the fact that no amounts have been paid to resolve any Brandon claims since 2001, the Company does not believe a meaningful estimate can be made regarding the range of possible loss with respect to these remaining claims.

### **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

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indemnification obligations, Mount Vernon has assumed the defense of these claims. On this basis, the Company has successfully moved for dismissal in a number of actions.

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While the Company does not believe, based on currently available information and for the reasons stated above, that a meaningful estimate of a range of possible loss can be made with respect to such claims, based on its understanding of the insurance policies available, how settlement amounts have been allocated to various policies, its settlement experience, the absence of any judgments against the Company or Brandon, the ratio of paper mill claims to total claims filed, and the defenses available, the Company currently does not anticipate any material liability relating to the resolution of the aforementioned pending proceedings in excess of existing insurance limits. Consequently, the

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

### 13. 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, 2007                   | \$35                       | \$3                        | \$326,608                        | \$544,228            | (\$12,180)   | (\$259,023)       | \$599,671                        |
| Net income                          |                            |                            |                                  | 5,164                |  |                   | 5,164                            |
| Shares contributed to<br>ESOP       |                            |                            | 4,594                            |                      |  |                   | 4,594                            |
| Proceeds from<br>options exercised  |                            |                            | 2,813                            |                      |  |                   | 2,813                            |
| Dividends declared                  |                            |                            |                                  | (10,424)             |  |                   | (10,424)                         |
| Stock option expense                |                            |                            | 126                              |                      |  |                   | 126                              |
| Tax benefit of<br>options exercised |                            |                            | 811                              |                      |  |                   | 811                              |
| Issuance of shares                  |                            |                            | 624                              |                      |  |                   | 624                              |

under long-term  
incentive plan

|  |      |     |           |           |           |             |           |
|--|------|-----|-----------|-----------|-----------|-------------|-----------|
| Change in derivative valuation adjustment        |      |     |           |           | (1,565)   |             | (1,565)   |
| Amortization and adjustment of pension liability |      |     |           |           | 24,196    |             | 24,196    |
| Cumulative translation adjustment/other          | 82   |     |           |           | (12,824)  | 152         | (12,590)  |
| September 30, 2008                               | \$35 | \$3 | \$335,658 | \$538,968 | (\$2,373) | (\$258,871) | \$613,420 |

#### 14. Comprehensive Income

Comprehensive income consists of the following:

| (in thousands)                                    | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |         |
|---|-------------------------------------|-----------|------------------------------------|---------|
|   | 2008                                | 2007      | 2008                               | 2007    |
| Net income/(loss)                                 | \$760                               | (\$3,871) | \$5,164                            | \$9,839 |
| Other comprehensive (loss)/income,<br>before tax: |                                     |           |                                    |         |
| Foreign currency translation adjustments          | (53,512)                            | 27,425    | (12,824)                           | 45,292  |
| Amortization of pension liability adjustment      | 371                                 | (497)     | 1,113                              | (1,491) |
| Pension and postretirement liability adjustments  | 44,726                              | -         | 38,599                             | -       |
| Derivative valuation adjustment                   | 6,913                               | -         | (2,566)                            | -       |

|   |            |          |          |          |
|---|------------|----------|----------|----------|
| Income tax (benefit)/expense related to items of other comprehensive (loss)/income: |            |          |          |          |
| Amortization of pension liability adjustment  | (145)      | -        | (435)    | -        |
| Pension and postretirement liability adjustments                                    | (17,443)   | -        | (15,081) | -        |
| Derivative valuation adjustment   | (2,245)    | -        | 1,001    | -        |
| Other comprehensive (loss)/income, net of tax                                       | (21,335)   | 26,928   | 9,807    | 43,801   |
| Comprehensive (loss)/income   | (\$20,575) | \$23,057 | \$14,971 | \$53,640 |

## 15. Recent Accounting Pronouncements

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements (FAS No. 157). FAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The Company's adoption of this Standard on January 1, 2008 did not have a material effect on its financial statements. Additional disclosure has been made in this document in Footnote 11. Financial Instruments. Relative to FAS 157, the FASB issued FASB Staff Positions (FSP) FAS 157-1, FAS 157-2, and FAS 157-3. FSP FAS 157-1 amends SFAS 157 to exclude SFAS No. 13, Accounting for Leases (SFAS 13), and its related interpretive accounting pronouncements that address leasing transactions, while FSP FAS 157-2 delays the effective date of the application of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. FSP FAS 157-3 clarifies the application of FAS 157 as it relates to the valuation of financial assets in a market that is not active for those financial assets. This FSP is effective immediately and includes those periods for which financial statements have not been issued. We currently do not have any financial assets that are valued using inactive markets, and as such are not impacted by the issuance of this FSP.

In February 2007, the FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (FAS No. 159). FAS No. 159 provides companies with a choice to measure certain financial assets and liabilities at fair value that are not currently required to be

measured at fair value (the Fair Value Option). Election of the Fair Value Option is made on an instrument-by-instrument basis and is irrevocable. The Company's adoption of this Standard on January 1, 2008 did not have a material effect on its financial statements.

In December 2007, the FASB issued FAS No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51. FAS No. 160 establishes accounting and reporting standards that require the ownership interest in subsidiaries held by parties other than the parent be clearly identified and presented in the consolidated balance sheets within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of earnings; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. This statement is effective for fiscal years beginning on or after December 15, 2008. The Company does not expect the adoption of FAS No. 160 to have a material effect on its financial statements.

In December 2007, the FASB issued FAS No. 141 (revised 2007), Business Combinations FAS No. 141(R)" which replaces FAS No. 141, Business Combinations. FAS No. 141 (R) retains the underlying concepts of FAS No. 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but FAS No. 141 (R) changed the method of applying the acquisition method in a number of significant aspects. FAS No. 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. FAS No. 141(R) amends FAS 109 such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of FAS No. 141(R) would also apply the provisions of FAS No. 141(R). Early adoption is not allowed. We are currently evaluating the effects, if any, that FAS No. 141(R) may have on our financial statements, but the Company does not expect the adoption of FAS No. 141(R) to have a material effect on its financial statements.

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In December 2007, the EITF issued Issue No. 07-1, Accounting for Collaborative Arrangements. This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. This Issue requires that transactions with third parties (i.e., revenue generated and costs incurred by the partners) should be reported in the appropriate line item in each company's financial statement pursuant to the guidance in EITF Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. This Issue also includes enhanced disclosure requirements regarding the nature and purpose of the arrangement, rights and obligations under the arrangement, accounting policy, amount and income statement classification of collaboration transactions between the parties. We are currently evaluating the effects this may have on our financial statements, but the Company does not expect the adoption to have a material effect on its financial statements.

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. The Standard requires enhanced disclosures about derivative instruments and is effective for fiscal periods beginning

after November 15, 2008. The Company does not expect adoption of this Standard to have a material effect on its financial statements.

In May 2008, the FASB issued FAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (FAS No. 162). FAS No. 162 identifies the sources of accounting principles and the framework for selecting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The FASB does not expect that FAS No. 162 will result in a change in current practice. However, transition provisions have been provided in the unusual circumstance that the application of the provisions of FAS No. 162 results in a change in practice. FAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411,

The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not expect the adoption of this pronouncement to have a material effect on its financial statements.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, "Determination of the Useful Life of Intangible Assets" (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets" and requires enhanced disclosures relating to: (a) the entity's accounting policy on the treatment of costs incurred to renew or extend the term of a recognized intangible asset; (b) in the period of acquisition or renewal, the weighted-average period prior to the next renewal or extension (both explicit and implicit), by major intangible asset class and (c) for an entity that capitalizes renewal or extension costs, the total amount of costs incurred in the period to renew or extend the term of a recognized intangible asset for each period for which a statement of financial position is presented, by major intangible asset class. FSP 142-3 must be applied prospectively to all intangible assets acquired as of and subsequent to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company is currently evaluating the impact that FSP142-3 will have on its financial statements.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP14-1). This staff position applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities. FSP 14-1 requires the issuer to separately account for the liability and equity components of convertible debt instruments in a manner that reflects the issuer's nonconvertible debt borrowing rate on the instrument's issuance date when interest cost is recognized. This staff position is

effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not allowed. The Company expects that adoption of FSP 14-1 will result in additional non-cash charges to interest expense beginning January 1, 2009. The Company estimates the additional interest expense will be approximately \$4,800,000 in 2009, and the amount of interest will increase by approximately \$300,000 per year while the bonds remain outstanding.

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

**For the three and nine month periods ended September 30, 2008**

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

### Overview

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

The Paper Machine Clothing segment includes fabrics and belts used in the manufacture of paper and paperboard (PMC or paper machine clothing). The Company designs, manufactures, and markets paper machine clothing for each section of the paper machine. It manufactures and sells more paper machine clothing worldwide than any other company. PMC consists of large permeable and non-permeable continuous belts of custom-designed and custom-manufactured engineered fabrics that are installed on paper machines and carry the paper stock through each stage of the paper production process. PMC products are consumable products of technologically sophisticated design that utilize polymeric materials in a complex structure. The design and material composition of PMC can have a considerable effect on the quality of paper products produced and the efficiency of the paper machines on which it is used. Principal products in the PMC segment include forming, pressing and dryer fabrics, and process belts. A forming fabric assists in sheet formation and conveys the very dilute sheet through the section. Press fabrics are designed to carry the sheet through the presses, where water pressed from the sheet is carried through the press nip in the fabric. In the dryer section, dryer fabrics manage air movement and hold the sheet against heated cylinders to enhance drying. Process belts are used in the press section to increase dryness and enhance sheet properties, as well as in other sections of the machine to improve runnability and enhance sheet qualities. The Company's customers in the PMC segment are paper industry companies, some of which operate in multiple regions of the world. The Company's manufacturing processes and distribution channels for PMC are substantially the same in each region of the world in which it operates.

Albany Door Systems (ADS) designs, manufactures, sells, and services high-speed, high-performance industrial doors worldwide, for a wide range of interior, exterior, and machine protection industrial applications. Already a high performance door leader, ADS further expanded its market position in North America with the second-quarter 2007 acquisition of the assets and business of R-Bac Industries, the fastest-growing high-performance door company in North America, whose product lines were complementary to Albany's. The business segment also derives revenue from aftermarket sales and service.

The Company's other reportable segments are emerging businesses that apply the Company's core competencies in advanced textiles and materials to other industries, including specialty materials and composite structures for aircraft and other applications (Albany Engineered Composites); a variety of products similar to PMC for application in the corrugators, pulp, nonwovens, building products, tannery and textile industries (Albany Engineered Fabrics); and insulation for outdoor clothing, gloves, footwear, sleeping bags and home furnishings (PrimaLoft® Products). No class of similar products or services within these segments accounted for 10% or more of the Company's consolidated net sales in any of the past three years.

## Trends

The Company's primary segment, Paper Machine Clothing, accounted for approximately 70% of consolidated revenues during 2007. Paper machine clothing is purchased primarily by manufacturers of paper and paperboard.

According to data published by RISI, Inc., world paper and paperboard production volumes have grown at an annual rate of approximately 2.6% over the last ten years. Based on data from RISI, demand for paper is expected to grow approximately 2.9% over the next five years. The paper and paperboard industry has been characterized by an evolving but essentially stable manufacturing technology based on the wet-forming papermaking process. This process, of which paper machine clothing is an integral element, requires a very large capital investment.

Consequently, management does not believe that a commercially feasible substitute technology to paper machine clothing is likely to be developed and incorporated into the paper production process by paper manufacturers in the foreseeable future. For this reason, management expects that demand for paper machine clothing will continue into the foreseeable future.

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

The world paper and paperboard industry has experienced a significant period of consolidation and rationalization since 2000. During this period, a number of older, less efficient machines in areas where significant established



capacity existed were closed or were the subject of planned closure announcements, while at the same time a number of newer, faster and more efficient machines began production or plans for the installation of such newer machines were announced in areas of growing demand for paper and paperboard (such as Asia and South America).

Management anticipates that this trend is likely to continue in the near term.

At the same time, technological advances in paper machine clothing, while contributing to the papermaking efficiency of customers, have lengthened the useful life of many of the Company's products and reduced the number of pieces required to produce the same volume of paper. As the Company introduces new value creating products and services, it is often able to charge higher prices or increase market share in certain areas as a result of these improvements. However, increased prices and share have not always been sufficient to offset completely a decrease in the number of fabrics sold.

The factors described above result in a steady decline in the number of pieces of paper machine clothing, while the average fabric size is increasing. The net effect of these trends is that the specific volume of paper machine clothing consumption (measured in kilograms or square meters) has been increasing at a rate of approximately 1% per year over the past several years. Management believes that the short term effects of a global recession could temporarily accelerate the trends described above.

During 2006, the Company reported that price competition in Western Europe had an adverse impact on the Company's operating results in this segment. In the third and fourth quarters of 2006, and in the first two quarters of 2007, sales of paper machine clothing to customers in Western Europe were significantly lower than the same quarter of the previous year. This also contributed to reduced operating income within this segment, as well as overall operating income, during those quarters.

The Company's response to that pricing disruption has been to initiate a deliberate, intensive three-year process of restructuring and performance improvement initiatives. In PMC, the Company's strategy for the past

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two years has been to offset the impacts of the maturation of the North American and Western European markets by (a) growing volume in these mature markets, (b) growing with the emerging markets in Asia and South America, and (c) reducing costs significantly through a company-wide, three-year restructuring and process-improvement program.

During this process of adjusting its manufacturing footprint to align with these regional markets, the Company has incurred restructuring charges. Specific charges reported have been incurred in connection with the reduction of PMC manufacturing capacity in the United States, Canada, Finland and Australia, and Doors segment manufacturing in Sweden. The Company has also incurred costs for idle capacity and equipment relocation that are related to the shutdown of these plants, and start-up costs related to the new PMC plant that is under construction in China. Expenses related to these items are included in Cost of Goods Sold. In addition, the Company also incurred restructuring charges related to the centralization of PMC administrative functions in Europe, and reorganization of

the Company's research and development function that has improved the Company's ability to bring value-added products to market faster.

In addition to these restructuring and restructuring-related activities, management has launched significant cost reduction and performance improvement initiatives. In 2006, the Company announced a plan to migrate its global enterprise resource planning system to SAP, and began a strategic procurement initiative designed to establish a world-class supply chain organization and processes that would lead to significant cost savings. Expenses incurred in connection with these actions are included in STG&R expenses. These expenses are not allocated to the reportable segments because they are Corporate-wide initiatives.

The Albany Door Systems segment derives most of its revenue from the sale of high-performance doors, particularly to customers in Europe. The purchase of these doors is normally a capital expenditure item for customers and, as such, market opportunities tend to fluctuate with industrial capital spending. If economic conditions weaken, customers may reduce levels of capital expenditures, which could have a negative effect on sales and earnings in the Albany Door Systems segment. The Company's response to this trend includes expansion of its aftermarket business which tends to be less sensitive to economic changes than sales of new doors. The large amount of revenue derived from sales and manufacturing outside the United States could cause the reported financial results for the Albany Door Systems segment to be more sensitive than the other segments of the Company to changes in currency rates.

The Engineered Fabrics segment derives its revenue from various industries that use fabrics and belts for industrial applications other than the manufacture of paper and paperboard. Approximately 40% of revenue in this segment is derived from sales to the nonwovens industry, which includes the manufacture of diapers, personal care and household wipes, and fiberglass-reinforced roofing shingles. Approximately 30% of segment revenue is derived from sales to markets that are adjacent to the paper industry, and 20% of revenue is derived from the building products market. Segment sales in the European and Pacific regions combined are almost at the same level as sales within the Americas.

The Engineered Composites segment (AEC) serves primarily the aerospace industry, with custom-designed composite and advanced composite parts for static and dynamic applications. Management believes AEC has the potential to grow at least 35% per annum from the base year of 2007 for the next five years and has the potential to become a second core business of the Company. AEC has experienced significant growth in net sales during the last few years, due both to the introduction of new products as well as growth in demand and application for previously existing products. The principal challenges and opportunities in this segment involve managing this growth opportunity.

The PrimaLoft® Products segment includes sales of insulation for outdoor clothing, gloves, footwear, sleeping bags, and home furnishings. The segment has manufacturing and sales operations in the United States, Europe, and Asia.

## Foreign Currency

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

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

## Review of Operations

*Total Company three months ended September 30, 2008*

In July 2008, the Company closed on the sale of its Filtration Technologies business, resulting in a pre-tax gain of \$6.1 million (\$0.21 per share) and the receipt of approximately \$45 million in cash. The activities of this business are reported as a discontinued operation in the third-quarter financial statements and, accordingly, are excluded from Tables 1 through 4 below.

Net sales from continuing operations increased \$2.0 million, or 0.7 percent compared to the same period last year. Excluding the effect of changes in currency translation rates, net sales decreased 2.6 percent as shown in Table 1, below:

Table 1

| Net Sales          | Impact of<br>Changes<br>in Currency | Percent Change |
|--------------------|-------------------------------------|----------------|
| Three Months ended |                                     |                |

| (in thousands)         | September 30, |           | Percent<br>Change | Translation<br>Rates | excluding Currency<br>Rate Effect |
|------------------------|---------------|-----------|-------------------|----------------------|-----------------------------------|
|                        | 2008          | 2007      |                   |                      |                                   |
| Paper Machine Clothing | \$179,449     | \$189,077 | -5.1%             | \$4,624              | -7.5%                             |
| Albany Door Systems    | 46,268        | 37,363    | 23.8%             | 2,911                | 16.0%                             |
| Engineered Fabrics     | 24,117        | 25,219    | -4.4%             | 1,149                | -8.9%                             |
| Engineered Composites  | 12,000        | 9,341     | 28.5%             | -                    | 28.5%                             |
| PrimaLoft® Products    | 5,088         | 3,960     | 28.5%             | 67                   | 26.8%                             |
| Total                  | \$266,922     | \$264,960 | 0.7%              | \$8,751              | -2.6%                             |

Gross profit was 33.4 percent of net sales in the third quarter of 2008, compared to 34.5 percent in the same period of 2007. The difference was principally due to higher costs associated with performance-improvement initiatives, and a decrease in gross profit in the Engineered Composites business. As presented in Tables 3

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and 4, costs associated with idle-capacity and performance-improvement initiatives were \$6.0 million in Q3 2008 and \$3.9 million in Q3 2007.

Selling, technical, general, and research (STG&R) expenses were 29.3 percent of net sales in the third quarter of 2008, compared to 29.0 percent in the third quarter of 2007. STG&R expenses were \$78.3 million in the third quarter of 2008, in comparison to \$76.8 million in the third quarter of 2007. The Company began amortizing capitalized costs associated with the SAP implementation in Q3 2008, resulting in additional expense of \$0.9 million. In addition, compared to Q3 2007, Q3 2008 STG&R expenses included a \$2.6 million increase in expenses related to the effect of changes in currency translation rates, and a \$0.3 million decrease in expenses related to performance-improvement initiatives.

Operating income was \$4.1 million in the third quarter of 2008, compared to \$1.0 million for the same period of 2007. The following table presents segment operating income for the three and nine month periods ending September 30, 2008 and 2007:

Table 2

| (in thousands) | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|----------------|-------------------------------------|------|------------------------------------|------|
|                | 2008                                | 2007 | 2008                               | 2007 |

#### Operating Income

|                        |          |          |          |          |
|------------------------|----------|----------|----------|----------|
| Paper Machine Clothing | \$19,246 | \$15,886 | \$65,221 | \$66,020 |
| Albany Door Systems    | 3,231    | (99)     | 10,389   | (556)    |
| Engineered Fabrics     | 4,060    | 4,429    | 13,206   | 13,282   |
| Engineered Composites  | (3,342)  | (1,309)  | (5,393)  | (3,621)  |
| PrimaLoft® Products    | 646      | 304      | 3,409    | 2,391    |
| Research expense       | (6,004)  | (5,892)  | (20,163) | (16,609) |
| Unallocated expenses   | (13,715) | (12,277) | (40,841) | (38,437) |
| Operating income       | 4,122    | 1,042    | 25,828   | 22,470   |

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The Company has incurred restructuring and other performance improvement costs in connection with significant restructuring of manufacturing facilities and administrative processes. The tables below present the amount of cost incurred by reportable segment:

Table 3

(in thousands)

|                              |
|------------------------------|
| Paper Machine Clothing       |
| Albany Door Systems          |
| Albany Engineered Composites |
| Research expenses            |
| Unallocated                  |
| Consolidated total           |

Costs related to idle capacity and performance improvement initiatives were reported in the statement of income as follows:

Cost of goods sold  
 Selling, technical, general and research  
 Total

Table 4

(in thousands)

Paper Machine Clothing  
 Albany Door Systems  
 Albany Engineered Fabrics  
 Research  
 Unallocated  
 Consolidated total

Costs related to idle capacity and performance improvement initiatives were reported in the statement of income as follows:

Cost of goods sold  
 Selling, technical, general and research  
 Total

Q3 2008 net restructuring costs totaled \$6.7 million and were related principally to the restructuring of the Company's Gosford, Australia, operation.

Q3 2008 idle capacity and performance-improvement costs totaled \$10.7 million, of which \$6.0 million was reported in cost of goods sold, and \$4.7 million was reported in STG&R expenses. Items reported in costs of goods sold include \$1.0 million related to previously announced closures of paper machine clothing (PMC) plants in the U.S., \$3.3 million for equipment relocation and \$1.5 million related to the new plant start-up in Hangzhou, China. The Hangzhou plant produced its first saleable products in October and will gradually increase to full production over the

next several quarters. Due to underutilization of the Hangzhou facility and high depreciation costs relative to production rates during the ramp-up period, the Company continues to expect the plant to show losses through the middle of 2009. Performance-improvement costs reported as STG&R expenses were primarily related to the implementation of SAP.

Q3 2007 costs for restructuring and performance-improvement initiatives amounted to \$22.4 million, of which \$13.5 million was reported as restructuring, \$5.0 million was included in STG&R expenses, and \$3.9 million was included in cost of goods sold.

Research expenses increased \$0.1 million, despite a reduction of \$0.5 million for restructuring and performance improvement costs. Increased research activity for PMC accounted for most of the increase. Unallocated expenses increased \$1.4 million, which is equal to the amount of increased expenses for performance improvement initiatives.

Interest expense increased to \$4.5 million for the third quarter of 2008, compared to \$3.8 million for 2007. The increase in 2008 reflects higher average levels of debt outstanding in 2008, which resulted from the Company's significant capital expenditures.

Third-quarter 2008 income tax expense includes the effect of discrete tax adjustments that decreased net income by \$4.3 million (\$0.14 per share). In addition, third-quarter 2008 income tax expense includes expense of \$1.7 million (\$0.06 per share) due to an out-of-period adjustment to correct an equivalent favorable discrete tax adjustment recorded in Q2 2007. The corrected item has no impact on EBITDA or cash flows in any period. The Company does not believe that the corrected item is or was material to any previously issued annual or quarterly financial statements; as a result, the Company has not restated its previously issued annual or quarterly financial statements. In the third quarter of 2007, the Company recorded discrete tax adjustments that reduced net income by \$1.1 million (\$0.04 per share). Please refer to Notes to Consolidated Financial Statements for additional information about the tax adjustments.

Q3 2008 income/loss from discontinued operations includes a pre-tax gain of \$6.1 million related to the sale of the business, and a loss of \$0.4 million from operating activities of that business up to the July 25, 2008 closing date. The geographical distribution of income and loss resulted in a tax benefit of \$0.4 million in Q3 2008. Operating activities of the discontinued operation generated operating income of \$0.7 million in the third quarter of 2007.

Net income per share was \$0.03, after reductions of \$0.48 from net restructuring charges, related idle-capacity costs, and costs related to continuing performance-improvement initiatives. Income tax adjustments reduced net income by \$0.20 per share, while a gain on the sale of the Company's Filtration Technologies business increased net income by \$0.21 per share. Net income/loss for Q3 2007 was a loss of \$0.13 per share, after reductions of \$0.57 from net restructuring charges, related idle-capacity costs, and costs related to performance-improvement initiatives. Income tax adjustments reduced Q3 2007 net income by \$0.04 per share.

*Total Company nine months ended September 30, 2008*

Net sales from continuing operations increased \$65.1 million, or 8.4 percent compared to the same period last year. Excluding the effect of changes in currency translation rates, net sales increased 2.2 percent as shown in Table 4 below:

Table 5

| (in thousands)         | Net Sales         |           |                   | Impact of<br>Changes<br>in Currency<br>Translation<br>Rates | Percent<br>Change<br>excluding<br>Currency<br>Rate Effect |
|------------------------|-------------------|-----------|-------------------|---|---|
|                        | Nine Months ended |           | Percent<br>Change |   |   |
|                        | 2008              | 2007      |                   |   |   |
| Paper Machine Clothing | \$561,941         | \$552,107 | 1.8%              | \$28,859  | -3.4%   |
| Albany Door Systems    | 140,245           | 105,181   | 33.3%             | 13,493  | 20.5%   |
| Engineered Fabrics     | 79,482            | 76,592    | 3.8%              | 5,658   | -3.6%   |
| Engineered Composites  | 37,065            | 24,259    | 52.8%             | -   | 52.8%   |
| PrimaLoft® Products    | 18,598            | 14,114    | 31.8%             | 460   | 28.5%   |
| Total                  | \$837,331         | \$772,253 | 8.4%              | \$48,470  | 2.2%  |

Gross profit was 34.3 percent of net sales for the first nine months of 2008, compared to 36.6 percent in the same period of 2007. The difference was principally due to costs associated with performance-improvement initiatives. As presented in Tables 3 and 4, cost of goods sold includes expenses associated with idle-capacity and performance-improvement initiatives were \$16.9 million for the first nine months of 2008, and \$4.9 million for the same period of 2007.

Selling, technical, general, and research (STG&R) expenses were 29.6 percent of net sales for the first nine months of 2008, compared to 30.0 percent for the same period of 2007. STG&R expenses were \$247.6 million for the first nine months of 2008, in comparison to \$231.9 million for the same period of 2007. Compared to 2007, 2008 STG&R expenses included a \$14.1 million increase in expenses related to the effect of changes in currency translation rates,



and a \$7.1 million increase in expenses related to performance-improvement initiatives.

Operating income was \$25.8 million in the first three quarters of 2008, compared to \$22.5 million for the same period of 2007. Segment operating income is presented in Table 2, above.

Research expenses increased \$3.6 million principally due to \$1.6 million for restructuring, and \$1.0 million for the Engineered Composites business, and \$0.8 million due to the effect of changes in currency translation rates.

Unallocated expenses increased \$2.4 million which included an increase of \$2.8 million for higher restructuring and performance improvement costs.

Interest expense increased to \$13.6 million for the first nine months of 2008, compared to \$10.7 million for the same period of 2007. The increase in 2008 reflects higher average levels of debt outstanding in 2008 which resulted from the Company's significant capital expenditures.

Included in income tax expense for the first nine months of 2008 are discrete tax adjustments that decreased net income by \$0.28 per share, and an unfavorable out-of-period adjustment that reduced net income by \$0.06 per share. Discrete tax adjustments had the effect of reducing net income for the first nine months of 2007 by \$0.06 per share. Please refer to Notes to Consolidated Financial Statements for additional information about the tax adjustments.

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Net income per share for the first nine months of 2008 was \$0.17, after reductions of \$1.33 from net restructuring charges, related idle-capacity costs, and costs related to continuing performance-improvement initiatives. Income tax adjustments reduced net income by \$0.34 per share. Net income per share for the first nine months of 2007 was \$0.33, after expenses related to restructuring and performance-improvement initiatives reduced net income per share by \$1.12 and discrete tax adjustments increased net income per share by \$0.06.

**Paper Machine Clothing Segment** - *three months ended September 30, 2008*

Q3 2008 net sales decreased 5.1 percent compared to the third quarter of 2007. Excluding the effect of currency translation rates, net sales decreased 7.5 percent. The decrease in sales was primarily due to lower sales volume. PMC gross profit as a percentage of net sales decreased from 37.7 percent in Q3 2007 to 36.6 percent in Q3 2008.

Compared to the third quarter of 2007, trade sales in the Americas declined 7.4 percent. Trade sales in South America decreased 3.1 percent, while sales in North America declined 8.2 percent. The decline in sales was due to both lower sales volume and lower average prices. Lower operating costs from plant closings and performance-improvement initiatives in North America helped to offset top-line pressures.

In Europe, compared to the third quarter of 2007, trade sales in euros decreased 5.7 percent due entirely to lower sales. As in the Americas, lower operating costs helped to offset the decline in sales volume.

Trade sales in Asia were 7.6 percent lower than the third quarter of 2007. Sales in China, compared to the same period, were flat. The new capacity in Asia continues to come on stream as planned.

Segment operating income increased \$3.4 million, principally due to a decrease of \$4.9 million in costs associated with restructuring and performance improvement initiatives.

#### **Paper Machine Clothing Segment** - *nine months ended September 30, 2008*

Year to date net sales increased 1.8 percent compared to the same period of 2007. Excluding the effect of currency translation rates, net sales decreased 3.4 percent, principally due to weakness in the North American market.

Year to date gross profit as a percentage of net sales was 37.1 percent for 2008 compared to 39.6 percent for 2007. The difference was principally due to higher costs for performance improvement initiatives and lower sales in North America. Segment operating income decreased \$0.8 million, principally due to an increase of \$3.2 million in costs associated with restructuring and performance improvement initiatives.

#### **Albany Door Systems Segment** - *three months ended September 30, 2008*

Third-quarter net sales increased 23.8 percent compared to the same period of 2007. Excluding the effect of currency translation rates, net sales increased 16.0 percent. Net sales in Europe in euros were up 15.8 percent compared to the third quarter of 2007. This increase was due to the continued strength in product sales and growth in the aftermarket. Compared to last year, operating income improved due to both higher sales and the 2007 consolidation of European manufacturing operations. In North America, net sales increased 24.5 percent compared to the same period last year

due to strong product sales.

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Third-quarter gross profit as a percentage of net sales was 31.6 percent for both 2008 and 2007. Third-quarter operating income increased to \$3.2 million from a loss of \$0.1 million in 2007, principally due to higher sales and a \$0.9 million decrease in costs related to restructuring and performance improvement initiatives.

**Albany Door Systems Segment** - *nine months ended September 30, 2008*

Year to date net sales increased 33.3 percent compared to the same period of 2007. Excluding the effect of currency translation rates, net sales increased 20.5 percent

Year to date gross profit as a percentage of net sales was 32.2 percent for 2008 compared to 32.1 percent for 2007. Year to date operating income increased to \$10.4 million from a loss of \$0.6 million in 2007, principally due to higher sales and a \$2.5 million decrease in costs related to restructuring and performance improvement initiatives.

**Engineered Fabrics Segment** - *three months ended September 30, 2008*

Third quarter net sales decreased 4.4 percent compared to the same period of 2007. Excluding the effect of currency translation rates, net sales decreased 8.9 percent. Sales were flat or down in every product line.

Third-quarter gross profit as a percentage of net sales was 37.8 percent for 2008 compared to 37.1 percent for 2007. Third-quarter operating income was \$4.1 million in 2008, compared to \$4.4 million in 2007. The decrease in 2008 was principally due to lower sales volume and higher depreciation at the new plant in Kaukauna, Wisconsin.

**Engineered Fabrics Segment** - *nine months ended September 30, 2008*

Year to date net sales increased 3.8 percent compared to the same period of 2007. Excluding the effect of currency translation rates, net sales decreased 3.6 percent.

Year to date gross profit as a percentage of net sales was 37.5 percent for both 2008 and 2007. Year to date operating income was \$13.2 million in 2008, compared to \$13.3 million in 2007. The decrease was principally due to weaker sales and higher depreciation costs.

**Engineered Composites Segment** - *three months ended September 30, 2008*

Net sales increased to \$12.0 million in the third quarter of 2008, compared to \$9.3 million in the third quarter of 2007, an increase of 28.5 percent.

During the third quarter, the Company announced a suspension of production for Eclipse, one of the key customers in this segment. That event contributed to an operating loss of \$3.3 million, compared to a loss of \$1.3 million for the third quarter of 2007.

Albany Engineered Composites (AEC) has accounts receivables from Eclipse totaling \$7.4 million. AEC believes the amount to be fully collectible and, accordingly, has not recorded a reserve for amounts due from Eclipse. It is possible that future events may necessitate a full or partial write-off of that balance.

**Engineered Composites Segment** - *nine months ended September 30, 2008*

Net sales increased to \$37.1 million for the first nine months of 2008, compared to \$24.3 million for the same period of 2007, an increase of 52.8 percent.

The segment had an operating loss of \$5.4 million in the first nine months of 2008 to an operating loss of \$3.6 million in the first nine months of 2007. The decrease was principally due to third quarter results as described above.

**PrimaLoft® Products Segment** - *three months ended September 30, 2008*

Third-quarter net sales increased 28.5 percent compared to the same period of 2007. Excluding the effect of currency translation rates, net sales increased 26.8 percent. The increase reflects continued strength in outerwear sales in North America and Europe. Home furnishings sales in North America continued to be negatively affected by weakness in the retail market.

Third-quarter gross profit as a percentage of net sales was 46.1 percent for 2008 compared to 41.2 percent for 2007. Third-quarter operating income increased from \$0.3 million in 2007 to \$0.6 million in 2008. The improvement in 2008 was principally due to higher sales.

**PrimaLoft® Products Segment** - *nine months ended September 30, 2008*

Year to date net sales increased 31.8 percent compared to the same period of 2007. Excluding the effect of currency translation rates, net sales increased 28.5 percent.

Year to date gross profit as a percentage of net sales was 47.0 percent for 2008 compared to 47.3% for 2007. Year to date operating income increased from \$2.4 million in 2007 to \$3.4 million in 2008. The improvement in 2008 was principally due to higher sales.

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**Liquidity and Capital Resources**

In July 2008, the Company closed on the sale of its Filtration Technologies business, the principal operations of which are in Gosford, Australia, and Zhangjiagang, China. At closing, the Company received approximately \$45 million which resulted in a gain of approximately \$6.1 million. The Company will use the proceeds of the sale to fund planned capital expenditures outside of the U.S. and for general working capital purposes.

Net cash provided by operating activities was \$31.9 million for the first three quarters of 2008, compared to \$39.3 million for the same period of 2007. For the first nine months of 2008, capital spending was \$105.0 million, compared to \$90.7 million in 2007. The increase in 2008 principally relates to the PMC investments that are part of the Company's three-year restructuring and performance improvement plan as described in the Trends section above, and in Risk Factors. The Company expects capital spending to be approximately \$150 million in 2008, and has decreased its estimate for 2009 from \$70 million to \$60 million. Depreciation and amortization were \$13.6 million and \$2.1

million, respectively, for the third quarter of 2008. Depreciation and amortization are estimated to be \$60 million and \$7 million for 2008, and \$70 million and \$8 million for 2009.

Earnings before interest, taxes, depreciation, and amortization (EBITDA) were \$26.4 million in the third quarter of 2008, compared to \$15.7 million in the same quarter of 2007. Included in third-quarter EBITDA are expenses related to restructuring and performance-improvement initiatives totaling \$17.4 million in 2008, and \$22.4 million in 2007. Q3 2008 also includes a gain of \$6.1 million related to the sale of the Filtration business.

The company currently expects that its tax rate for the remainder of 2008 will be approximately 18 percent, before any discrete items. However, there is no assurance that this will not change in future periods.

Under Trends , management discussed certain recent trends in its paper machine clothing segment that have had a negative impact on demand for the Company's products within that segment, as well as its strategy for addressing these trends. Management also discussed pricing competition within this segment and the negative effect of such competition on segment sales and earnings. If these trends continue or intensify, and if management's strategy for addressing them should prove inadequate, the Company's operating cash flow could be adversely affected. In any event, although historical cash flows may not, for all of these reasons, necessarily be indicative of future cash flows, the Company expects to continue to be able to generate substantial cash from sales of its products and services in future periods.

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

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

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events of default comparable to those in the Company's current principal revolving credit facility. For disclosure purposes, the Company is required to measure the fair value of outstanding debt on a recurring basis. The fair value of the note agreement was approximately \$142,558,000, which was measured using active market interest rates.

In March 2006, the Company issued \$180,000,000 principal amount of 2.25% convertible notes. The notes are convertible upon the occurrence of specified events and at any time on or after February 15, 2013, into cash up to the principal amount of notes converted and shares of the Company's Class A common stock with respect to the remainder, if any, of the Company's conversion obligation at a conversion rate of 22.5351 shares per \$1,000 principal amount of notes (equivalent to a conversion price of \$44.38 per share of Class A common stock). The fair value of the convertible notes was approximately \$145,350,000, which was measured using quoted prices in active markets.

Holder may convert their notes at any time on or after February 15, 2013. Before February 15, 2013, a holder may convert notes during the five-business day period immediately after any period of five consecutive trading days in which the trading price per note for each of such five days was less than 103% of the product of the last reported sale price of the Company's Class A common stock and the conversion rate on such day. Additionally, holders may convert prior to February 15, 2013 if the Company elects to distribute to all or substantially all of its Class A shareholders (a) rights or warrants to purchase shares of Class A common stock for less than their trading value, or (b) assets, debt securities or rights to purchase securities, which distribution has a per-share value exceeding 15% of the current trading value of the Class A common stock.

Converting holders are entitled to receive, upon conversion of their notes, (1) an amount in cash equal to the lesser of the principal amount of the note and the note's conversion value, and (2) if the conversion value of the note exceeds the principal amount, shares of the Company's Class A common stock in respect of the excess conversion value. The conversion rate of the notes (subject to adjustment upon the occurrence of certain events) is 22.5351 shares per \$1,000 principal amount of notes (equivalent to a conversion price of \$44.38 per share of Class A common stock). The exact amount payable upon conversion would be determined in accordance with the terms of the indenture pursuant to which the notes were issued and will be based on a daily conversion value calculated on a proportionate basis by reference to the volume-weighted average price of the Company's Class A common stock for each day during a twenty-five day period relating to the conversion.

In connection with the sale of the notes, the Company entered into hedge and warrant transactions with respect to its Class A common stock. 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 in an amount equal to the number of shares which the Company would be required to deliver upon conversion of the notes. These transactions had the economic effect to the Company of increasing the conversion price of the Notes to \$52.25 per share.

Pursuant to the hedge transactions, if the Company delivers notice to the counterparties of any conversion of the Notes on or prior to March 15, 2013, the counterparties are in the aggregate obligated to deliver to the Company the number of shares of Class A common stock that the Company is obligated to deliver to the holders of the notes with respect to

such conversion, exclusive of any shares deliverable by the Company by reason of any additional (or make whole ) premium relating to the notes or by reason of any election by the Company to unilaterally increase the conversion rate. The note hedge and warrant transactions had a net cost of \$14,700,000.

On April 14, 2006, the Company entered into a \$460,000,000 five-year revolving credit agreement (the Credit Agreement ), under which \$196,000,000 was outstanding as of September 30, 2008. The applicable interest rate for borrowings under the agreement is LIBOR plus a spread, based on the Company's leverage ratio at the time of borrowing. The agreement includes covenants that could limit the Company's ability to purchase Common Stock, pay dividends, acquire other companies or dispose of its assets.

Reflecting, in each case, the effect of subsequent amendments to each agreement, the Company is required to maintain a leverage ratio of not greater than 3.50 to 1.00 under the Credit Agreement, and a leverage ratio of not greater than 3.00 to 1.00 (or 3.50 to 1.00 for a period of six fiscal quarters following a material acquisition, as defined) under the Prudential Agreement. The Company is also required to maintain minimum interest coverage of 3.00 to 1.00 under each agreement. As of September 30, 2008, the Company's leverage ratio under the agreement was 2.62 to 1.00 and the interest coverage ratio was 7.72 to 1.00. The Company may purchase its Common Stock or pay dividends to the extent its leverage ratio remains at or below 3.00 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. The Company's ability to borrow additional amounts under the credit agreement is conditional upon the absence of any defaults, as well as the absence of any material adverse change. Based on the maximum leverage ratio and the Company's consolidated EBITDA (as defined in the

agreement), and without modification to any other credit agreements as of September 30, 2008, the Company would have been able to borrow an additional \$58,584,000 under its loan agreements.

On December 10, 2007, the Company and Bank of America entered into a US dollar-to-euro cross-currency and interest rate swap agreement with a notional value of \$150,000,000. The Company designated the swap to be an effective hedge of its euro net asset exposure relating to European operations. Under the swap agreement, the Company notionally exchanged \$150,000,000 at a fixed interest rate of 5.34% for euro 101,951,000 at a fixed interest rate of 5.28%. The exchange was executed at an exchange rate of 1.4713 US dollars per euro. The majority of the cash flows in the swap agreement were aligned with the Company's principal and interest payment obligations on its \$150,000,000, Prudential Agreement. The final maturity of the swap matched the final maturity of the Prudential Agreement. This cross-currency and interest rate swap was terminated on September 8, 2008. In consideration of the early termination of the swap, \$8,090,000 was paid to Albany International by Bank of America. The Company's swap agreement qualified as a hedge of net investments in foreign operations under the provisions of FAS No. 133,

Accounting for Derivative Instruments and Hedging Activities . The \$8,090,000 cash settlement resulted in a \$4,783,000 increase to shareholders' equity, net of tax, in the Translation adjustments caption, and an increase of \$3,307,000 to Deferred tax liability.



Dividends have been declared each quarter since the fourth quarter of 2001, and third-quarter dividends per share were \$0.12 in 2008 and \$0.11 in 2007. Decisions with respect to whether a dividend will be paid, and the amount of the dividend, are made by the Board of Directors each quarter. To the extent the Board declares cash dividends in the future, the Company would expect to pay such dividends out of operating cash flow. Future cash dividends will be dependent on debt covenants and on the Board's assessment of the Company's ability to generate sufficient cash flows.

In August 2006, the Company announced that the Board of Directors authorized management to purchase up to 2 million additional shares of its Class A Common Stock. The Board's action authorizes management to purchase shares from time to time, in the open market or otherwise, whenever it believes such purchase to be advantageous to the Company's shareholders, and it is otherwise legally permitted to do so. As of September 30, 2008, no share purchases had been made under the 2006 authorization.

## Outlook

Despite a rapidly deteriorating general economy and paper industry, and the effects of the previously announced slowdown at Eclipse Aviation, earnings in Q3 2008 were comparable to earnings in Q3 2007, excluding the effects of restructuring, performance-improvement initiatives and income tax adjustments. The effects of weak PMC and EF sales and AEC income were largely offset by continued reductions in cost and another outstanding quarter for Albany Door Systems. More generally, the Q3 results offer a window into the performance trends that the Company anticipates for the next few quarters. The top line, particularly in PMC, is certainly being hurt by the global recession. On the other hand, even in a long and deep recession, the Company expects to continue to make good progress, just as it did in Q3, toward its twin objectives of restoring the long-term cash generating potential of PMC, and establishing a family of new businesses with the potential for significant, sustainable, and profitable growth. Management is, of course, acutely aware of the likelihood of a prolonged global recession. But fundamentally, management is confident that its cash and grow strategy is sound, and that the Company will come out of the recession in an even stronger competitive position in each of its businesses than they were in at its outset.

Turning first to PMC, Q3 sales, excluding the effects of currency translation, were 8 percent lower than in Q3 2007. This was an across-the-board effect. Sales in every region were lower than normal, primarily due to lower sales volume. Sales were especially weak in August 2008, suggesting that normal seasonal downturns are likely to be magnified during recession. Operating income in Q3, excluding costs associated with

restructuring and performance-improvement initiatives, was 5 percent lower than a year ago as continuing cost reductions partially offset the lower sales.

Management expects this global slowdown in PMC sales to continue for the length of the recession, as paper makers in every region reduce mill operating rates, slow down operating speeds, extend downtime periods, and accelerate the pace of machine shutdowns. And yet, as the paper industry weakens, the Company's competitive strength in the PMC market continues to grow, which is why even in the face of global recession, management remains confident about its overall strategy and progress. The Company gained market share year to date in the Americas, Europe, and China; maintained what is for this time of year a strong order-to-sales ratio in North America; continued to make progress with key contract negotiations in Europe; and completed promising new product trials in each of the Company's major product lines. Meanwhile, the Company's three-year, global restructuring process enters its final year on schedule. The pacing item now in this process is the ramp-up of the Company's three plants in Asia. The expansion the Company's Korean plant is largely complete, and the team there has already expanded its production rates while maintaining exceptional quality levels. And the new plant in Hangzhou, China, passed an important milestone in early October, when it successfully produced its first set of products for shipment.

Engineered Fabrics had another tough quarter in Q3. This business shares many similarities with PMC, and about 30 percent of its revenue derives from sales to markets adjacent to paper. Another 20 percent of revenue derives from products that serve the struggling building products market. If there is a silver lining here, it is that 40 percent of EF revenue derives from sales to the nonwovens industry, which is still growing even in North America and Europe. Q3 2008 orders for the nonwovens industry grew by 25 percent compared to Q3 2007, and by 15 percent compared to Q2 2008. Moreover, the Company's sales to the building products industry appear to have bottomed; orders in Q3, 2008 were comparable to Q3 2007 and considerably stronger than in Q2 2008. For this reason, even though EF sales performance in Q3 was similar to PMC's, there is reason to believe that the recession will not have as large an effect on this business as it is already having in PMC.

Turning next to Albany Doors Systems, Q3 2008 was another strong quarter. Compared to Q3 2007, and excluding currency effects, sales grew by 16 percent and operating income by 250 percent. Once again, performance was strong across the board, in all regions and in both product sales and aftermarket. Orders in Q3 2008 were 20 percent higher than Q3 2007. Nonetheless, management still expects a slowdown in this business next year. How severe the effect will be is uncertain. Product sales will likely decline, which will especially affect North America, where product sales represent 90 percent of revenue. On the other hand, in Europe, which represents 70 percent of total segment sales, the impact of recession should be lessened by the aftermarket business, which should continue to grow during recession. Europe's aftermarket business represents about 35 percent of European sales and an even larger fraction of segment operating income. And even in the product side of the business, we have been preparing for a downturn for at least a year by reducing fixed costs in manufacturing operations, and shifting the underlying operating model to one with a heavier reliance on variable costs.

Turning finally to Composites, in August the Company announced that Eclipse Aviation, AEC's largest customer, was substantially cutting back production. For AEC, this meant a complete stoppage of production of parts for Eclipse. The Company also stated in August that it expected Eclipse to ramp back up in 2009. Indications from Eclipse are that they are on track for a 2009 recovery, which would mean that AEC production of Eclipse components would return to at least Q2 2008 rates by Q3 of 2009.

In the short term, the slowdown has clearly affected our results. We had been expecting AEC to at least break even in Q3. Instead, it lost \$3.3 million (\$0.09 per share). Even without Eclipse, AEC did grow by 29 percent compared to Q3 2007, but since Eclipse represented by far the Company's highest volume and therefore most efficient production line, losing those sales had a disproportionate effect on income.

The Company will update its five-year projections for AEC in our Q1 2009 release. For now, in the short term, we still believe AEC has the potential to continue to grow along the five-year, 35 percent compound annual growth rate that management projected at the end of 2007. The Company's experience in Q3 suggests that short-term setbacks to the realization of this potential will likely be of the sort that was experienced with Eclipse in Q3, rather than more general recessionary pressures.

Beyond the five-year horizon, the Eclipse slowdown in no way alters management's view of the long-term potential of this business. Management has spoken in earlier announcements of AEC's potential to become significantly larger than the \$150 million enterprise that had earlier envisioned, and to become a second core business of the Company. During Q3, management conducted a comprehensive analysis of the size and nature of the AEC market opportunity. Management now sees a business with the potential to grow organically to \$400 million in sales, with operating income margins at least comparable to PMC, by the time the next-generation single-aisle aircraft goes into service late next decade.

In sum, across all of the Company's businesses, Q3 suggests that the Company is continuing to make progress with its cash flow and grow strategy, and that the long term vision of a mutually reinforcing portfolio of advanced textiles businesses continues to unfold in the manner management has been anticipating. That said, management is under no illusions about the economic environment that the Company is facing. While the Company hopes it is wrong about this, it is preparing for a long and deep global recession. And so, company-wide, management is approaching 2009 with two overarching principles.

On the one hand, the Company's goal for each of its businesses is to come out of this recession in a stronger competitive position than it was in when we entered. This means the Company will continue to push ahead with its various strategic initiatives, whether they be new business development in AEC, growth of the aftermarket in Doors, introduction of new product lines in EF, or completion of the three-year restructuring plan and introduction of new products in PMC.

On the other hand, the Company must do and is doing everything possible to maximize cash flow. Management has frozen travel, except when it entails working with customers; frozen hiring, except when it entails bringing on board exceptional talent; is delaying capital expenditures, except when they directly promote advancement of strategic initiatives; have slowed down the global rollout of SAP, which, compared to this year, will reduce cash outlays for consulting by as much as \$10 million in 2009; is accelerating efforts to reduce working capital; and in general, has

instilled a sense of awareness throughout the Company that in a recession as long and deep as this one is likely to be, cash is unquestionably king. Management has told investors for the past two years that its objective for 2009 was to generate significant cash flow. While the recession means that the Company will not generate as much cash as it had been anticipating, management does still expect 2009 EBITDA to significantly exceed capital expenditures and to therefore enable the Company to significantly reduce debt.

Like everyone in this economy, the Company is sobered by the prospect of global recession. And there is no doubt that revenue and income are being affected by it. Q3 results, especially in PMC, give us an indication of the magnitude of that effect. But management is also confident that the strategic pathway it set out on two years ago is still the right course for Albany International and its investors. The Company is making good progress toward the development of its cash and grow portfolio of businesses, and despite the recession, the timeline for the development of that portfolio remains unchanged. Management continues to expect that, by this time in 2010, the cash and grow portfolio will have been fully implemented.

### **Non-GAAP Measures**

This Form 10-Q contains certain items, such as sales excluding currency effects, earnings before interest, taxes, depreciation, and amortization (EBITDA), and costs associated with restructuring and performance-improvement initiatives that could be considered non-GAAP financial measures. Such items are provided because management believes that, when presented together with the GAAP items to which they relate, they provide additional useful information to investors regarding the registrant's financial condition, results of operations, and cash flows. Presenting increases or decreases in sales, after currency effects are excluded, can give management and investors insight into underlying sales trends. An understanding of the impact in a particular quarter of specific restructuring and performance-improvement measures, and in particular of the costs associated with the implementation of such measures, on the Company's net income, operating income and EBITDA, or on the operating income of a business segment, can give management and investors additional insight into quarterly performance, especially when compared to quarters in which such measures had a greater or lesser effect, or no effect.

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

The Company calculates EBITDA by adding Interest expense, net, Income taxes, Depreciation and Amortization to Net income. We believe that EBITDA provides useful information to investors because it provides one indication of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures and strategic investments, as well as our ability to incur and service debt. While depreciation and amortization are operating costs under GAAP, they are non-cash expenses equal to current period

allocation of costs associated with capital and other long-lived investments made in prior periods. While the Company will continue to make capital and other investments in the future, it is currently in the process of concluding a period of significant investment in plant, equipment and software. Depreciation and amortization associated with these investments will begin to have a significant impact on the Company's net income in future quarters. EBITDA is also a calculation commonly used by investors and analysts to evaluate and compare the periodic and future operating performance and value of companies. EBITDA, as defined by the Company, may not be similar to EBITDA measures of other companies, is not a measurement under GAAP and should be considered in addition to, but not as a substitute for, the information contained in our statements of operations.

*The following table contains the calculation of third-quarter EBITDA:*

|                       | EBITDA             |           |
|-----------------------|--------------------|-----------|
|                       | Three Months ended |           |
|                       | September 30,      |           |
| (in thousands)        | 2008               | 2007      |
| Net income/(loss)     | \$760              | (\$3,871) |
| Interest expense, net | 4,520              | 3,795     |
| Income tax expense    | 5,437              | 185       |
| Depreciation          | 13,613             | 14,320    |
| Amortization          | 2,107              | 1,263     |
| Total                 | \$26,437           | \$15,692  |

The Company discloses certain income and expense items on a per share basis. The Company believes that such disclosures provide important insight into underlying earnings. The Company calculates the per share amount for items included in continuing operations by using the tax rate at the end of the applicable reporting period (before the effect of any discrete items) and the weighted average number of shares outstanding for the period. For the gain on sale of the discontinued operation, the Company used the tax rate applicable to that transaction.

**Quarter ended September 30, 2008**

|   | Pretax<br>amounts | Tax Effect | After-tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|---|-------------------|------------|---------------------|-----------------------|---------------------|
| (in thousands, except per share data)                 |                   |            |                     |                       |                     |
| Engineered Composites operating loss                  | \$ 3,342          | \$ 602     | \$ 2,740            | 29,857                | \$0.09              |
| Restructuring and other performance-improvement costs | 17,433            | 3,138      | 14,296              | 29,857                | 0.48                |
| Gain on sale of discontinued operation                | 6,134             | (259)      | 6,393               | 29,857                | 0.21                |
| Discrete tax adjustments                              | 4,259             | ---        | 4,259               | 29,857                | 0.14                |
| Out of period tax adjustment                          | 1,706             | ---        | 1,706               | 29,857                | 0.06                |

**Quarter ended September 30, 2007**

|   | Pretax<br>amounts | Tax Effect | After-tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|---|-------------------|------------|---------------------|-----------------------|---------------------|
| (in thousands, except per share data)                 |                   |            |                     |                       |                     |
| Restructuring and other performance-improvement costs | \$22,368          | \$5,592    | \$16,776            | 29,492                | \$0.57              |
| Discrete tax adjustments                              | 1,160             | ----       | 1,160               | 29,492                | 0.04                |

**Nine months ended September 30, 2008**

|   | Pretax<br>amounts | Tax Effect | After-tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|---|-------------------|------------|---------------------|-----------------------|---------------------|
| (in thousands, except per share data)                 |                   |            |                     |                       |                     |
| Restructuring and other performance-improvement costs | 48,414            | 8,715      | 39,699              | 29,743                | 1.33                |
| Gain on sale of discontinued operation                | 6,134             | (259)      | 6,393               | 29,743                | 0.21                |
| Discrete tax adjustments                              | 8,387             | ---        | 8,387               | 29,743                | 0.28                |
| Out of period tax adjustment                          | 1,706             | ---        | 1,706               | 29,743                | 0.06                |

**Nine months ended September 30, 2007**

| (in thousands, except per share data)                     | Pretax<br>amounts | Tax Effect | After-tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|---|-------------------|------------|---------------------|-----------------------|---------------------|
| Restructuring and other performance-<br>improvement costs | \$43,763          | \$10,941   | \$32,822            | 29,380                | \$1.12              |
| Discrete tax adjustments                                  | 1,676             | ----       | 1,676               | 29,380                | 0.06                |

**Tax rate disclosures:**

The Company discloses its tax rate before the effect of any discrete items as a forward looking estimate of the income tax rate that would be incurred in future quarters. Management believes that this information can provide valuable insight about possible future operating results or cash flows. The estimated tax rate is subject to many variables, including geographical distribution of income or loss, and the total amount of income or loss. The estimated tax rate does not take into account any discrete tax items that could arise in future quarters.

**Recent Accounting Pronouncements**

In September 2006, the FASB issued FAS No.157, Fair Value Measurements (FAS No. 157). FAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The Company's adoption of this Standard on January 1, 2008 did not have a material effect on its financial statements. Additional disclosure has been made in this document in Footnote 11. Financial Instruments. Relative to FAS 157, the FASB issued FASB Staff Positions (FSP) FAS 157-1, FAS 157-2, and FAS 157-3. FSP FAS 157-1 amends SFAS 157 to exclude SFAS No. 13, Accounting for Leases (SFAS 13), and its related interpretive accounting pronouncements that address leasing transactions, while FSP FAS 157-2 delays the effective date of the application of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities

that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. FSP FAS 157-3 clarifies the application of FAS 157 as it relates to the valuation of financial assets in a market that is not active for those financial assets. This FSP is effective immediately and includes those periods for which financial statements have not been issued. We currently do not have any financial assets that are valued using inactive markets, and as such are not impacted by the issuance of this FSP.

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (FAS No. 159)*. FAS No. 159 provides companies with a choice to measure certain financial assets and liabilities at fair value that are not currently required to be measured at fair value (the *Fair Value Option*). Election of the Fair Value Option is made on an instrument-by-instrument basis and is irrevocable. The Company's adoption of this Standard on January 1, 2008 did not have a material effect on its financial statements.

In December 2007, the FASB issued FAS No. 160 *Noncontrolling Interests in Consolidated Financial Statements* an amendment to ARB No. 51. FAS No. 160 establishes accounting and reporting standards that require the ownership interest in subsidiaries held by parties other than the parent be clearly identified and presented in the consolidated balance sheets within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of earnings; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. This

statement is effective for fiscal years beginning on or after December 15, 2008. The Company does not expect the adoption of FAS No. 160 to have a material effect on its financial statements.

In December 2007, the FASB issued FAS No. 141 (revised 2007), *Business Combinations* (FAS No. 141(R)) which replaces FAS No. 141, *Business Combinations*. FAS No. 141 (R) retains the underlying concepts of FAS No. 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but FAS No. 141(R) changed the method of applying the acquisition method in a number of significant aspects. FAS No. 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. FAS No. 141(R) amends FAS 109 such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of FAS No. 141(R) would also apply the provisions of FAS



No. 141(R). Early adoption is not allowed. We are currently evaluating the effects, if any, that FAS No. 141(R) may have on our financial statements, but the Company does not expect the adoption of FAS No. 141(R) to have a material effect on its financial statements.

In December 2007, the EITF issued Issue No. 07-1, *Accounting for Collaborative Arrangements*. This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. This Issue requires that transactions with third parties (i.e., revenue generated and costs incurred by the partners) should be reported in the appropriate line item in each company's financial statement pursuant to the guidance in EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. This Issue also includes enhanced disclosure requirements regarding the nature and purpose of the arrangement, rights and obligations under the arrangement, accounting policy, amount and income statement classification of collaboration transactions between the parties. We are currently evaluating the effects this may have on our financial statements, but the Company does not expect the adoption to have a material effect on its financial statements.

In March 2008, the FASB issued FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. The Standard requires enhanced disclosures about derivative instruments and is effective for fiscal periods beginning after November 15, 2008. The Company does not expect adoption of this Standard to have a material effect on its financial statements.

In May 2008, the FASB issued FAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (FAS No. 162). FAS No. 162 identifies the sources of accounting principles and the framework for selecting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The FASB does not expect that FAS No. 162 will result in a change in current practice. However, transition provisions have been provided in the unusual circumstance that the application of the provisions of FAS No. 162 results in a change in practice. FAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company does not expect the adoption of this pronouncement to have a material effect on its financial statements.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, "Determination of the Useful Life of Intangible Assets" (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets" and requires enhanced disclosures relating to: (a) the entity's accounting policy on the treatment of costs incurred to renew or extend the term of a

recognized intangible asset; (b) in the period of acquisition or renewal, the weighted-average period prior to the next renewal or extension (both explicit and implicit), by major intangible asset class and (c) for an entity that capitalizes renewal or extension costs, the total amount of costs incurred in the period to renew or extend the term of a recognized intangible asset for each period for which a statement of financial position is presented, by major intangible asset class. FSP 142-3 must be applied prospectively to all intangible assets acquired as of and subsequent to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company is currently evaluating the impact that FSP142-3 will have on its financial statements.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP14-1). This staff position applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. FSP 14-1 requires the issuer to separately account for the liability and equity components of convertible debt instruments in a manner that reflects the issuer's nonconvertible debt borrowing rate on the instrument's issuance date when interest cost is recognized. This staff position is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not allowed. The Company expects that adoption of FSP 14-1 will result in additional non-cash charges to interest expense beginning January 1, 2009. The Company estimates the additional interest expense will be approximately \$4,800,000 in 2009, and the amount of interest will increase by approximately \$300,000 per year while the bonds remain outstanding.

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

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

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. Some of these estimates require judgments about matters that are inherently uncertain.

Accounting policies whose application may have a significant effect on the reported results of operations and financial position, and that can require judgments by management that affect their application, include FAS No. No. 5, *Accounting for Contingencies*, FAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, FAS

No. 142, Goodwill and Other Intangible Assets, FAS No. 87, Employers Accounting for Pensions, FAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions, as amended by FAS No. 132 and 132(R), Employers Disclosures About Pension and Other Postretirement Benefits, FAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, and FAS No. 109, Accounting for Income Taxes, including recent accounting requirements under FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes.

The Company records sales when persuasive evidence of an arrangement exists, delivery has occurred, title has been transferred, the selling price is fixed, and collectability 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. Some of these contracts provide for title transfer upon delivery, or upon reaching a specific date, while other contracts provide for title transfer to occur upon consumption of the product. 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.

Products and services provided under long-term contracts represent a significant portion of sales in the Engineered Composites segment. The Company uses the percentage of completion method for accounting for these projects. That method requires significant judgment and estimation, which could be considerably different if the underlying circumstances were to change. When adjustments in estimated contract revenues or costs are required, any changes from prior estimates are included in earnings in the current period. Additionally, the fact that these projects are long-term could increase the chance that a party to the contract may be unable to fulfill their obligations.

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.

The Company maintains reserves for possible impairment in the value of inventories. Such reserves can be specific to certain inventory, or general based on judgments about the overall condition of the inventory. General reserves are established based on percentage write-downs applied to aged inventories, or for inventories that are slow-moving. If actual results differ from estimates, additional inventory write-downs may be necessary.

The net carrying amount of property, plant and equipment (PP&E) was \$576.6 million, or 37% of total assets, as of September 30, 2008. For the nine months ended September 30, 2008 depreciation expense totaled \$43.6 million, or 5% of operating expenses. Given the significance of PP&E and associated depreciation to the Company's financial statements, determination of an asset's cost basis and its economic useful life are considered critical accounting estimates. PP&E is recorded at cost, which is generally objectively quantifiable when assets are purchased singly. However, when assets are purchased in groups, as would be the case for a business acquisition, costs assigned to PP&E are based on an estimate of fair value of each asset at the date of acquisition. These estimates are based on assumptions about asset condition, remaining useful life and market conditions. The Company may employ expert appraisers to aid in allocating cost to assets purchased as a group. Included in the cost basis of PP&E are those costs that substantially increase the useful lives or capacity of existing PP&E. Significant judgment is needed to determine which costs should be capitalized under these criteria, and which should be expensed as repairs and maintenance costs. Economic useful life is the duration of time an asset is expected to be productively employed by the Company, which may be less than its physical life. Management's estimate of useful life is monitored to determine its appropriateness, especially in light of changed business circumstances. Changes in these estimates that affect PP&E could have a significant impact on the Company's financial statements. However, significant adjustments have not been required in recent years. Management also monitors changes in business conditions and events such as a plant closure that could indicate that PP&E asset values are impaired. The determination of asset impairment involves significant judgment about market values and future cash flows.

Goodwill amounted to \$194.2 million at September 30, 2008 or 12% of total assets. A goodwill impairment exists when the carrying amount of goodwill exceeds its fair value. Assessments of possible impairment of goodwill are made when events or changes in circumstances indicate that the carrying value of the asset may not be recoverable through future operations. Additionally, testing for possible impairment of recorded goodwill and intangible asset balances is required annually. The amount and timing of any impairment charges based on these assessments require the estimation of future cash flows and the fair market value of the related

assets based on management's best estimates of certain key factors, including future selling prices and volumes, operating, raw material, energy and freight costs, and various other projected operating and economic factors. As these key factors change in future periods, the Company will update its impairment analysis to reflect its latest estimates and projections.

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

The Company is self insured for some employee and business risks, including health care and workers compensation programs in the United States. Losses under all of these programs are accrued based upon estimates of the ultimate liability for claims reported and an estimate of claims incurred but not reported, with assistance from third-party actuaries and service providers. However, these liabilities are difficult to assess and estimate due to unknown factors, including the severity of an illness or injury and the number of incidents not reported. The accruals are based upon known facts and historical trends and management believes such accruals to be adequate. If actual results significantly differ from estimates used to calculate the liability, the Company's financial condition, results of operations and cash flows could be materially impacted.

The Company has pension and postretirement benefit costs and liabilities that are developed from actuarial valuations. Inherent in these valuations are key assumptions, including discount rates and expected return on plan assets, which are updated on an annual basis. The Company is required to consider current market conditions, including changes in interest rates, in making these assumptions. Changes in the related pension and postretirement benefit costs or credits may occur in the future due to changes in the assumptions. The amount of annual pension plan funding and annual expense is subject to many variables, including the investment return on pension plan assets and interest rates. Assumptions used for determining pension plan liabilities and expenses are evaluated and updated at least annually. The largest benefit plans are the U.S. pension plan and the U.S. postretirement benefits plan, which account for 41% and 21% of the total company benefit obligations as of the September 30, 2007. Discount rate assumptions are based on the population of plan participants and a mixture of high-quality fixed income investments for which the average maturity approximates the average remaining service period of plan participants. The largest portion of pension plan assets (35% for the U.S. plan and 74% for non-U.S. plans) was invested in equities. The assumption for expected return on plan assets is based on historical and expected returns on various categories of plan assets. The U.S. plan accounts for 64% of the total consolidated pension plan assets. The actual return on assets in the U.S. pension plan for 2007 was 71% of the total assumed return. For the U.S. pension plan, 2007 pension expense was determined using the 1983 Group Annuity Mortality table. The benefit obligation as of September 30, 2007 was calculated using the RP-2000 Combined Healthy Mortality Table projected to 2015 using Scale AA with phase-out and without collar adjustment. Weakness in investment returns and low interest rates, or deviations in results from other assumptions, could result in the Company making equal or greater pension plan contributions in future years, as compared to 2007. Including anticipated contributions for all pension plans, the Company estimates that contributions will amount to approximately \$9.6 million for 2008, compared to actual contributions for 2007 of \$20.8 million. The Company adopted the provisions of FAS No. 158 in the fourth quarter of 2006, resulting in an increase of \$23.7 million in noncurrent deferred tax assets, a decrease of \$5.6 million in intangible assets, an increase of \$59.6 million in pension liabilities, and an increase of \$41.5 million in accumulated other comprehensive losses.

The Company records deferred income tax assets and liabilities for the tax consequences of differences between financial statement and tax bases of existing assets and liabilities. A tax valuation allowance is established, as needed, to reduce net deferred tax assets to the amount expected to be realized. In the event

it becomes more likely than not that some or all of the deferred tax asset allowances will not be needed, the valuation allowance will be adjusted. Management judgment is required to determine income tax expense and the related balance sheet amounts. Judgments are required concerning the ultimate outcome of tax contingencies and the realization of deferred tax assets. Actual income taxes paid may differ from estimates, depending upon changes in income tax laws, actual results of operations, and the final audit of tax returns by authorities. Additionally, tax assessments may arise several years after the tax returns have been filed. The Company believes its recorded tax liabilities adequately provide for the estimated outcome of these assessments.

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

The Company has certain financial assets and liabilities that are measured at fair market value on a recurring basis, in accordance with FAS No. 157. Fair market values are based on assumptions that market participants would use in pricing an asset or liability, which include review of observable inputs, market quotes, and assumptions of expected cash flows. In certain cases this determination of value may require some level of valuation analysis, interpretation of information, and judgment. As these key observable inputs and assumptions change in future periods, the Company will update its valuation to reflect market conditions.

A substantial portion of the Company's sales is denominated in euros or other foreign currencies. As a result, the Company may enter into foreign currency or other derivative contracts from time to time in order to mitigate volatility in the Company's earnings, which can be caused by changes in currency exchange rates. To qualify for hedge accounting under FAS 133, the hedging relationship between the hedging instrument and the hedged item must be effective in achieving the offset of changes that are attributable to the hedged risk, both at the inception of the hedge and on a continuing basis until maturity or settlement of the hedging instrument. Hedge effectiveness, which would be tested by the Company periodically, is dependent upon market factors and changes in currency exchange rates, which are unpredictable. In the event that the hedged item falls below the hedging instrument, any gains and losses related to the ineffective portion of the hedge will be recognized in the current period in earnings.

### **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, 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: the duration and severity of the global economic downturn, 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 Trends and Outlook 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.



**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 18,385 claims as of October 27, 2008. This compares with 18,462 such claims as of July 25, 2008, 18,529 claims as of May 2, 2008, 18,789 claims as of February 1, 2008, 18,791 claims as of October 19, 2007, 18,813 claims as of July 27, 2007, 19,120 claims as of April 27, 2007, 19,388 claims as of February 16, 2007, 19,416 claims as of December 31, 2006, 24,451 claims as of December 31, 2005, 29,411 claims as of December 31, 2004, 28,838 claims as of December 31, 2003, 22,593 claims as of December 31, 2002, 7,347 claims as of December 31, 2001, 1,997 claims as of December 31, 2000, and 2,276 claims as of December 31, 1999. These suits allege a variety of lung and other diseases based on alleged exposure to products previously manufactured by Albany. The following table sets forth the number of claims filed, the number of claims settled, dismissed or otherwise resolved, and the average settlement amount during the periods presented:

| <i>Year ended<br/>December<br/>31,</i> | <i>Opening<br/>Number<br/>of claims</i> | <i>Claims<br/>Dismissed,<br/>Settled or<br/>Resolved</i> | <i>New<br/>Claims</i> | <i>Closing<br/>Number<br/>of<br/>Claims</i> | <i>Amounts Paid<br/>(thousands) to<br/>Settle or<br/>Resolve (\$\$)</i> |
|--|---|--|-----------------------|---|---|
| <i>2005</i>                            | <i>29,411</i>                           | <i>6,257</i>   | <i>1,297</i>          | <i>24,451</i>                               | <i>504</i>  |
| <i>2006</i>                            | <i>24,451</i>                           | <i>6,841</i>   | <i>1,806</i>          | <i>19,416</i>                               | <i>3,879</i>  |
| <i>2007</i>                            | <i>19,416</i>                           | <i>808</i>   | <i>190</i>            | <i>18,798</i>                               | <i>15</i>   |
| <i>2008 to date</i>                    | <i>18,798</i>                           | <i>523</i>   | <i>110</i>            | <i>18,385</i>                               | <i>52</i>   |

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

As of October 27, 2008, approximately 12,436 of the claims pending against Albany were pending in Mississippi. Of these, approximately 11,871 are in federal court, at the multidistrict litigation panel ( MDL ), either through removal or original jurisdiction. (In addition to the 11,871 Mississippi claims pending against the Company at the MDL, there are approximately 888 claims pending against the Company at the MDL removed from various United States District Courts in other states.)

As of October 27, 2008, the remaining 5,949 claims pending against Albany were pending in states other than Mississippi. Pleadings and discovery responses in those cases in which work histories have been provided indicate claimants with paper mill exposure in less than 26% 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. For these reasons, the Company expects the percentage of these remaining claimants able to demonstrate time spent in a paper mill to which Albany supplied asbestos-containing products during a period in which Albany's asbestos-containing products were in use to be considerably lower than the total number of pending claims. In addition, over half of these remaining non-Mississippi claims have not provided any disease information. Detailed exposure and disease information sufficient meaningfully to estimate a range of possible loss of a particular claim is typically not available until late in the discovery process, and often not until a trial date is imminent and a settlement demand has been received. For these reasons, the Company does not believe a meaningful estimate can be made regarding the range of possible loss with respect to these remaining claims.

On May 31, 2007 the MDL issued an administrative order that required each MDL plaintiff to provide detailed information regarding, among other things, the alleged asbestos-related medical diagnoses. The order does not require exposure information with this initial filing. The first set of plaintiffs were required to submit their filings with the Court by August 1, 2007, with deadlines for additional sets of plaintiffs monthly thereafter until December 1, 2007, but the process is continuing with defendants reviewing the submissions for compliance.

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

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

It is the position of Albany and the other paper machine clothing defendants that there was insufficient exposure to asbestos from any paper machine clothing products to cause asbestos-related injury to any plaintiff. Furthermore, asbestos contained in Albany's synthetic products was encapsulated in a resin-coated yarn woven into the interior of the fabric, further reducing the likelihood of fiber release. While the Company believes it has meritorious defenses to these claims, it has settled certain of these cases for amounts it considers reasonable given the facts and circumstances of each case. The Company's insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of October 27, 2008, the Company had resolved, by means of settlement or dismissal, 22,046 claims. The total cost of resolving all claims was \$6,758,000. Of this amount, \$6,713,000, or 99%, was paid by the Company's insurance carrier. The Company has approximately \$130 million in confirmed insurance coverage that should be available with respect to current and future asbestos claims, as well as additional insurance coverage that it should be able to access.

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

Brandon Drying Fabrics, Inc. ( Brandon ), a subsidiary of Geschmay Corp., which is a subsidiary of the Company, is also a separate defendant in many of the asbestos cases in which Albany is named as a defendant. Brandon was defending against 8,664 claims as of October 27, 2008. This compares with 8,672 such claims as of July 25, 2008, 8,689 claims as of May 2, 2008, 8,741 claims as of February 1, 2008 and October 19, 2007, 9,023 claims as of July 27, 2007, 9,089 claims as of April 27, 2007, 9,189 claims as of

February 16, 2007, 9,114 claims as of December 31, 2006, 9,566 claims as of December 31, 2005, 9,985 claims as of December 31, 2004, 10,242 claims as of December 31, 2003, 11,802 claims as of December 31, 2002, 8,759 claims as of December 31, 2001, 3,598 claims as of December 31, 2000, and 1,887 claims as of December 31, 1999. The following table sets forth the number of claims filed, the number of claims settled, dismissed or otherwise resolved, and the average settlement amount during the periods presented:

| <i>Year ended<br/>December<br/>31,</i> | <i>Opening<br/>Number<br/>of claims</i> | <i>Claims<br/>Dismissed,<br/>Settled or<br/>Resolved</i> | <i>New<br/>Claims</i> | <i>Closing<br/>Number<br/>of<br/>Claims</i> | <i>Amounts Paid<br/>(thousands) to<br/>Settle or<br/>Resolve (\$\$)</i> |
|--|---|--|-----------------------|---|---|
| 2005                                   | 9,985                                   | 642  | 223                   | 9,566                                       | 0   |
| 2006                                   | 9,566                                   | 1182   | 730                   | 9,114                                       | 0   |
| 2007                                   | 9,114                                   | 462  | 88                    | 8,740                                       | 0   |
| 2008 to date                           | 8,740                                   | 86   | 10                    | 8,664                                       | 0   |

The Company acquired Geschmay Corp., formerly known as Wangner Systems Corporation, in 1999. Brandon is a wholly-owned subsidiary of Geschmay Corp. In 1978, Brandon acquired certain assets from Abney Mills ( Abney ), a South Carolina textile manufacturer. Among the assets acquired by Brandon from Abney were assets of Abney s wholly-owned subsidiary, Brandon Sales, Inc. which had sold, among other things, dryer fabrics containing asbestos made by its parent, Abney. It is believed that Abney ceased production of asbestos-containing fabrics prior to the 1978 transaction. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. Under the terms of the Assets Purchase Agreement between Brandon and Abney, Abney agreed to indemnify, defend, and hold Brandon harmless from any actions or claims on account of products manufactured by Abney and its related corporations prior to the date of the sale, whether or not the product was sold subsequent to the date of the sale. It appears that Abney has since been dissolved. Nevertheless, a representative of Abney has been notified of the pendency of these actions and demand has been made that it assume the defense of these actions. Because Brandon did not manufacture asbestos-containing products, and because it does not believe that it was the legal successor to, or otherwise responsible for obligations of Abney with respect to products manufactured by Abney, it believes it has strong defenses to the claims that have been asserted against it. In some instances, plaintiffs have voluntarily dismissed claims against it, while in others it has entered into what it considers to be reasonable settlements. As of October 27, 2008, Brandon has resolved, by means of settlement or dismissal, 8,911 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.

As of October 27, 2008, 6,821 (or approximately 79%) of the claims pending against Brandon were pending in Mississippi. For the same reasons set forth above with respect to Albany s Mississippi and other claims, as well as the fact that no amounts have been paid to resolve any Brandon claims since 2001, the Company does not believe a meaningful estimate can be made regarding the range of possible loss with respect to these remaining claims.

### **Mount Vernon**

In some of these asbestos cases, the Company is named both as a direct defendant and as the successor in interest to Mount Vernon Mills ( Mount Vernon ). The Company acquired certain assets from Mount Vernon in 1993. Certain

plaintiffs allege injury caused by asbestos-containing products alleged to have been sold by

Mount Vernon many years prior to this acquisition. Mount Vernon is contractually obligated to indemnify the Company against any liability arising out of such products. The Company denies any liability for products sold by Mount Vernon prior to the acquisition of the Mount Vernon assets. Pursuant to its contractual indemnification obligations, Mount Vernon has assumed the defense of these claims. On this basis, the Company has successfully moved for dismissal in a number of actions.

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

**Item 1A. Risk Factors.**

Other than as set forth below, there have been no material changes in risks since December 31, 2007. For a discussion of risk factors, please refer to Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2007 (the 2007 10-K ). See also the Outlook section of Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 of this report for general discussion of risks to the Company posed by a global economic downturn.

The effects of a global economic and paper industry downturn may exacerbate the effect of previously disclosed risks, and may also generally have an adverse impact on the Company's business and results of operations.

The Company's 2007 10-K identified a number of risks to the Company, the effects of which may be exacerbated in a severe recession: Continued global economic and paper industry conditions may increase consolidation and rationalization within the paper industry, further reducing global consumption of paper machine clothing. Reduced consumption of PMC could in turn increase the risk of greater price competition within the PMC industry and greater effort by competitors to gain market share at the expense of the Company. Sales in the Company's other business segments may also be adversely affected by an economic downturn.

Deteriorating economic and paper industry conditions also increases the risk that one or more of our customers could be unable to pay outstanding accounts receivable, whether as the result of bankruptcy or an inability to obtain working capital financing from banks or other lenders. In such a case, we could be forced to write-off such accounts, which could have a material adverse effect on our operating results, financial condition and/or liquidity. Furthermore, many of our businesses design and manufacture products that are custom designed for a specific customer application, at a specific location. In the event that of a customer liquidity issue, the Company could also be required to write off amounts that are included in inventories.

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

Management made no share purchases during the third quarter of 2008. Management remains authorized by the Board of Directors to purchase up to 2,000,000 shares of its Class A Common Stock.

**Item 3.**

**Defaults Upon Senior Securities**

None

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

None

**Item 5. Other Information**

None

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**Item 6. Exhibits**

**Exhibit No.**

**Description**

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31.1

Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act.

31.2

Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act.

32.1

Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code).

99.1

Quantitative and qualitative disclosures about market risks as reported at December 31, 2007.

## 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: November 7, 2008

By /s/ Michael C. Nahl

Michael C. Nahl

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)

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