

ALBANY INTERNATIONAL CORP /DE/  
Form 10-Q  
August 02, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

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

For the quarterly period ended: June 30, 2013

OR

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

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

Commission file number: 1-10026

ALBANY INTERNATIONAL CORP.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

14-0462060  
(IRS Employer Identification No.)

216 Airport Drive, Rochester, New Hampshire 03867  
(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [  ] No [  ]

Edgar Filing: ALBANY INTERNATIONAL CORP /DE/ - Form 10-Q

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

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

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

The registrant had 28.4 million shares of Class A Common Stock and 3.2 million shares of Class B Common Stock outstanding as of July 15, 2013.

**ALBANY INTERNATIONAL CORP.**

**TABLE OF CONTENTS**

Page No.

**Part I Financial information**

|   |    |
|---|----|
| Item 1. Financial Statements  |    |
| <u>Consolidated statements of operations– three and six months ended June 30, 2013 and 2012</u>           | 3  |
| <u>Consolidated statements of comprehensive income– three and six months ended June 30, 2013 and 2012</u> | 4  |
| <u>Consolidated balance sheets – June 30, 2013 and December 31, 2012</u>                                  | 5  |
| <u>Consolidated statements of cash flows – three and six months ended June 30, 2013 and 2012</u>          | 6  |
| <u>Notes to consolidated financial statements</u>   | 7  |
| <u>Forward-looking statements</u>   | 26 |
| <u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>      | 28 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>                                 | 42 |
| <u>Item 4. Controls and Procedures</u>  | 42 |

**Part II Other Information**

|  |    |
|--|----|
| <u>Item 1. Legal Proceedings</u>   | 43 |
| <u>Item 1A. Risk Factors</u>   | 43 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 43 |
| <u>Item 3. Defaults upon Senior Securities</u>                             | 43 |
| <u>Item 4. Mine Safety Disclosures</u>                                     | 43 |
| <u>Item 5. Other Information</u>   | 43 |
| <u>Item 6. Exhibits</u>  | 44 |

## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

| Three Months Ended |            |   | Six Months Ended |           |
|--------------------|------------|---|------------------|-----------|
| June 30,           |            |   | June 30,         |           |
| 2013               | 2012       |   | 2013             | 2012      |
| \$197,974          | \$191,940  | Net sales   | \$384,628        | \$372,017 |
| 120,541            | 113,440    | Cost of goods sold                                      | 234,426          | 225,231   |
| 77,433             | 78,500     | Gross profit  | 150,202          | 146,786   |
| 41,994             | 37,146     | Selling, general, and administrative expenses           | 78,547           | 84,169    |
| 14,631             | 13,646     | Technical, product engineering, and research expenses   | 27,693           | 26,385    |
| 24,321             | 3,152      | Restructuring and other, net                            | 24,957           | 3,410     |
| -                  | 110,560    | Pension settlement expense                              | -                | 119,735   |
| (3,513)            | (86,004)   | Operating income/(loss)                                 | 19,005           | (86,913)  |
| 3,547              | 3,969      | Interest expense, net                                   | 7,572            | 8,613     |
| 2,211              | (2,555)    | Other expense/(income), net                             | 2,945            | 1,993     |
| (9,271)            | (87,418)   | Income/(loss) before income taxes                       | 8,488            | (97,519)  |
| (2,243)            | (29,643)   | Income tax expense/(benefit)                            | 4,005            | (39,615)  |
| (7,028)            | (57,775)   | Income/(loss) from continuing operations                | 4,483            | (57,904)  |
| (575)              | 2,760      | (Loss)/income from operations of discontinued business  | (575)            | 4,776     |
| -                  | 34,709     | Gain on sale of discontinued business                   | -                | 92,677    |
| (224)              | 13,439     | Income tax (benefit)/expense on discontinued operations | (224)            | 26,253    |
| (351)              | 24,030     | (Loss)/income from discontinued operations              | (351)            | 71,200    |
| (\$7,379)          | (\$33,745) | Net income/(loss)                                       | \$4,132          | \$13,296  |
|                    |            | Earnings per share - Basic                              |                  |           |
| (\$0.22)           | (\$1.84)   | Income/(loss) from continuing operations                | \$0.14           | (\$1.85)  |
| (0.01)             | 0.76       | Discontinued operations                                 | (0.01)           | 2.27      |
| (\$0.23)           | (\$1.08)   | Net income/(loss)                                       | \$0.13           | \$0.42    |
|                    |            | Earnings per share - Diluted                            |                  |           |
| (\$0.22)           | (\$1.84)   | Income/(loss) from continuing operations                | \$0.14           | (\$1.84)  |
| (0.01)             | 0.76       | Discontinued operations                                 | (0.01)           | 2.26      |
| (\$0.23)           | (\$1.08)   | Net income/(loss)                                       | \$0.13           | \$0.42    |

Shares used in computing earnings per share:

Edgar Filing: ALBANY INTERNATIONAL CORP /DE/ - Form 10-Q

|        |        |                     |        |        |
|--------|--------|---------------------|--------|--------|
| 31,628 | 31,349 | Basic               | 31,562 | 31,329 |
| 31,628 | 31,349 | Diluted             | 31,856 | 31,518 |
| \$0.15 | \$0.14 | Dividends per share | \$0.29 | \$0.27 |

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

3

## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data)

(unaudited)

| Three Months |            |   | Six Months |          |
|--------------|------------|---|------------|----------|
| Ended        |            |   | Ended      |          |
| June 30,     |            |   | June 30,   |          |
| 2013         | 2012       |   | 2013       | 2012     |
| (\$7,379)    | (\$33,745) | Net income/(loss)   | \$4,132    | \$13,296 |
|              |            | Other comprehensive (loss)/income, before tax:                      |            |          |
| (2,647)      | (20,540)   | Foreign currency translation adjustments                            | (13,269)   | (7,222)  |
| -            | 110,197    | Pension settlement  | -          | 118,350  |
| -            | (24,617)   | Pension plan remeasurement  | -          | (24,617) |
|              |            | Amortization of pension liability adjustment:                       |            |          |
| 17           | 18         | Transition obligation   | 34         | 37       |
| (909)        | (909)      | Prior service (credit)/cost   | (1,817)    | (1,817)  |
| 1,664        | 1,870      | Net actuarial loss  | 3,328      | 4,447    |
| 2,414        | (318)      | Derivative valuation adjustment                                     | 2,871      | (664)    |
|              |            | Income taxes related to items of other comprehensive (loss)/income: |            |          |
| -            | (37,002)   | Pension settlement  | -          | (39,146) |
| -            | 7,270      | Pension plan remeasurement  | -          | 7,270    |
| (271)        | (304)      | Amortization of pension liability adjustment                        | (541)      | (827)    |
| (941)        | 124        | Derivative valuation adjustment                                     | (1,119)    | 259      |
| (673)        | 35,789     | Other comprehensive (loss)/income, net of tax                       | (10,513)   | 56,070   |
| (\$8,052)    | \$2,044    | Comprehensive (loss)/income   | (\$6,381)  | \$69,366 |

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

## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(unaudited)

|   | June 30,<br>2013 | December<br>31,<br>2012 |
|---|------------------|-------------------------|
| <b>ASSETS</b>   |                  |                         |
| Cash and cash equivalents   | \$197,321        | \$190,718               |
| Accounts receivable, net  | 174,881          | 171,535                 |
| Inventories   | 117,443          | 119,183                 |
| Income taxes receivable and deferred  | 20,298           | 20,594                  |
| Prepaid expenses and other current assets   | 12,311           | 10,435                  |
| Total current assets  | 522,254          | 512,465                 |
| Property, plant and equipment, net  | 406,845          | 420,154                 |
| Intangibles   | 733              | 848                     |
| Goodwill  | 75,688           | 76,522                  |
| Deferred taxes  | 125,549          | 123,886                 |
| Other assets  | 26,875           | 22,822                  |
| Total assets  | \$1,157,944      | \$1,156,697             |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                  |                         |
| Notes and loans payable   | \$610            | \$586                   |
| Accounts payable  | 34,032           | 35,117                  |
| Accrued liabilities   | 130,269          | 103,257                 |
| Current maturities of long-term debt  | 55,014           | 83,276                  |
| Income taxes payable and deferred   | 7,795            | 13,552                  |
| Total current liabilities   | 227,720          | 235,788                 |
| Long-term debt  | 265,368          | 235,877                 |
| Other noncurrent liabilities  | 131,808          | 136,012                 |
| Deferred taxes and other credits  | 52,771           | 55,509                  |
| Total liabilities   | 677,667          | 663,186                 |
| <b>SHAREHOLDERS' EQUITY</b>   |                  |                         |
| Preferred stock, par value \$5.00 per share;<br>authorized 2,000,000 shares; none issued  | -                | -                       |
| Class A Common Stock, par value \$.001 per share;<br>authorized 100,000,000 shares; issued<br>36,875,127 in 2013 and 36,642,204 in 2012 | 37               | 37                      |
| Class B Common Stock, par value \$.001 per share;<br>authorized 25,000,000 shares; issued and<br>outstanding 3,236,098 in 2013 and 2012 | 3                | 3                       |

|   |             |             |
|---|-------------|-------------|
| Additional paid in capital  | 397,606     | 395,381     |
| Retained earnings   | 430,736     | 435,775     |
| Accumulated items of other comprehensive income:                                    |             |             |
| Translation adjustments   | (22,153 )   | (7,659 )    |
| Pension and postretirement liability adjustments                                    | (67,255)    | (69,484 )   |
| Derivative valuation adjustment   | (1,126 )    | (2,878 )    |
| Treasury stock (Class A), at cost 8,463,635 shares<br>in 2013 and 8,467,873 in 2012 | (257,571 )  | (257,664 )  |
| Total shareholders' equity  | 480,277     | 493,511     |
| Total liabilities and shareholders' equity  | \$1,157,944 | \$1,156,697 |

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



## ALBANY INTERNATIONAL CORP.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

| Three Months Ended   |             |   | Six Months Ended |            |
|--|-------------|---|------------------|------------|
| June 30,   |             |   | June 30,         |            |
| 2013   | 2012        |   | 2013             | 2012       |
| <b>OPERATING ACTIVITIES</b>  |             |   |                  |            |
| (\$7,379 )   | (\$33,745 ) | Net income/(loss)   | \$4,132          | \$13,296   |
| Adjustments to reconcile net income to net cash provided by /(used in) operating activities: |             |   |                  |            |
| 14,427   | 14,340      | Depreciation  | 28,638           | 28,685     |
| 1,654  | 1,767       | Amortization  | 3,317            | 3,553      |
| -  | 209         | Noncash interest expense  | -                | 614        |
| (7,864 )   | (58,125 )   | Change in long-term liabilities, deferred taxes and other credits | (3,991 )         | (125,244 ) |
| -  | 110,197     | Write-off of pension liability adjustment due to settlement       | -                | 118,350    |
| 21   | 677         | Provision for write-off of property, plant and equipment          | 65               | 200        |
| -  | (34,709 )   | (Gain) on disposition of assets                                   | (3,763 )         | (92,677 )  |
| (172 )   | (8 )        | Excess tax benefit of options exercised                           | (524 )           | (11 )      |
| (476 )   | 566         | Compensation and benefits paid or payable in Class A Common Stock | (1,174 )         | 1,403      |
| Changes in operating assets and liabilities, net of business divestitures:                   |             |   |                  |            |
| (4,515 )   | (13,893 )   | Accounts receivable   | (6,238 )         | (10,525 )  |
| 2,458  | 3,783       | Inventories   | (530 )           | (129 )     |
| 1,544  | 619         | Prepaid expenses and other current assets                         | (2,033 )         | (997 )     |
| 28   | 832         | Income taxes prepaid and receivable                               | 180              | 7,392      |
| (1,139 )   | (6,199 )    | Accounts payable  | (592 )           | (25 )      |
| 29,912   | 9,179       | Accrued liabilities   | 20,929           | 7,364      |
| 441  | (4,486 )    | Income taxes payable  | (4,877 )         | (2,530 )   |
| (793 )   | (1,784 )    | Other, net  | (1,231 )         | (2,167 )   |
| 28,147   | (10,780 )   | Net cash provided by/(used in) operating activities               | 32,308           | (53,448 )  |
| <b>INVESTING ACTIVITIES</b>  |             |   |                  |            |
| (14,620 )  | (9,881 )    | Purchases of property, plant and equipment                        | (27,808 )        | (14,190 )  |
| (555 )   | 22          | Purchased software  | (648 )           | (8 )       |
| -  | -           | Proceeds from sale of assets                                      | 6,268            | -          |
| -  | 38,081      | Proceeds from sale of discontinued operations, net of expenses    | -                | 150,654    |
| (15,175 )  | 28,222      | Net cash (used in)/provided by investing activities               | (22,188 )        | 136,456    |
| <b>FINANCING ACTIVITIES</b>  |             |   |                  |            |
| 5,037  | 29,164      | Proceeds from borrowings  | 51,905           | 38,164     |
| (18,476 )  | (11,981 )   | Principal payments on debt  | (50,659 )        | (69,223 )  |
| 1,004  | 79          | Proceeds from options exercised                                   | 2,968            | 268        |
| 172  | 8           | Excess tax benefit of options exercised                           | 524              | 11         |

Edgar Filing: ALBANY INTERNATIONAL CORP /DE/ - Form 10-Q

|                     |  |                     |  |
|---------------------|--|---------------------|--|
| (76 ) -             | Debt acquisition costs                                       | (1,639 ) -          |  |
| (4,423 ) (4,069 )   | Dividends paid   | (4,423 ) (8,138 )   |  |
| (16,762 ) 13,201    | Net cash (used in)/provided by financing activities          | (1,324 ) (38,918 )  |  |
| 1,278 (6,976 )      | Effect of exchange rate changes on cash and cash equivalents | (2,193 ) 1,593      |  |
| (2,512 ) 23,667     | Increase/(decrease) in cash and cash equivalents             | 6,603 45,683        |  |
| 199,833 140,925     | Cash and cash equivalents at beginning of period             | 190,718 118,909     |  |
| \$197,321 \$164,592 | Cash and cash equivalents at end of period                   | \$197,321 \$164,592 |  |

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

ALBANY INTERNATIONAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

***1. Basis of Presentation***

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of only normal recurring adjustments and elimination of intercompany transactions necessary for a fair presentation of results for such periods. Albany International Corp. consolidates the financial results of its subsidiaries for all periods presented. The results for any interim period are not necessarily indicative of results for the full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with “Risk Factors,” “Legal Proceedings,” “Management’s Discussion and Analysis of Financial Condition and Results of Operation,” “Quantitative and Qualitative Disclosures about Market Risk” and the Consolidated Financial Statements and Notes thereto included in Items 1A, 3, 7, 7A and 8, respectively, of the Albany International Corp. Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

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

***2. Discontinued Operations***

In October 2011 we entered into a contract to sell the assets and liabilities of our Albany Door Systems (ADS) business to Assa Abloy AB for \$130 million. Closing on the transaction occurred on January 11, 2012. Under the terms of the contract, Assa Abloy AB acquired our equity ownership of Albany Doors Systems GmbH in Germany, Albany Door Systems AB in Sweden, and other ADS affiliates in Germany, France, the Netherlands, Turkey, Poland, Belgium, New Zealand, and other countries, as well as the remaining ADS business assets, most of which were located in the United States, Australia, China, and Italy. In January 2012, the Company completed the sale of Albany Door Systems, and in March 2012, we finalized certain post-closing adjustments that increased the sale price by \$5 million. As of December 31, 2012, \$122 million of the total \$135 million sale price had been received, with the remainder received in July 2013.

In May 2012, we announced an agreement to sell our PrimaLoft® Products business and that transaction closed on June 29, 2012. Under the terms of the agreement, the purchaser acquired all of the assets of that business, which were located in the United States, Italy and Germany. The purchase price of \$38.0 million included \$3.8 million held in an escrow account which is included in Accounts receivable and is expected to be received in December 2013. The Company recorded a pre-tax gain in the second quarter of 2012 of \$34.9 million as result of that sale. The Company recorded an accrual of \$0.6 million for pre-closing liabilities that arose during the second quarter of 2013.

We have provided customary representations and warranties in the sale of both of these businesses but we do not expect any material negative financial consequence will result from these arrangements. In accordance with the applicable accounting guidance for discontinued businesses, the associated results of operations and financial position are reported separately in the accompanying Consolidated Statements of Operations and Balance Sheets. Cash flows

of the discontinued operation were combined with cash flows from continuing operations in the Consolidated Statements of Cash Flows.

7

The table below summarizes operating results of the discontinued operations:

| (in thousands)  | Three months<br>ended<br>June 30, 2013 | Three months<br>ended<br>June 30, 2012 | Six months<br>ended<br>June 30, 2013 | Six months<br>ended<br>June 30, 2012 |
|---|--|--|--------------------------------------|--------------------------------------|
| Net sales   | \$0                                    | \$ 10,283                              | \$0                                  | \$ 19,774                            |
| (Loss)/Income from operations of discontinued business before tax | (575)                                  | 2,760                                  | (575)                                | 4,776                                |
| Gain on disposition of discontinued operations                    | -                                      | 34,709                                 | -                                    | 92,677                               |
| Income tax (benefit)/expense                                      | (224)                                  | 13,439                                 | (224)                                | 26,253                               |

### 3. Reportable Segments

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

| (in thousands)   | Three months ended<br>June 30, |             | Six months ended<br>June 30, |             |
|--|--------------------------------|-------------|------------------------------|-------------|
|  | 2013                           | 2012        | 2013                         | 2012        |
| Net sales  |                                |             |                              |             |
| Machine Clothing (MC)  | \$177,536                      | \$177,122   | \$344,946                    | \$341,410   |
| Engineered Composites (AEC)                                  | 20,438                         | 14,818      | 39,682                       | 30,607      |
| Consolidated total   | \$197,974                      | \$191,940   | \$384,628                    | \$372,017   |
| Operating income/(loss)                                      |                                |             |                              |             |
| Machine Clothing   | \$20,699                       | \$44,997    | \$63,607                     | \$75,842    |
| Engineered Composites  | (1,825 )                       | (369 )      | (3,888 )                     | (340 )      |
| Research expense   | (7,673 )                       | (7,253 )    | (14,664 )                    | (13,318 )   |
| Unallocated expenses   | (14,714 )                      | (123,379 )  | (26,050 )                    | (149,097 )  |
| Operating income/(loss) before reconciling items             | (3,513 )                       | (86,004 )   | 19,005                       | (86,913 )   |
| Reconciling items:   |                                |             |                              |             |
| Interest income  | (300 )                         | (522 )      | (600 )                       | (606 )      |
| Interest expense   | 3,847                          | 4,491       | 8,172                        | 9,219       |
| Other expense/ (income), net                                 | 2,211                          | (2,555 )    | 2,945                        | 1,993       |
| Income/(loss) from continuing operations before income taxes | (\$9,271 )                     | (\$87,418 ) | \$8,488                      | (\$97,519 ) |

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

| (in thousands)        | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|-----------------------|--------------------------------|-----------|------------------------------|-----------|
|                       | 2013                           | 2012      | 2013                         | 2012      |
| Pension settlement    |                                |           |                              |           |
| Unallocated expenses  | \$0                            | \$110,560 | \$0                          | \$119,735 |
| Restructuring expense |                                |           |                              |           |
| Machine Clothing      | \$24,230                       | \$2,903   | \$24,423                     | \$3,576   |
| Engineered Composites | 91                             | -         | 534                          | -         |
| Unallocated expenses  | -                              | 249       | -                            | (166 )    |
| Consolidated total    | \$24,321                       | \$3,152   | \$24,957                     | \$3,410   |

Substantially all of the restructuring charges recorded in the second quarter of 2013 relate to the completion of consultations with employee works councils in Sélestat and St. Junien, France, which will result in the reduction of approximately 200 employees, most of which will leave the Company during the third quarter of 2013. The restructuring program was driven by the Company's need to balance manufacturing capacity and demand.

Through the first six months of 2013, the Company incurred some restructuring costs in the Engineered Composites segment that were related to organizational changes and exiting certain aerospace programs.

The 2012 restructuring expense was principally due to a reduction in workforce in Sweden and curtailment of manufacturing in New York and Wisconsin which was related to the lower demand for paper machine clothing. Those costs were partially offset by a reduction in accruals related to the Company's headquarters.

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

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

##### *Pension Plans*

The Company has defined benefit pension plans covering certain U.S. and non-U.S. employees. The U.S. qualified defined benefit pension plan has been closed to new participants since October 1998 and, as of February 2009, benefits accrued under this plan were frozen. As a result of the freeze, employees covered by the pension plan will receive, at retirement, benefits already accrued through February 2009, but no new benefits accrue after that date. Benefit accruals under the U.S. Supplemental Executive Retirement Plan ("SERP") were similarly frozen. The eligibility, benefit formulas, and contribution requirements for plans outside of the U.S. vary by location.

##### *Other Postretirement Benefits*

In addition to providing pension benefits, the Company provides various medical, dental, and life insurance benefits for certain retired United States employees. U.S. employees hired prior to 2005 may become eligible for these benefits if they reach normal retirement age while working for the Company. Benefits provided under this plan are subject to change. Retirees share in the cost of these

benefits. Effective January 2005, any new employees who wish to be covered under this plan will be responsible for the full cost of such benefits, except for life insurance benefits, which continue to be provided. In September 2008, we changed the cost sharing arrangement under this program such that increases in health care costs are the responsibility of plan participants.

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

The composition of the net periodic benefit plan cost for the six months ended June 30, 2013 and 2012 was as follows:

| (in thousands)                              | Pension plans |           | Other postretirement benefits |         |
|---|---------------|-----------|-------------------------------|---------|
|   | 2013          | 2012      | 2013                          | 2012    |
| Components of net periodic benefit cost:    |               |           |                               |         |
| Service cost                                | \$1,684       | \$1,699   | \$571                         | \$536   |
| Interest cost                               | 4,000         | 7,589     | 1,604                         | 1,844   |
| Expected return on assets                   | (4,068)       | (7,184)   | -                             | -       |
| Amortization of prior service cost/(credit) | 17            | 17        | (1,834)                       | (1,834) |
| Amortization of transition obligation       | 34            | 37        | -                             | -       |
| Amortization of net actuarial loss          | 1,571         | 2,839     | 1,757                         | 1,608   |
| Settlement                                  | -             | 119,735   | -                             | -       |
| Net periodic benefit cost                   | \$3,238       | \$124,732 | \$2,098                       | \$2,154 |

In the first quarter of 2012, the Company announced a plan to significantly reduce its pension plan liabilities by settling certain pension obligations leading to settlement charges totaling \$119.7 million for the first six months of 2012. In the first quarter of 2012, we recorded a settlement charge of \$9.2 million related to the extinguishment of our pension plan liability in Sweden. In the second quarter of 2012, we recorded settlement charges totaling \$110.6 million related to settling a majority of the defined benefit pension plan liabilities in the United States and Canada.

## 5. Restructuring

During the second quarter of 2013, the Company completed consultations with employee works councils regarding a plan to restructure operations at the Company's Machine Clothing production facilities in Sélestat and St. Junien, France. The restructuring program was driven by the Company's need to balance manufacturing capacity and demand. The restructuring charges recorded primarily related to severance and social costs. Under the terms of the restructuring plan, the Company will also provide training, outplacement and other programs. The costs for those benefits will be recorded as restructuring in future quarters when they are incurred and are expected to total \$6 to \$8 million.

The Company expects to record a pension curtailment gain the second half of 2013 related to this restructuring activity, but the amount has not yet been determined. Whereas most of the affected employees were involved in the production process, the full effect of cost savings associated with the restructuring, estimated to be \$10 million per year, will not be fully realized until the second half of 2014. The effects of the cost reduction will principally affect



cost of goods sold.

Substantially all of the restructuring charges recorded in the second quarter of 2013 relate to the completion of these consultations, which will result in the reduction of approximately 200 employees, most of which will leave the Company during the third quarter of 2013. Whereas most of

10

the affected employees were involved in the production process, the full effect of cost savings associated with the restructuring will not be fully realized until the second half of 2014. Through the first six months of 2013, the Company incurred some restructuring costs in the Engineered Composites segment that were related to organizational changes and exiting certain aerospace programs.

The 2012 restructuring expense was principally due to a reduction in workforce in Sweden and curtailment of manufacturing in New York and Wisconsin which was related to the lower demand for paper machine clothing. Those costs were partially offset by a reduction in accruals related to the Company's headquarters.

The following table summarizes charges reported in the Statements of Operations under "Restructuring and other":

| (in thousands)        | Three months ended<br>June 30, |         | Six months ended<br>June 30, |         |
|-----------------------|--------------------------------|---------|------------------------------|---------|
|                       | 2013                           | 2012    | 2013                         | 2012    |
| Machine Clothing      | \$24,230                       | \$2,903 | \$24,423                     | \$3,576 |
| Engineered Composites | 91                             | -       | 534                          | -       |
| Unallocated expenses  | -                              | 249     | -                            | (166 )  |
| Total                 | \$24,321                       | \$3,152 | \$24,957                     | \$3,410 |

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

| Six months ended<br>June 30, 2012 | Total restructuring<br>costs incurred | Termination and<br>other costs | Impairment of plant<br>and equipment | Benefit plan<br>curtailment/<br>settlement |
|-----------------------------------|---------------------------------------|--------------------------------|--------------------------------------|--|
| (in thousands)                    |                                       |                                |                                      |  |
| Machine Clothing                  | \$3,576                               | \$3,576                        | \$ -                                 | \$ -                                       |
| Engineered<br>Composites          | -                                     | -                              | -                                    | -  |
| Unallocated<br>expenses           | (166)                                 | 380                            | (546)                                | -  |
| Total                             | \$3,410                               | \$3,956                        | (\$546)                              | \$ -                                       |

We expect that substantially all accruals for restructuring liabilities will be paid within one year. The table below presents year-to-date changes in restructuring liabilities for 2013 and 2012 all of which related to termination costs:

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

| (in thousands) | December 31, 2011 | Restructuring charges accrued | Payments  | Currency translation/<br>other | June 30,<br>2012 |
|----------------|-------------------|-------------------------------|-----------|--------------------------------|------------------|
| Total          | \$6,979           | \$3,830                       | (\$2,778) | (\$243)                        | \$7,788          |

### 6. Other Expense/(Income), net

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

| (in thousands)                                    | Three months<br>ended<br>June 30, |           | Six months<br>ended<br>June 30, |         |
|---|-----------------------------------|-----------|---------------------------------|---------|
|   | 2013                              | 2012      | 2013                            | 2012    |
| Currency transactions                             | \$1,894                           | (\$3,133) | \$1,903                         | \$699   |
| Bank fees and amortization of debt issuance costs | 377                               | 533       | 998                             | 1,209   |
| Letter of credit fees                             | -                                 | 351       | -                               | 770     |
| Other   | (60 )                             | (306 )    | 44                              | (685 )  |
| Total   | \$2,211                           | (\$2,555) | \$2,945                         | \$1,993 |

### 7. Income Taxes

The following table presents components of income tax expense/(benefit) for the three and six month periods ended June 30, 2013 and 2012:

| (in thousands)   | Three months<br>ended<br>June 30, |           | Six months ended<br>June 30, |           |
|--|-----------------------------------|-----------|------------------------------|-----------|
|  | 2013                              | 2012      | 2013                         | 2012      |
| Income tax based on income from continuing operations, at estimated tax rates of 39.0% and 26.5%, respectively | (\$3,616)                         | \$6,133   | \$3,310                      | \$5,896   |
| Pension plan settlement  | -                                 | (37,047 ) | -                            | (39,460 ) |
| Tax rate adjustment on pension plan settlement   | -                                 | 886       | -                            | -         |
| Provision for change in estimated tax rates  | 888                               | (297 )    | -                            | -         |
| Income tax before discrete items   | (2,728 )                          | (30,325 ) | 3,310                        | (33,564 ) |
| Discrete tax expense/(benefit):  |                                   |           |                              |           |
| Provision for/resolution of tax audits and contingencies, net  | 425                               | 682       | 425                          | (6,051 )  |
| Repatriation of non-U.S. prior year earnings   | 186                               | -         | 186                          | -         |
| Adjustments to prior period tax liabilities  | (126 )                            | -         | 84                           | -         |

|                                    |           |            |         |            |
|------------------------------------|-----------|------------|---------|------------|
| Total income tax expense/(benefit) | (\$2,243) | (\$29,643) | \$4,005 | (\$39,615) |
|------------------------------------|-----------|------------|---------|------------|

The second quarter estimated effective tax rate on continuing operations was 39.0 percent in 2013 compared to 26.5 percent for the same period in 2012. The change in the estimated effective tax rate was primarily attributable to changes in the anticipated amount and distribution of income and loss among the countries in which we operate. The 2012 second quarter tax rate was also impacted by operating losses generated in tax jurisdictions where no tax benefit was recognized.

The Company records the residual U.S. and foreign taxes on certain amounts of current foreign earnings that have been targeted for repatriation to the U.S. As a result, such amounts are not considered to be permanently reinvested, and the Company accrued for the residual taxes on these earnings to the extent they cannot be repatriated in a tax-free manner. At June 30, 2013, the Company recorded a deferred tax liability of \$0.9 million on \$12.4 million of non-U.S. earnings that have been targeted for future repatriation to the U.S.

We conduct business globally and, as a result, the Company or one or more of our subsidiaries files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business we are subject to examination by taxing authorities throughout the world, including major jurisdictions as the United States, Brazil, Canada, France, Germany, Italy, Mexico, and Switzerland. Open tax years in these jurisdictions range from 2000 to 2012. We are currently under audit in the U.S. and non-U.S. tax jurisdictions, including but not limited to Canada, Germany, and France.

It is reasonably possible that over the next twelve months the amount of unrecognized tax benefits may change within a range of a net increase of \$0 million to a net decrease of \$2.5 million, from the reevaluation of uncertain tax positions arising in examinations, in appeals, or in the courts, or from the closure of tax statutes. Not included in the range is \$22.7 million of tax benefits in Germany related to a 1999 reorganization that have been challenged by the German tax authorities in the course of an audit, of which \$11.6 million would have a direct impact on our statement of income if resolved unfavorably. In 2008 the German Federal Tax Court (FTC) denied tax benefits to other taxpayers in a case involving German tax laws relevant to our reorganization. One of these cases involved a non-German party, and in the ruling in that case, the FTC acknowledged that the German law in question may be violative of European Union (EU) principles and referred the issue to the European Court of Justice (ECJ) for its determination on this issue. In September 2009, the ECJ issued an opinion in this case that is generally favorable to the other taxpayer and referred the case back to the FTC for further consideration. In May 2010 the FTC released its decision, in which it resolved certain tax issues that may be relevant to our audit and remanded the case to a lower court for further development. In 2012, the lower court decided in favor of the taxpayer and the government appealed the findings to the FTC. Although we were required to pay tax and interest of approximately \$13.0 million to the German tax authorities in order to continue to pursue the position, when taking into consideration the ECJ decision, the latest FTC decision and the lower court decision, we believe that it is more likely than not that the relevant German law is violative of EU principles and, accordingly, we have not accrued tax expense on this matter. As we continue to monitor developments, it may become necessary for us to accrue tax expense and related interest.

## ***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.

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

| <b>(in thousands, except market price data)</b>   | Three months<br>ended<br>June 30,<br>2013 |            | Six months<br>ended<br>June 30,<br>2012 |          |
|---|---|------------|---|----------|
| Net income/(loss) available to common shareholders  | (\$7,379)                                 | (\$33,745) | \$4,132                                 | \$13,296 |
| Weighted average number of shares:  |   |            |   |          |
| Weighted average number of shares used in calculating basic net income/(loss) per share   | 31,628                                    | 31,349     | 31,562                                  | 31,329   |
| Effect of dilutive stock-based compensation plans:  |   |            |   |          |
| Stock options   | -   | -          | 125                                     | 69       |
| Long-term incentive plan  | -   | -          | 169                                     | 120      |
| Weighted average number of shares used in calculating diluted net income/(loss) per share | 31,628                                    | 31,349     | 31,856                                  | 31,518   |
| Average market price of common stock used for calculation of dilutive shares              | \$30.59                                   | \$20.22    | \$28.53                                 | \$22.08  |
| Net income per share:   |   |            |   |          |
| Basic   | (\$0.23 )                                 | (\$1.08 )  | \$0.13                                  | \$0.42   |
| Diluted   | (\$0.23 )                                 | (\$1.08 )  | \$0.13                                  | \$0.42   |

As a result of a net loss in the second quarter of 2013 and 2012, the potential dilutive effect of stock-based compensation plans was not included in the computation of diluted earnings per share for these periods because to do so would have been antidilutive.

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 |
|----------------|-------------------|-------------------|--------------------------|---------------------------|
| June 30, 2013  | 36,875,127        | 3,236,098         | (8,463,635)              | 31,647,590                |
| March 31, 2013 | 36,827,227        | 3,236,098         | (8,467,873)              | 31,595,452                |
| June 30, 2012  | 36,589,304        | 3,236,098         | (8,467,873)              | 31,357,529                |

### ***9. Accumulated Other Comprehensive Income***

The Company adopted the provisions of Accounting Standards Update 2013-02 in the first quarter of 2013, which requires enhanced disclosures of Accumulated Other Comprehensive Income.

The table below presents changes in the components of Accumulated Other Comprehensive Income for the period December 31, 2012 to June 30, 2013:

14



| (in thousands)   | Translation<br>adjustments | Pension and<br>postretirement<br>liability<br>adjustments | Derivative<br>valuation<br>adjustment | Total Other<br>Comprehensive<br>Income |
|--|----------------------------|---|---------------------------------------|--|
| Balance, December 31, 2012   | (\$7,659 )                 | (\$69,484 )   | (\$2,878 )                            | (\$80,021 )                            |
| Other comprehensive income before reclassifications  | (14,494 )                  | 1,225   | 2,301                                 | (10,968 )                              |
| Interest expense related to swaps reclassified to the Statement of Operations, net of tax            |                            |   | (549 )                                | (549 )                                 |
| Pension and postretirement liability adjustments reclassified to Statement of Operations, net of tax |                            | 1,004   |                                       | 1,004                                  |
| Net current period other comprehensive income  | (14,494 )                  | 2,229   | 1,752                                 | (10,513 )                              |
| Balance, June 30, 2013   | (\$22,153 )                | (\$67,255 )   | (\$1,126 )                            | (\$90,534 )                            |

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

| (in thousands)  | Three months<br>ended<br>June 30, 2013 | Six months<br>ended<br>June 30, 2013 |
|---|--|--------------------------------------|
| Pretax Derivative valuation reclassified from Accumulated Other Comprehensive Income:                   |  |                                      |
| Swap interest expense   | (\$500 )                               | (\$900 )                             |
| Income tax effect   | (195 )                                 | (351 )                               |
| Effect on net income due to items reclassified from Accumulated Other Comprehensive Income              | (\$305 )                               | (\$549 )                             |
| Pretax pension and postretirement liabilities reclassified from Accumulated Other Comprehensive Income: |  |                                      |
| Amortization of prior service cost/(credit)   | (\$908 )                               | (\$1,817 )                           |
| Amortization of transition obligation   | 17                                     | 34                                   |
| Amortization of net actuarial loss  | 1,664                                  | 3,328                                |
| Total pretax amount reclassified  | 773                                    | 1,545                                |
| Income tax effect   | (270 )                                 | (541 )                               |
| Effect on net income due to items reclassified from Accumulated Other Comprehensive Income              | \$503                                  | \$1,004                              |

***10. Accounts Receivable***

Accounts receivable includes trade receivables and revenue in excess of progress billings on Engineered Composites contracts accounted for under the percentage of completion method. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company determines the allowance based on historical write-off experience, customer specific facts and economic conditions. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

15

The components of Accounts receivable are summarized below:

| <b>(in thousands)</b>                                      | <b>June 30, 2013</b> | December 31, 2012 |
|--|----------------------|-------------------|
| Trade accounts receivable                                  | <b>\$154,279</b>     | \$149,737         |
| Revenue in excess of progress billings                     | <b>15,688</b>        | 17,105            |
| Receivables related to the sale of discontinued businesses | <b>16,795</b>        | 16,555            |
| Less: allowance for doubtful accounts                      | <b>(11,881)</b>      | (11,862)          |
| Total Accounts receivable, net                             | <b>\$174,881</b>     | \$171,535         |

### ***11. Inventories***

The components of Inventories are summarized below:

| <b>(in thousands)</b>     | <b>June 30, 2013</b> | December 31, 2012 |
|---------------------------|----------------------|-------------------|
| Finished goods            | <b>\$48,698</b>      | \$49,235          |
| Work in process           | <b>42,871</b>        | 44,866            |
| Raw material and supplies | <b>25,874</b>        | 25,082            |
| Total inventories         | <b>\$117,443</b>     | \$119,183         |

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

### ***12. Goodwill and Other Intangible Assets***

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

Determining the fair value of a reporting unit requires the use of significant estimates and assumptions, including revenue growth rates, operating margins, discount rates, and future market conditions, among others. Goodwill and other long-lived assets are reviewed for impairment whenever events, such as significant changes in the business climate, plant closures, changes in product offerings, or other circumstances indicate that the carrying amount may not be recoverable.

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

earn.

The entire balance of goodwill is attributable to the Machine Clothing business. In the second quarter of 2013 the Company applied the quantitative assessment approach in performing its annual evaluation of goodwill and concluded that no impairment provision was required. In addition, there were no amounts at risk due to the large spread between the fair and carrying values.

16

We are continuing to amortize certain patents, trade names, customer contracts and technology assets that have finite lives. The changes in intangible assets and goodwill from December 31, 2012 to June 30, 2013, were as follows:

| (in thousands)                    | Balance at<br>December 31, 2012 | <b>Amortization</b> | Currency<br>Translation | Balance at<br>June 30, 2013 |
|-----------------------------------|---------------------------------|---------------------|-------------------------|-----------------------------|
| Amortized intangible assets:      |                                 |                     |                         |                             |
| AEC trade names                   | \$38                            | (\$2 )              | \$ -                    | \$36                        |
| AEC customer contracts            | 606                             | (101 )              | -                       | 505                         |
| AEC technology                    | 204                             | (12 )               | -                       | 192                         |
| Total amortized intangible assets | \$848                           | (\$115 )            | \$ -                    | \$733                       |
| Unamortized intangible assets:    |                                 |                     |                         |                             |
| Goodwill                          | \$76,522                        | \$ -                | (\$834 )                | \$75,688                    |

As of June 30, 2013, the balance of goodwill was \$75.7 million and was completely attributable to our Machine Clothing reportable segment.

Estimated amortization expense of intangibles for the years ending December 31, 2013 through 2017, is as follows:

| <b>Annual amortization</b> |       |
|----------------------------|-------|
| <b>Year (in thousands)</b> |       |
| 2013                       | \$231 |
| 2014                       | 231   |
| 2015                       | 231   |
| 2016                       | 29    |
| 2017                       | 29    |

**13. Financial Instruments**

Long-term debt consists of:

| (in thousands, except interest rates)  | June 30,<br>2013 | December<br>31, 2012 |
|--|------------------|----------------------|
| Convertible notes, par value \$28,437, issued in March 2006 with fixed contractual interest rates of 2.25%, due in 2026, redeemed March 2013   | \$-              | \$28,261             |
| Private placement with a fixed interest rate of 6.84%, due in 2013 through 2017  | 150,000          | 150,000              |
| Credit agreement with borrowings outstanding at an end of period interest rate of 2.75% in 2013 and 3.92% in 2012, due in 2018   | 164,000          | 132,000              |
| Various notes and mortgages relative to operations principally outside the United States, at an average end of period rate of 3.07% in 2013 and 3.06% in 2012, due in varying amounts through 2021 | 6,382            | 8,892                |
| Long-term debt   | 320,382          | 319,153              |
| Less: current portion  | (55,014 )        | (83,276 )            |
| Long-term debt, net of current portion   | \$265,368        | \$235,877            |

The note agreement and guaranty (“Prudential agreement”) was entered into in October 2005, and was amended and restated September 17, 2010 and March 26, 2013, with the Prudential Insurance Company of America, and on certain other purchasers, in an aggregate principal amount of \$150 million, with interest at 6.84% and a maturity date of October 25, 2017. There are mandatory payments of \$50 million 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 Prudential agreement contains customary terms, as well as affirmative covenants, negative covenants, and events of default comparable to those in our current principal credit facility (as described below). For disclosure purposes, we are required to measure the fair value of outstanding debt on a recurring basis. As of June 30, 2013, the fair value of the Prudential agreement was approximately \$168.5 million, which was measured using active market interest rates, which would be considered Level 2 for fair value measurement purposes.

On March 26, 2013, we entered into a \$330 million, unsecured Five-Year Revolving Credit Facility Agreement (“Credit agreement”), under which \$164 million of borrowings were outstanding as of June 30, 2013. The Credit agreement replaces the previous \$390 million five-year Credit agreement made in 2010. The applicable interest rate for borrowings under the Credit agreement, as well as under the former agreement, is LIBOR plus a spread, based on our leverage ratio at the time of borrowing. At the time of the last borrowing on June 24, 2013, the spread was 1.375%. The spread is based on a pricing grid, which can go as low as 1.25% or as high as 1.875%, based on our

leverage ratio.

Our ability to borrow additional amounts under the Credit agreement is conditional upon the absence of any defaults, as well as the absence of any material adverse change. Based on our maximum leverage ratio and our consolidated EBITDA (as defined in the Credit agreement), and

18

without modification to any other Credit agreements, as of June 30, 2013 we would have been able to borrow an additional \$166 million under the Credit agreement.

On July 16, 2010, we entered into interest rate hedging transactions that have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$105 million of the indebtedness drawn under the Credit agreement at the rate of 2.04% for five years. Under the terms of these transactions, we pay the fixed rate of 2.04% and the counterparties pay a floating rate based on the three-month LIBOR rate at each quarterly calculation date, which on April 16, 2013 was 0.28%. The net effect is to fix the effective interest rate on \$105 million of indebtedness at 2.04%, plus the applicable spread, until these swap agreements expire on July 16, 2015. As of June 30, 2013, the all-in rate on the \$105 million of debt was 3.415%.

On May 20, 2013, we entered into interest rate hedging transactions for the period July 16, 2015 through March 16, 2018. These transactions have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$110 million of the indebtedness drawn under the Credit agreement at the rate of 1.414% during this period. Under the terms of these transactions, we pay the fixed rate of 1.414% and the counterparties pay a floating rate based on the one-month LIBOR rate at each monthly calculation date, which on June 28, 2013 was 0.19%. The net effect is to fix the effective interest rate on \$110 million of indebtedness at 1.414%, plus the applicable spread, during the swap period.

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

We are currently required to maintain a leverage ratio of not greater than 3.50 to 1.00 and minimum interest coverage of 3.00 to 1.00 under the Credit agreement and Prudential agreement.

As of June 30, 2013, our leverage ratio was 1.75 to 1.00 and our interest coverage ratio was 8.57 to 1.00. We may purchase our Common Stock or pay dividends to the extent our leverage ratio remains at or below 3.50 to 1.00, and may make acquisitions with cash provided our leverage ratio would not exceed 3.50 to 1.00 after giving pro forma effect to the acquisition.

On March 15, 2013, the Company redeemed, at 100 percent of par, all remaining 2.25% Convertible Senior Notes due 2026 (the "Notes"). The cash payments of \$28.4 million were funded by increased borrowings under the Credit agreement.

In connection with the sale of the Notes, we entered into hedge and warrant transactions with respect to our Class A common stock. These transactions were intended to reduce the potential dilution upon conversion of the Notes by



providing us with the option, subject to certain exceptions, to acquire shares in an amount equal to the number of shares that we 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. The Notes hedge and warrant transactions had a net cost of \$14.7 million. The hedge transactions expired on March 15, 2013.

Pursuant to the warrant transactions, we sold a total of 4.1 million 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, which began on June 15, 2013, with a final expiration date of September 10, 2013. If the warrants are exercised when they expire, we may choose either net cash or net share settlement. If the warrants are exercised before they expire, they must be net share settled. If we elect to net cash settle the warrants, we 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 our Class A common stock on the expiration date of such warrants (the “settlement price”) over the strike price. Under net share settlement, we will deliver to the warrant holders a number of shares of our Class A common stock equal to, for each exercise of warrants, the amount payable upon net cash settlement divided by the settlement price.

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

We were in compliance with all debt covenants as of June 30, 2013.

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

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Accounting principles establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. 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 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 in which there is little, if any, market activity for the asset or liability.

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

20

| (in thousands)                         | Total fair<br>value | Quoted<br>prices in<br>active<br>markets<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) |
|--|---------------------|---|---|
| Fair Value at June 30, 2013            |                     |   |   |
| Assets:                                |                     |   |   |
| Cash equivalents                       | \$30,586            | \$30,586  | \$ -  |
| Other assets:                          |                     |   |   |
| Common stock of foreign public company | 848                 | 848   | -   |
| Interest rate swap                     | 1,852               | -   | 1,852   |
| Liabilities:                           |                     |   |   |
| Other noncurrent liabilities:          |                     |   |   |
| Interest rate swap                     | (3,699 )            | -   | (3,699 )  |
| Fair Value at December 31, 2012        |                     |   |   |
| Assets:                                |                     |   |   |
| Cash equivalents                       | \$33,171            | \$33,171  | \$ -  |
| Other assets:                          |                     |   |   |
| Common stock of foreign public company | 562                 | 562   | -   |
| Interest rate swap                     | -                   | -   | -   |
| Liabilities:                           |                     |   |   |
| Other noncurrent liabilities:          |                     |   |   |
| Interest rate swap                     | (4,718 )            | -   | (4,718 )  |

During the six-months ended June 30, 2013, there were no transfers between levels 1, 2, and 3.

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

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

Foreign currency instruments are entered into periodically, and consist of foreign currency option contracts and forward contracts that are valued using quoted prices in active markets obtained from independent pricing sources. These instruments are measured using market foreign exchange prices and are recorded in the Consolidated Balance Sheets as Other current assets and Accounts payable, as applicable. Changes in fair value of these instruments are recorded as gains or losses within Other (income)/expense. There were no gains/(losses) for the six months ended June 30, 2013, and there were no open contracts at that date. Gains for the six months ended June 30, 2012 were \$0.1 million.

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

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

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

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

The interest rate swaps are accounted for as hedges of future cash flows. The fair value of our interest rate swaps are derived from a discounted cash flow analysis based on the terms of the contract and the interest rate curve, and is included in Other assets and Other noncurrent liabilities in the Consolidated Balance Sheet. As of June 30, 2013, we reported an asset of \$1.9 million, which is comprised of a liability of \$4.1 million for the floating rate leg and a receivable of \$5.9 million for the fixed rate leg, and a liability of \$3.7 million, which is comprised of a liability of \$4.9 million for the fixed rate leg, and a receivable of \$1.2 million for the floating rate leg. Unrealized gains and losses on the swaps will flow through the caption Derivative valuation adjustment in the Shareholders' equity section of the Consolidated Balance Sheets, to the extent that the hedges are highly effective. Gains and losses related to the ineffective portion of the hedges will be recognized in the current period in earnings. Amounts accumulated in Other comprehensive income are reclassified as Interest expense, net when the related interest payments (that is, the hedged forecasted transactions) affect earnings. Interest expense related to the swaps totaled \$0.9 million and \$0.8 million for the six months ended June 30, 2013 and 2012, respectively.

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

|   | Three<br>months<br>ended<br>June 30,<br><b>2013</b> | Six<br>months<br>ended<br>June 30,<br><b>2012</b> | Three<br>months<br>ended<br>June 30,<br><b>2013</b> | Six<br>months<br>ended<br>June 30,<br><b>2012</b> |
|---|---|---|---|---|
| (in thousands)                                    |   |   |   |   |
| Derivatives not designated as hedging instruments |   |   |   |   |
| Forward exchange options                          | -   | 119   | -   | 118   |



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

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

We were defending 4,295 claims as of July 19, 2013.

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

| <i>Year ended<br/>December 31,</i> | <i>Opening Number of Claims</i> | <i>Claims Dismissed,<br/>Settled, or<br/>Resolved</i> | <i>New Claims</i> | <i>Closing Number<br/>of Claims</i> | <i>Amounts Paid<br/>(thousands) to<br/>Settle or<br/>Resolve</i> |
|------------------------------------|---------------------------------|---|-------------------|-------------------------------------|--|
| 2005                               | 29,411                          | 6,257   | 1,297             | 24,451                              | \$ 504   |
| 2006                               | 24,451                          | 6,841   | 1,806             | 19,416                              | 3,879  |
| 2007                               | 19,416                          | 808   | 190               | 18,798                              | 15   |
| 2008                               | 18,798                          | 523   | 110               | 18,385                              | 52   |
| 2009                               | 18,385                          | 9,482   | 42                | 8,945                               | 88   |
| 2010                               | 8,945                           | 3,963   | 188               | 5,170                               | 159  |
| 2011                               | 5,170                           | 789   | 65                | 4,446                               | 1,111  |
| 2012                               | 4,446                           | 90  | 107               | 4,463                               | 530  |
| <b>2013 as of July 19</b>          | <b>4,463</b>                    | <b>215</b>  | <b>47</b>         | <b>4,295</b>                        | <b>\$ 3</b>  |

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

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

While we believe we have meritorious defenses to these claims, we have settled certain claims for amounts we consider reasonable given the facts and circumstances of each case. Our insurer, Liberty Mutual, has defended each case and funded settlements under a standard reservation of rights. As of July 19, 2013, we had resolved, by means of settlement or dismissal, 36,585 claims. The total cost of resolving all claims was \$8.6 million. Of this amount, almost 100% was paid by our

insurance carrier. The Company has over \$125 million in confirmed insurance coverage that should be available with respect to current and future asbestos claims, as well as additional insurance coverage that we should be able to access.

Brandon Drying Fabrics, Inc. (“Brandon”), a subsidiary of Geschmay Corp., which is a subsidiary of the Company, is also a separate defendant in many of the asbestos cases in which Albany is named as a defendant. Brandon was defending against 7,815 claims as of July 19, 2013.

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

| <i>Year ended<br/>December<br/>31,</i> | <i>Opening Number<br/>of Claims</i> | <i>Claims Dismissed,<br/>Settled, or<br/>Resolved</i> | <i>New Claims</i> | <i>Closing<br/>Number 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                               | 1,182   | 730               | 9,114                                   | 0  |
| 2007                                   | 9,114                               | 462   | 88                | 8,740                                   | 0  |
| 2008                                   | 8,740                               | 86  | 10                | 8,664                                   | 0  |
| 2009                                   | 8,664                               | 760   | 3                 | 7,907                                   | 0  |
| 2010                                   | 7,907                               | 47  | 9                 | 7,869                                   | 0  |
| 2011                                   | 7,869                               | 3   | 11                | 7,877                                   | 0  |
| 2012                                   | 7,877                               | 12  | 2                 | 7,867                                   | 0  |
| <b>2013 as of July 19</b>              | <b>7,867</b>                        | <b>54</b>   | <b>2</b>          | <b>7,815</b>                            | <b>\$ 0</b>  |

We acquired Geschmay Corp., formerly known as Wangner Systems Corporation, in 1999. Brandon is a wholly owned subsidiary of Geschmay Corp. In 1978, Brandon acquired certain assets from Abney Mills (“Abney”), a South Carolina textile manufacturer. Among the assets acquired by Brandon from Abney were assets of Abney’s wholly owned subsidiary, Brandon Sales, Inc. which had sold, among other things, dryer fabrics containing asbestos made by its parent, Abney. Although Brandon manufactured and sold dryer fabrics under its own name subsequent to the asset purchase, none of such fabrics contained asbestos. Because Brandon did not manufacture asbestos-containing products, and because it does not believe that it was the legal successor to, or otherwise responsible for obligations of Abney with respect to products manufactured by Abney, it believes it has strong defenses to the claims that have been asserted against it. As of July 19, 2013, Brandon has resolved, by means of settlement or dismissal, 9,787 claims for a total of \$0.2 million. Brandon’s insurance carriers initially agreed to pay 88.2% of the total indemnification and defense costs related to these proceedings, subject to the standard reservation of rights. The remaining 11.8% of the costs had been borne directly by Brandon. During 2004, Brandon’s insurance carriers agreed to cover 100% of indemnification and defense costs, subject to policy limits and the standard reservation of rights, and to reimburse Brandon for all indemnity and defense costs paid directly by Brandon related to these proceedings.



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

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

Although we do not believe, based on currently available information and for the reasons stated above, that a meaningful estimate of a range of possible loss can be made with respect to such claims, based on our understanding of the insurance policies available, how settlement amounts have been allocated to various policies, our settlement experience, the absence of any judgments against the Company or Brandon, the ratio of paper mill claims to total claims filed, and the defenses available, we currently do not anticipate any material liability relating to the resolution of the aforementioned pending proceedings in excess of existing insurance limits. Consequently, we currently do not anticipate, based on currently available information, that the ultimate resolution of the aforementioned proceedings will have a material adverse effect on the financial position, results of operations, or cash flows of the Company. Although we cannot predict the number and timing of future claims, based on the foregoing factors and the trends in claims against us to date, we do not anticipate that additional claims likely to be filed against us in the future will have a material adverse effect on our financial position, results of operations, or cash flows. We are aware that litigation is inherently uncertain, especially when the outcome is dependent primarily on determinations of factual matters to be made by juries.

#### **NAFTA Audits**

The Company's affiliate in Mexico was notified in November 2010 that Mexican customs authorities expected to issue demands for duties on certain imports of paper machine clothing (PMC) from the Company and the Company's affiliate in Canada for which the Company has claimed duty-free treatment under the North American Free Trade Agreement ("NAFTA").

The notices result from a decision by the Mexican Servicio de Administración Tributaria ("SAT") to invalidate NAFTA certificates provided by the Company on products shipped to its Mexican affiliate during the years 2006 through 2008. The Demand Notices arose from an SAT audit during 2010, at the conclusion of which the SAT determined that the Company had failed to provide documentation sufficient to show that the certificates were validly issued, and declared the certificates issued during this period to be invalid. The Company believed that the certificates of origin were valid and properly issued and therefore commenced administrative appeals with SAT disputing its resolutions.

As a result of the aforementioned appeals, SAT ultimately revoked its earlier declarations of invalidation with respect to the certificates of origin at issue in all 36 open audit files, and ordered a further review of such certificates. The Company has now been informed that review of all 36 audit files has been completed, and that only a small number of shipments were ineligible for duty-free NAFTA treatment, primarily due to some alternative raw material that was sourced from Europe during a brief period when sufficient U.S.-sourced material was temporarily unavailable. As a result, the Company could be liable for an immaterial amount of tariff charges and penalties with respect to the

shipments determined to be ineligible. The Company does not believe that it faces any material risk of certificates being invalidated with respect to any period other than the 2006 through 2008 audit period. For this reason, the Company does not feel that this matter is likely to have a material adverse effect on the Company's financial position, results of operations and cash flows.

### 16. Changes in Shareholders' 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, 2012   | \$37                       | \$3                        | \$395,381                        | \$435,775            | (\$80,021 )  | (\$257,664)       | \$493,511                        |
| Net income  | -                          | -                          | -                                | 4,132                | -  | -                 | 4,132                            |
| Dividends declared  | -                          | -                          | -                                | (9,171 )             | -  | -                 | (9,171 )                         |
| Compensation and benefits paid or payable in Class A Common Stock | -                          | -                          | (1,311 )                         | -                    | -  | -                 | (1,311 )                         |
| Options exercised   | -                          | -                          | 3,492                            | -                    | -  | -                 | 3,492                            |
| Shares issued to Directors  | -                          | -                          | 44                               | -                    | -  | 93                | 137                              |
| Cumulative translation adjustment                                 | -                          | -                          | -                                | -                    | (14,494 )  | -                 | (14,494 )                        |
| Change in pension liability adjustment                            | -                          | -                          | -                                | -                    | 2,229  | -                 | 2,229                            |
| Change in derivative valuation adjustment                         | -                          | -                          | -                                | -                    | 1,752  | -                 | 1,752                            |
| June 30, 2013   | \$37                       | \$3                        | \$397,606                        | \$430,736            | (\$90,534 )  | (\$257,571)       | \$480,277                        |

### 17. Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued ASU 2013-02 which requires enhanced disclosures about changes in Accumulated Other Comprehensive Income. We adopted these provisions in the first quarter of 2013 by adding a Note to the Consolidated Financial Statements that provides the additional disclosures.

In the first quarter of 2013, the Company adopted the provisions of ASU 2013-01 which requires enhanced disclosures of the effect or potential effect of netting arrangements on an entity's financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities within the scope of this Update. The Company has an interest rate swap agreement that is within the scope of Update and we have added additional disclosure in the Notes to Consolidated Financial Statements about the offsetting asset and liability components of that agreement.

### Forward-looking statements

This quarterly report and the documents incorporated or deemed to be incorporated by reference in this quarterly report contain statements concerning our future results and performance and other matters that are “forward-looking” statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The words “believe,” “expect,” “intend,” “estimate,” “anticipate,” “project,” “will,” “and similar expressions identify forward-looking statements, which generally are not historical in nature. Forward-looking statements are subject to certain risks and uncertainties (including, without limitation, those set forth in the Company’s most recent Annual Report on Form 10-K or prior Quarterly Reports

on Form 10-Q) that could cause actual results to differ materially from the Company's historical experience and our present expectations or projections.

Forward-looking statements in this quarterly report include, without limitation, statements about economic and paper industry trends and conditions during 2013 and in future years; sales, EBITDA, Adjusted EBITDA and operating income expectations in 2013 and in future periods in each of the Company's businesses and for the Company as a whole; the timing and impact of production and development programs in the Company's AEC business segment and AEC sales growth potential; the amount and timing of capital expenditures, future tax rates and cash paid for taxes, depreciation and amortization; the amount and timing of charges related to announced restructuring activities; future debt levels and debt covenant ratios, and future revaluation gains and losses. Furthermore, a change in any one or more of the foregoing factors could have a material effect on the Company's financial results in any period. Such statements are based on current expectations, and the Company undertakes no obligation to publicly update or revise any forward-looking statements.

Statements expressing management's assessments of the growth potential of its businesses, or referring to earlier assessments of such potential, are not intended as forecasts of actual future growth, and should not be relied on as such. While management believes such assessments to have a reasonable basis, such assessments are, by their nature, inherently uncertain. This release and earlier releases set forth a number of assumptions regarding these assessments, including historical results, independent forecasts regarding the markets in which these businesses operate, and the timing and magnitude of orders for our customers' products. Historical growth rates are no guarantee of future growth, and such independent forecasts and assumptions could prove materially incorrect, in some cases.

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 the "Business Environment and Trends," "Liquidity and Capital Resources," and "Legal Proceedings" sections of this quarterly report, in Note 15 of Notes to Consolidated Financial Statements, as well as in the "Risk Factors", section of our most recent Annual Report on Form 10-K. Although we believe the expectations reflected in our forward-looking statements are based upon reasonable assumptions, it is not possible to foresee or identify all factors that could have a material and negative impact on future performance. The forward-looking statements included or incorporated by reference in this quarterly report are made on the basis of our assumptions and analyses, as of the time the statements are made, in light of their experience and perception of historical conditions, expected future developments and other factors believed to be appropriate under the circumstances.

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

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

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

### *Overview*

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

Machine Clothing is the Company's long-established core business and primary generator of cash. While the paper and paperboard industry in our traditional geographic markets has suffered from well-documented overcapacity in publication grades, especially newsprint, the industry is still expected to grow on a global basis, driven by demand for packaging and tissue grades, as well as the expansion of paper consumption and production in Asia and South America. Although we do not consider the market for Machine Clothing as having significant growth potential, we do believe it provides the Company with significant prospects for long-term cash generation. We feel we are now well-positioned in these markets, with high-quality, low-cost production in growth markets, substantially lower fixed costs in mature markets, and continued strength in new product development, field services, and manufacturing technology. We seek to maintain the cash-generating potential of this business by maintaining the low costs that we achieved through restructuring, and competing vigorously by using our differentiated products and services to reduce our customers' total cost of operation and improve their paper quality.

We believe that AEC provides the greatest growth potential, both near and long term, for our Company. Our strategy is to grow organically by focusing our proprietary technology on high-value aerospace and defense applications that cannot be served effectively by conventional composites. AEC supplies a number of customers in the aerospace industry. AEC's largest aerospace customer is the Safran Group, and the most significant program is the production of fan blades and other components for the LEAP engine. AEC is also developing other new and potentially significant composite products for aerospace (engine and airframe) applications.

### **Consolidated Results of Operations**

#### **Net sales**

The following table summarizes our net sales by business segment:

| (in thousands, except percentages) | Three months ended |           |        | Six months ended |           |        |
|------------------------------------|--------------------|-----------|--------|------------------|-----------|--------|
|                                    | June 30,           |           | %      | June 30,         |           | %      |
|                                    | 2013               | 2012      | Change | 2013             | 2012      | Change |
| Machine Clothing                   | \$177,536          | \$177,122 | 0.23%  | \$344,946        | \$341,410 | 1.04%  |
| Engineered Composites              | 20,438             | 14,818    | 37.93% | 39,682           | 30,607    | 29.65% |
| Total                              | \$197,974          | \$191,940 | 3.14%  | \$384,628        | \$372,017 | 3.39%  |

Net sales were affected by the following:

**Three month comparison**

Changes in currency translation rates had the effect of increasing net sales by \$0.1 million during the second quarter of 2013 as compared to 2012.

Excluding the effect of changes in currency translation rates, net sales increased 3.1% compared to the same period in 2012.

|   |   |   |
|---|---|---|
| · | § | Excluding the effect of changes in currency translation rates:<br>Net sales in MC increased 0.2%. |
| § | § | Net sales in Engineered Composites increased 37.9%.   |

**Six month comparison**

Changes in currency translation rates had the effect of decreasing net sales by \$0.3 million during 2013 as compared to 2012.

Excluding the effect of changes in currency translation rates, net sales increased 3.5% compared to the same period in 2012.

|   |   |   |
|---|---|---|
| · | § | Excluding the effect of changes in currency translation rates:<br>Net sales in MC increased 1.1%. |
| § | § | Net sales in Engineered Composites increased 29.7%.   |

**Gross Profit**

The following table summarizes gross profit by business segment:

| (in thousands, except percentages) | Three months ended |          | Six months ended |           |
|------------------------------------|--------------------|----------|------------------|-----------|
|                                    | June 30, 2013      | 2012     | June 30, 2013    | 2012      |
| Machine Clothing                   | \$77,797           | \$78,245 | \$151,786        | \$146,243 |
| Engineered Composites              | 667                | 1,311    | 481              | 2,704     |
| Unallocated expenses               | (1,031 )           | (1,056 ) | (2,065 )         | (2,161 )  |
| Total                              | \$77,433           | \$78,500 | \$150,202        | \$146,786 |
| % of Net Sales                     | 39.1 %             | 40.9 %   | 39.1 %           | 39.5 %    |

**Three month comparison**

The decrease in gross profit, compared to the same period in 2012, was principally due to the net effect of the following:

Gross profit margins in MC decreased slightly from 44.2 percent to 43.8 percent. AEC profit margin was negatively affected by \$0.9 million of inventory write-offs associated with a legacy program at the Company's Boerne, Texas, facility.

*Six month comparison*

The increase in gross profit during 2013 was principally due to the net effect of the following:

A \$4.0 million increase due to higher gross profit margin in MC. The improved gross profit margin reflects strong performance in the Americas and the cumulative effect of productivity improvements and restructuring.

A \$1.5 million increase due to higher sales in MC.

A \$1.1 million decrease in AEC due to negative effects of inventory write-offs associated with a legacy program at the Company's Boerne, Texas, facility.



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

The following table summarizes STG&R by business segment:

| (in thousands)        | Three months ended |          | Six months ended |           |
|-----------------------|--------------------|----------|------------------|-----------|
|                       | June 30,           | June 30, | June 30,         | June 30,  |
|                       | 2013               | 2012     | 2013             | 2012      |
| Machine Clothing      | \$32,867           | \$30,345 | \$63,755         | \$66,825  |
| Engineered Composites | 2,402              | 1,680    | 3,835            | 3,044     |
| Research              | 7,673              | 7,253    | 14,664           | 13,318    |
| Unallocated expenses  | 13,683             | 11,514   | 23,986           | 27,367    |
| Total                 | \$56,625           | \$50,792 | \$106,240        | \$110,554 |
| % of Net Sales        | 28.6               | % 26.5   | % 27.6           | % 29.7    |

***Three month comparison***

STG&R expenses increased \$5.8 million, compared to the same period in 2012, principally due to the net effect of the following:

Revaluation of nonfunctional currency assets and liabilities resulted in gains of \$0.5 million during the second quarter of 2013 and gains of \$2.7 million in the comparable quarter of 2012.

Adjustments to various accruals, including incentive compensation accruals that are tied to the Company's share price, were unfavorably adjusted by \$0.4 million in 2013, and favorably adjusted by \$1.5 million in 2012.

U.S. Pension expense decreased by \$0.4 million principally due to the settlement in 2012 of certain pension plan liabilities.

***Six month comparison***

A gain on the sale of former manufacturing facility in Australia reduced 2013 expenses by \$3.8 million.

Revaluation of nonfunctional currency assets and liabilities resulted in gains of \$1.2 million during 2013 and gains of \$1.0 million in 2012.

U.S. Pension expense decreased by \$1.6 million principally due to the settlement in 2012 of certain pension plan liabilities.

**Operating Income**

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

| <b>(in thousands)</b>                     | Three months ended      |            | Six months ended        |            |
|---|-------------------------|------------|-------------------------|------------|
|   | June 30,<br><b>2013</b> | 2012       | June 30,<br><b>2013</b> | 2012       |
| Machine Clothing                          | <b>\$20,699</b>         | \$44,997   | <b>\$63,607</b>         | \$75,842   |
| Engineered Composites                     | <b>(1,825)</b>          | (369)      | <b>(3,888)</b>          | (340)      |
| Research expense                          | <b>(7,673)</b>          | (7,253)    | <b>(14,664)</b>         | (13,318)   |
| Unallocated expenses - pension settlement | -                       | (110,560)  | -                       | (119,735)  |
| Unallocated expenses - other              | <b>(14,714)</b>         | (12,819)   | <b>(26,050)</b>         | (29,362)   |
| Total                                     | <b>(\$3,513)</b>        | (\$86,004) | <b>\$19,005</b>         | (\$86,913) |

## Pension Settlement Expense

In 2012, we took actions to settle certain pension plan liabilities in the U.S., Canada, and Sweden leading to charges totaling \$119.7 million, which were included in Unallocated Expenses. In the first quarter of 2012, we recorded a settlement charge of \$9.2 million related to the extinguishment of our pension plan liability in Sweden. In the second quarter of 2012, we recorded settlement charges totaling \$110.6 million related to settling a majority of the defined benefit pension plan liabilities in the United States and Canada. No similar charges were incurred during 2013.

## Restructuring Expense

In addition to the items discussed above affecting gross profit, STG&R, and pension settlement charges, operating income was affected by restructuring costs of \$24.3 million in the second quarter of 2013 and \$3.2 million in the second quarter of 2012.

The following table summarizes restructuring expense by business segment:

| (in thousands)        | Three months ended |         | Six months |         |
|-----------------------|--------------------|---------|------------|---------|
|                       | 2013               | 2012    | 2013       | 2012    |
| Machine Clothing      | \$24,230           | \$2,903 | \$24,423   | \$3,576 |
| Engineered Composites | 91                 | -       | 534        | -       |
| Unallocated expenses  | -                  | 249     | -          | (166)   |
| Total                 | \$24,321           | \$3,152 | \$24,957   | \$3,410 |

Substantially all of the restructuring charges recorded in the second quarter of 2013 relate to the completion of consultations with employee works councils in Sélestat and St. Junien, France, which will result in the reduction of approximately 200 employees, most of which will leave the Company during the third quarter of 2013. The restructuring program was driven by the Company's need to balance manufacturing capacity and demand. The restructuring charges recorded primarily related to severance and social costs. Under the terms of the restructuring plan, the Company will also provide training, outplacement and other programs. The costs for those benefits will be recorded as restructuring in future quarters when they are incurred and are expected to total \$6 to \$8 million. The Company expects to record a pension curtailment gain the second half of 2013 related to this restructuring activity, but the amount has not yet been determined. Whereas most of the affected employees were involved in the production process, the full effect of cost savings associated with the restructuring, estimated to be \$10 million per year, will not be fully realized until the second half of 2014. The effects of the cost reduction will principally affect cost of goods sold.

Through the first six months of 2013, the Company incurred some restructuring costs in the Engineered Composites segment that were related to organizational changes and exiting certain aerospace programs.

The 2012 restructuring expense was principally due to a reduction in workforce in Sweden and curtailment of manufacturing in New York and Wisconsin which was related to the lower demand for paper machine clothing. Those costs were partially offset by a reduction in accruals related to the Company's headquarters.

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

**Other Earnings Items**

| <b>(in thousands)</b>                                  | Three months ended      |          | Six months ended        |          |
|--|-------------------------|----------|-------------------------|----------|
|  | June 30,<br><b>2013</b> | 2012     | June 30,<br><b>2013</b> | 2012     |
| Interest expense, net                                  | <b>\$3,547</b>          | \$3,969  | <b>\$7,572</b>          | \$8,613  |
| Other expense/(income), net                            | <b>2,211</b>            | (2,555)  | <b>2,945</b>            | 1,993    |
| Income tax expense/(benefit)                           | <b>(2,243)</b>          | (29,643) | <b>4,005</b>            | (39,615) |
| (Loss)/income from discontinued operations, net of tax | <b>(351)</b>            | 24,030   | <b>(351)</b>            | 71,200   |
| Net income/(loss)                                      | <b>(7,379)</b>          | (33,745) | <b>4,132</b>            | 13,296   |

**Interest Expense, net**

Year to date interest expense, net, decreased \$1.0 million compared to the first six months of 2012 and \$0.5 million in the second quarter as compared to prior year principally due to a reduction in interest rates under our Credit agreement. The average balance outstanding under our revolving credit agreement for the first six months of 2013 and 2012 was \$155.4 million and \$158.8 million, respectively. For more information on borrowings and interest rates, see Note 13 to the Consolidated Financial Statements in Item 1 which is incorporated herein by reference.

In March 2013, the Company amended and extended its Credit agreement and also amended its Prudential agreement to substantially conform financial and other covenants to the Credit agreement. The total cost for the amendments was \$1.6 million. At March 2013 debt levels, the annual savings in interest and associated fees resulting from improved terms of the Credit agreement would be approximately \$1.9 million. See the Capital Resources section below for further discussion of borrowings and interest rates.

**Other Expense/(Income), net*****Three month comparison***

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

Foreign currency revaluations of intercompany balances resulted in losses of \$1.9 million in the second-quarter 2013 income, but resulted in gains of \$3.1 million in the same quarter in 2012. The revaluation effects were principally due to the euro's relative strength against the U.S. dollar, Canadian dollar, Australian dollar, and Japanese yen.

***Six month comparison***

Foreign currency revaluations of intercompany balances resulted in losses of \$1.9 million for the first six months of 2013 income and losses of \$0.7 million for the same period in 2012. The revaluation effects were principally due to the euro's relative strength against the U.S. dollar, Canadian dollar, Australian dollar, and Japanese yen.

### **Income Tax**

The Company has operations which constitute a taxable presence in 16 countries outside of the United States. All of these countries except one had income tax rates that were lower than the United States federal tax rate of 35% during the periods reported. The jurisdictional location of earnings is a significant component of our effective tax rate each year and therefore on our overall income tax expense.

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

The Company's effective tax rates for the second quarters of 2013 and 2012 were 24.2% and 33.9%, respectively. The tax rate is affected by recurring items, such as the income tax rate in the U.S. and in non-U.S. jurisdictions and the mix of income earned in those jurisdictions. The tax rate is also affected by U.S. tax costs on foreign earnings that have been or will be repatriated to the U.S., and by discrete items that may occur in any given year, but are not consistent from year to year.

Significant items that impacted the tax rate in the second quarter of 2013 included the following (percentages reflect the effect of each item as a percentage of income before income taxes):

• A \$1.4 million (14.8%) net charge related to discrete items and the effect of a change in the estimated tax rate for the year.

• The income tax rate on continuing operations, excluding the items above, was 39.0%.

Significant items that impacted the second-quarter 2012 tax rate included the following:

• A \$0.4 million (0.4%) net charge related to discrete items and the effect of a change in the estimated tax rate for the year.

• A \$36.2 million (41.4%) discrete income tax benefit related to pension settlements in Sweden and the U.S.

• The income tax rate on continuing operations, excluding the items above, was 26.5%.

### ***Six month Comparison***

The Company's effective tax rate for the first six-month periods of 2013 and 2012 was 47.2% and 40.6%, respectively. The tax rate is affected by recurring items, such as the income tax rate in the U.S. and in non-U.S. jurisdictions and the mix of income earned in those jurisdictions. The tax rate is also affected by U.S. tax costs on foreign earnings that have been or will be repatriated to the U.S., and by discrete items that may occur in any given year but are not consistent from year to year.

Significant items that impacted the 2013 tax rate included the following (percentages reflect the effect of each item as a percentage of Income before income taxes):

• A \$0.7 million (8.2%) net tax expense related to discrete items.

• The income tax rate on continuing operations, excluding discrete items, was 39.0%.

Significant items that impacted the 2012 tax rate included the following:

• A \$39.5 million (40.5%) discrete income tax benefit related to pension settlements in Sweden and the U.S.

• A net discrete tax benefit of \$6.1 million (6.2%) primarily related to the settlement of a tax audit in Canada.

• The income tax rate on continuing operations, excluding discrete items, was 26.5%.

### **Income from Discontinued Operations**

In the first quarter of 2012, the Company completed the sale of its Albany Door Systems business and, in the second quarter 2012, the Company completed the sale of its PrimaLoft® Products business resulting in a pre-tax gain of \$92.7 million. Including operations of the discontinued business, recognition of pre-closing liabilities and related income taxes, six-month period loss from discontinued operations was \$0.4 million in 2013 and a gain of \$71.2 million in

2012.

33



## Segment Results of Operations

### Machine Clothing Segment

#### Business Environment and Trends

Machine Clothing is our primary business segment and has accounted for nearly 92% of our consolidated revenues during the first six months of 2013. Machine clothing is purchased primarily by manufacturers of paper and paperboard.

According to RISI, Inc., global production of paper and paperboard is expected to grow at an annual rate of 2-3% over the next five years, driven primarily by secular demand increases in the Asia and South America, with stabilization in the mature markets of Europe and North America.

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

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

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

#### Review of Operations

|                                    | Three months ended June 30, |           | Six months ended June 30, |           |
|------------------------------------|-----------------------------|-----------|---------------------------|-----------|
| (in thousands, except percentages) | 2013                        | 2012      | 2013                      | 2012      |
| Net sales                          | <b>\$177,536</b>            | \$177,122 | <b>\$344,946</b>          | \$341,410 |
| Gross profit                       | <b>77,797</b>               | 78,245    | <b>151,786</b>            | 146,243   |
| % of net sales                     | <b>43.8%</b>                | 44.2%     | <b>44.0%</b>              | 42.8%     |
| Operating income                   | <b>20,699</b>               | 44,997    | <b>63,607</b>             | 75,842    |

Net Sales

Net sales were affected by the following:

*Three month comparison*

Changes in currency translation rates had the effect of increasing 2013 sales by \$0.1 million. Excluding the effect of changes in currency translation rates, sales increased 0.2% compared to the same period in 2012.

The flat level of sales reflects stability in most of the geographic regions in which the Company competes.

*Six month comparison*

Changes in currency translation rates had the effect of decreasing 2013 sales by \$0.3 million. Excluding the effect of changes in currency translation rates, sales increased 1.1% compared to the same period in 2012.

Sales remained stable in Europe and Asia; compared to 2012 sales in Asia were 10% lower.

**Gross Profit**

*Three month comparison*

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

A \$0.6 million decrease due to a lower gross profit margin in MC.

A \$0.2 million increase due to a higher sales in MC.

*Six month comparison*

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

A \$4.0 million increase due to a higher gross profit margin in MC.

A \$1.5 million increase due to a higher sales in MC.

**Operating Income**

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

*Three month comparison*

Restructuring charges of \$24.2 million in second-quarter 2013 compared to \$2.9 million in the comparable period 2012.

Lower gross profit, as described above.

Revaluation of nonfunctional currency assets and liabilities resulted in second-quarter gains of \$0.5 million in 2013 and gains of \$2.7 million in the comparable period in 2012.

*Six month comparison*

Higher gross profit, as described above.

Revaluation of nonfunctional currency assets and liabilities resulted in gains of \$1.2 million in 2013 and gains of \$1.0 million in the comparable period in 2012.

Restructuring charges of \$24.4 million in 2013 compared to \$3.6 million in 2012.

## Engineered Composites Segment

### Business Environment and Trends

The Engineered Composites segment (AEC) provides custom-designed advanced composite structures based on proprietary technology to customers in the aerospace and defense industries. AEC's largest current development program relates to the LEAP engine being developed by CFM International. Under this program, AEC is developing a family of composite parts, including fan blades, to be incorporated into the LEAP engine. In 2012, approximately 25% of this segment's sales were related to U.S. government contracts or programs.

## Review of Operations

| (in thousands, except percentages) | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                    | 2013                           | 2012     | 2013                         | 2012     |
| Net sales                          | \$20,438                       | \$14,818 | \$39,682                     | \$30,607 |
| Gross profit                       | 667                            | 1,311    | 481                          | 2,704    |
| % of net sales                     | 3.3 %                          | 8.8 %    | 1.2 %                        | 8.8 %    |
| Operating income/(loss)            | (1,825 )                       | (369 )   | (3,888 )                     | (340 )   |

**Net Sales***Three and Six month comparison*

The increase in sales was principally due to LEAP program activities.

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

The decrease in gross profit included the following:

AEC gross margin was negatively affected by inventory write-offs associated with a legacy program at the Company's Boerne, Texas, facility that amounted to \$0.9 million in the second quarter and \$1.1 million for the first six months of 2013.

**Operating Income***Three and six month comparison*

Second-quarter 2013 operating income decreased principally due to the decrease in gross profit as described above.

**Liquidity and Capital Resources**

**Cash Flow Summary**

| (in thousands)   | Six months ended |            |
|--|------------------|------------|
|  | June 30,         |            |
|  | 2013             | 2012       |
| Net income   | \$4,132          | \$13,296   |
| Depreciation and amortization                                      | 31,955           | 32,238     |
| Changes in working capital   | 5,608            | (1,617 )   |
| Gain on disposition of assets                                      | (3,763 )         | (92,677 )  |
| Changes in long-term liabilities, deferred taxes and other credits | (3,991 )         | (125,244 ) |
| Write-off of pension liability adjustment                          | -                | 118,350    |
| Other operating items  | (1,633 )         | 2,206      |
| Net cash provided by/(used in) operating activities                | 32,308           | (53,448 )  |
| Net cash provided by/(used in) investing activities                | (22,188 )        | 136,456    |
| Net cash (used in) financing activities                            | (1,324 )         | (38,918 )  |
| Effect of exchange rate changes on cash flows                      | (2,193 )         | 1,593      |
| Increase in cash and cash equivalents                              | 6,603            | 45,683     |
| Cash and cash equivalents at beginning of year                     | 190,718          | 118,909    |
| Cash and cash equivalents at end of year                           | \$197,321        | \$164,592  |

## **Operating activities**

Cash provided by operating activities was \$32.3 million in 2013, compared to a use of \$53.4 million for the same period last year. Cash flow in 2012 was heavily influenced by contributions to pension plans, which is included in Changes in long-term liabilities, deferred taxes and other credits in the above table. As part of the Company's plan to fund or settle part of our pension liabilities in the U.S., Canada, and Sweden, \$30 million of cash was used to settle Swedish pension liabilities in Q1 2012, we contributed \$30 million in Q1 and \$20 million in Q2 to the U.S. pension plan, and subsequently settled two-thirds of our U.S. pension obligations, and \$18 million was contributed in Q2 to the plan in Canada to fully fund the plan and settle about half of the plan obligation. As a result of the settlement activities, the Company recorded total settlement expense of \$119.7 million in 2012, which included the write-off of \$118.4 million of deferred pension charges.

Changes in working capital provided cash flow of \$5.6 million in 2013, principally resulting from a \$6.7 million use of cash for Accounts receivable and Inventory, offset by a \$24.3 Accrued liability provision associated with the French restructuring as described in Note 5 to the Consolidated Financial statements. We expect substantially all of the France restructuring accrual will be paid in the second half of 2013. For the first six months of 2012, changes in working capital resulted in a use of cash of \$1.7 million that resulted primarily from an increase in Accounts receivable of \$10.5 million offset by decrease of \$7.4 million in Accrued liabilities in 2012. Including the utilization of net operating loss carry-forwards and other deferred tax assets, and payments related to tax audits cash paid for income taxes through the first two quarters of 2013 was \$14.6 million and is expected to total about \$25 million for the full year.

At June 30, 2013, the Company had \$197.3 million of cash and cash equivalents, of which \$183.1 million was held by subsidiaries outside of the United States. As disclosed in the Notes to Consolidated Financial Statements, we determined that all but \$12.4 million of this amount (which represents the amount of earnings to be repatriated to the United States at some point in the future) is intended to be utilized by these non-U.S. operations for an indefinite period of time. Our current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations or satisfy debt obligations in the United States. In the event that such funds were to be needed to fund operations in the U.S., and if associated accruals for U.S. tax have not already been provided, we would be required to accrue and pay additional U.S. taxes to repatriate these funds.

## **Investing Activities**

Capital spending for equipment and software was \$28.5 million for 2013, including \$16.8 million for the Engineered Composites segment and its expansion associated with the LEAP program. Depreciation and amortization was \$32.0 million for 2013, compared to \$32.2 million for 2012. We continue to expect that average capital spending, for the entire Company, during the five-year period 2012 to 2016 will be approximately \$70 million per year. During 2013, the Company completed the sale of its production facility in Gosford, Australia, resulting in net proceeds of \$6.3 million.

In January 2012, the Company completed the sale of Albany Door Systems, and in March 2012, we finalized certain postclosing adjustments that increased the sale price by \$5 million. As of December 31, 2012, \$122 million of the total \$135 million sale price had been received, with the remainder received in July 2013. During Q2 2012, the Company completed the sale of PrimaLoft® Products. Of the \$38 million sale price, \$34 million was received in June, with the remainder expected to be received in December 2013.



## Financing Activities

Dividends have been declared each quarter since the fourth quarter of 2001. Decisions with respect to whether a dividend will be paid, and the amount of the dividend, are made by the Board of Directors each quarter. The dividend declared in the fourth quarter of 2012 was also paid during that quarter which resulted in two dividend payments during the fourth quarter of 2012, and no cash payments for dividends during the first quarter of 2013. To the extent the Board declares cash dividends in the future, we expect to pay such dividends out of operating cash flows. Future cash dividends will also depend on debt covenants and on the Board's assessment of our ability to generate sufficient cash flows.

## Capital Resources

We finance our business activities primarily with cash generated from operations and borrowings, largely through our revolving credit agreement as discussed below. Our subsidiaries outside of the United States may also maintain working capital lines with local banks, but borrowings under such local facilities tend not to be significant. Substantially all of our cash balance at June 30, 2013 was held by non-U.S. subsidiaries. Based on cash on hand and credit facilities, we anticipate that the Company has sufficient capital resources to operate for the foreseeable future. We were in compliance with all debt covenants as of June 30, 2013.

On March 26, 2013, we entered into a \$330 million, unsecured Five-Year Revolving Credit Facility Agreement (the "Credit agreement"), under which \$164 million of borrowings were outstanding as of June 30, 2013. The Credit agreement replaces the previous \$390 million five-year facility agreement entered into in 2010. The applicable interest rate for borrowings under the Credit agreement, as well as under the former agreement, is LIBOR plus a spread, based on our leverage ratio at the time of borrowing. The Company also amended its note agreement with Prudential to substantially conform the financial and other covenants with the Credit agreement. The total cost for the amendments was \$1.6 million. At March 2013 debt levels, the annual savings in interest and associated fees resulting from improved terms of the Credit agreement would be approximately \$1.9 million. For more information on our borrowings, see Note 13 to the Consolidated Financial Statements in Item 1, which is incorporated herein by reference.

On July 16, 2010, we entered into interest rate hedging transactions that have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$105 million of the indebtedness drawn under the 2010 agreement at the rate of 2.04% for a period of five years. Under the terms of these transactions, we pay the fixed rate of 2.04% and the counterparties pay a floating rate based on the three-month LIBOR rate at each quarterly calculation date, which on April 16, 2013 was 0.28%. The net effect is to fix the effective interest rate on \$105 million of indebtedness at 2.04%, plus the applicable spread, until these swap agreements expire on July 16, 2015. As of June 30, 2013, the all-in rate on this \$105 million of debt was 3.415%. This interest rate swap is accounted for as a hedge of future cash flows. For more information on our interest rate swaps, see Note 14 to the Consolidated Financial Statements in Item 1, which is incorporated herein by reference.

On May 20, 2013, we entered into interest rate hedging transactions for the period July 16, 2015 through March 16, 2018. These transactions have the effect of fixing the LIBOR portion of the effective interest rate (before addition of the spread) on \$110 million of the indebtedness drawn under the Credit agreement at the rate of 1.414% during this period. Under the terms of these transactions, we pay the fixed rate of 1.414% and the counterparties pay a floating

rate based on the one-month LIBOR rate at each monthly calculation date, which on June 28, 2013 was 0.19%. The net effect is to fix the effective interest rate on \$110 million of indebtedness at 1.414%, plus the applicable spread, during the swap period. As of June 30, 2013, our leverage ratio was 1.75 to 1.00 and our interest coverage ratio was 8.57 to 1.00. We may purchase our Common Stock or pay dividends to the extent

38

our leverage ratio remains at or below 3.50 to 1.00, and may make acquisitions with cash provided our leverage ratio would not exceed 3.50 to 1.00 after giving pro forma effect to the acquisition.

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

As of June 30, 2013, we have no off-balance sheet arrangements required to be disclosed pursuant to Item 303(a)(4) of Regulation S-K.

### **Recent Accounting Pronouncements**

The information set forth under Note 17 contained in the “Notes to Consolidated Financial Statements” is incorporated herein by reference.

### **Non-GAAP Measures**

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

The effect of changes in currency translation rates is calculated by converting amounts reported in local currencies into U.S. dollars at the exchange rate of a prior period. That amount is then compared to the U.S. dollar amount reported in the current period. The Company calculates Income tax adjustments by adding discrete tax items to the effect of a change in tax rate for the reporting period. The Company calculates its Income tax rate, exclusive of Income tax adjustments, by removing Income tax adjustments from total Income tax expense, then dividing that result by Income before tax. The Company calculates EBITDA by adding Interest expense net, Income taxes, and Depreciation and Amortization to Income from Continuing Operations. Adjusted EBITDA is calculated by adding to EBITDA, costs associated with restructuring and pension settlement charges, and then adding or subtracting revaluation losses or gains and subtracting building share gains. The Company believes that EBITDA and Adjusted EBITDA provide useful information to investors because they provide an indication of the strength and performance of the Company's ongoing business operations, including its ability to fund discretionary spending such as capital

expenditures and strategic investments, as well as its ability to incur and service debt. While depreciation and amortization are operating costs under GAAP, they are non-cash expenses equal to current period allocation of costs associated with capital and other long-lived investments made in prior periods. While restructuring expenses, foreign currency revaluation losses or gains, pension settlement charges, and building sale gains have an impact on the Company's net income, removing them from EBITDA can provide, in the opinion of the Company, a better measure of operating performance. EBITDA is also a calculation commonly used by investors and analysts to evaluate and compare the periodic and future operating performance and value of companies. EBITDA, as defined by the Company, may not be similar to EBITDA measures of other companies. Such EBITDA measures may not be considered measurements under GAAP, and should be considered in addition to, but not as substitutes for, the information contained in the Company's statements of income.

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

Three months ended June 30, 2013

| (in thousands)                              | Machine<br>Clothing | AEC       | Research<br>and<br>Unallocated | Total<br>Company |
|---|---------------------|-----------|--------------------------------|------------------|
| Income/(loss) from continuing operations    | \$20,699            | (\$1,825) | (\$25,902 )                    | (\$7,028 )       |
| Interest expense, net                       | -                   | -         | 3,547                          | 3,547            |
| Income tax (benefit)/expense                | -                   | -         | (2,243 )                       | (2,243 )         |
| Depreciation and amortization               | 11,479              | 1,874     | 2,728                          | 16,081           |
| EBITDA                                      | 32,178              | 49        | (21,870 )                      | 10,357           |
| Restructuring and other, net                | 24,230              | 91        | -                              | 24,321           |
| Foreign currency revaluation losses/(gains) | (452 )              | -         | 1,896                          | 1,444            |
| Adjusted EBITDA                             | \$55,956            | \$140     | (\$19,974 )                    | \$36,122         |

Six months ended June 30, 2013

| (in thousands)                                    | Machine<br>Clothing | AEC       | Research<br>and<br>Unallocated | Total<br>Company |
|---|---------------------|-----------|--------------------------------|------------------|
| Income/(loss) from continuing operations          | \$63,607            | (\$3,888) | (\$55,236 )                    | \$4,483          |
| Interest expense, net                             | -                   | -         | 7,572                          | 7,572            |
| Income tax expense/(benefit)                      | -                   | -         | 4,005                          | 4,005            |
| Depreciation and amortization                     | 23,039              | 3,576     | 5,340                          | 31,955           |
| EBITDA  | 86,646              | (312 )    | (38,319 )                      | 48,015           |
| Restructuring and other, net                      | 24,423              | 534       | -                              | 24,957           |
| Foreign currency revaluation losses/gains         | (1,195 )            | -         | 1,907                          | 712              |
| (Gain) on sale of former manufacturing facilities | -                   | -         | (3,763 )                       | (3,763 )         |
| Adjusted EBITDA                                   | \$109,874           | \$222     | (\$40,175 )                    | \$69,921         |

Three months ended June 30, 2012

| (in thousands)                              | Machine<br>Clothing | AEC      | Research<br>and<br>Unallocated | Total<br>Company |
|---|---------------------|----------|--------------------------------|------------------|
| Income/(loss) from continuing operations    | \$44,997            | (\$369 ) | (\$102,403 )                   | (\$57,775)       |
| Interest expense, net                       | -                   | -        | 3,969                          | 3,969            |
| Income tax (benefit)/expense                | -                   | -        | (29,643 )                      | (29,643 )        |
| Depreciation and amortization               | 11,745              | 1,448    | 2,849                          | 16,042           |
| EBITDA                                      | 56,742              | 1,079    | (125,228 )                     | (67,407 )        |
| Restructuring and other, net                | 2,903               | -        | 249                            | 3,152            |
| Foreign currency revaluation (gains)/losses | (2,721 )            | -        | (3,126 )                       | (5,847 )         |
| Pension plan settlement charges             | -                   | -        | 110,560                        | 110,560          |
| Adjusted EBITDA                             | \$56,924            | \$1,079  | (\$17,545 )                    | \$40,458         |



Six months ended June 30, 2012

| (in thousands)                              | Machine<br>Clothing | AEC      | Research and<br>Unallocated | Total<br>Company |
|---|---------------------|----------|-----------------------------|------------------|
| Income/(loss) from continuing operations    | \$75,842            | (\$340 ) | (\$133,406 )                | (\$57,904)       |
| Interest expense, net                       | -                   | -        | 8,613                       | 8,613            |
| Income tax (benefit)/expense                | -                   | -        | (39,615 )                   | (39,615 )        |
| Depreciation and amortization               | 23,798              | 2,853    | 5,418                       | 32,069           |
| EBITDA                                      | 99,640              | 2,513    | (158,990 )                  | (56,837 )        |
| Restructuring and other, net                | 3,576               | -        | (166 )                      | 3,410            |
| Foreign currency revaluation (gains)/losses | (955 )              | -        | 708                         | (247 )           |
| Pension plan settlement charges             | -                   | -        | 119,735                     | 119,735          |
| Adjusted EBITDA                             | \$102,261           | \$2,513  | (\$38,713 )                 | \$66,061         |

The Company calculates its income tax rate excluding tax adjustments by removing from tax expense any tax adjustments, and then dividing that result by income before income tax. Tax adjustments includes any discrete tax provisions, the effect on tax expense resulting from a change in the estimated tax rate that occurred since the last reporting period, and the income tax associated with unusual pre-tax events, such as pension settlements or the sale of discontinued businesses.

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

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

| Three months ended June 30, 2013<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|-----------------------|---------------------|
| Restructuring and other, net   | \$24,321           | \$9,485       | \$14,836            | 31,628                | \$0.47              |
| Foreign currency revaluation losses  | 1,444              | 563           | 881                 | 31,628                | 0.03                |
| Negative effect of change in estimated income tax rate                       | -                  | 888           | 888                 | 31,628                | 0.03                |
| Net discrete tax charges   | -                  | 485           | 485                 | 31,628                | 0.02                |

| Six months ended June 30, 2013<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|-----------------------|---------------------|
| Restructuring and other, net   | \$24,957           | \$9,733       | \$15,224            | 31,562                | \$0.48              |
| Foreign currency revaluation gains   | 712                | 278           | 434                 | 31,562                | 0.01                |
| Gain on sale of former manufacturing facility                              | 3,763              | 1,468         | 2,295               | 31,562                | 0.07                |
| Net discrete tax charges   | -                  | 695           | 695                 | 31,562                | 0.02                |

| Three months ended June 30, 2012<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|-----------------------|---------------------|
| Restructuring and other, net   | \$3,152            | \$1,214       | \$1,938             | 31,349                | \$0.06              |
| Foreign currency revaluation gains   | 5,847              | \$2,251       | 3,596               | 31,349                | 0.11                |
| Pension plan settlement charges  | 110,560            | 36,161        | 74,399              | 31,349                | 2.37                |
| Net favorable discrete tax adjustments                                       | -                  | 297           | 297                 | 31,349                | 0.01                |
| Favorable effect of change in estimated income tax rate                      | -                  | 682           | 682                 | 31,349                | 0.02                |



| Six months ended June 30, 2012<br>(in thousands, except per share amounts) | Pre tax<br>Amounts | Tax<br>Effect | After tax<br>Effect | Shares<br>Outstanding | Per Share<br>Effect |
|--|--------------------|---------------|---------------------|-----------------------|---------------------|
| Restructuring and other, net   | \$3,410            | \$1,313       | \$2,097             | 31,329                | \$0.07              |
| Foreign currency revaluation gains   | 247                | \$95          | 152                 | 31,329                | 0.00                |
| Pension plan settlement charges  | 119,735            | 39,460        | 80,275              | 31,329                | 2.56                |
| Net discrete tax benefit   | -                  | 6,051         | 6,051               | 31,329                | 0.19                |

The following table contains the calculation of net debt:

| (in thousands)                       | June 30, 2013     | March 31, 2013    | December 31, 2012 |
|--------------------------------------|-------------------|-------------------|-------------------|
| Notes and loans payable              | \$ 610            | \$ 780            | \$ 586            |
| Current maturities of long-term debt | 55,014            | 55,014            | 83,276            |
| Long-term debt                       | 265,368           | 278,622           | 235,877           |
| <b>Total debt</b>                    | <b>320,992</b>    | <b>334,416</b>    | <b>319,739</b>    |
| Cash                                 | 197,321           | 199,833           | 190,718           |
| Net debt                             | <b>\$ 123,671</b> | <b>\$ 134,583</b> | <b>\$ 129,021</b> |

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

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

### Item 4. Controls and Procedures

#### a) Disclosure controls and procedures.

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

#### (b) Changes in internal control over financial reporting.

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

financial reporting.

42

## **PART II – OTHER INFORMATION**

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

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

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

There have been no material changes in risks since December 31, 2012. For discussion of risk factors, refer to Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012.

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

We made no share purchases during the second quarter of 2013. We remain authorized by the Board of Directors to purchase up to 2 million shares of our Class A Common Stock.

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

None.

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

Not Applicable.

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

None.

43

**Item 6. Exhibits**

Exhibit No. Description

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

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

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

99.1 Quantitative and qualitative disclosures about market risks as reported at June 30, 2013.

<sup>101</sup> The following financial information from the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in eXtensible Business Reporting Language (XBRL), filed herewith:

(i) Consolidated Statements of Operations for the three and six months ended June 30, 2013 and 2012.

(ii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2012.

(iii) Consolidated Balance Sheets at June 30, 2013 and December 31, 2012.

(iv) Consolidated Statements of Cash Flows for the three and six months ended June 30, 2013 and 2012.

(v) Notes to Consolidated Financial Statements.

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

**SIGNATURES**

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

ALBANY INTERNATIONAL CORP.

(Registrant)

Date: August 2, 2013

By /s/ John B. Cozzolino

John B. Cozzolino  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)

45