

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 1-11406

KADANT INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

52-1762325
(I.R.S. Employer Identification No.)

One Technology Park Drive
Westford, Massachusetts
(Address of Principal Executive Offices)

01886
(Zip Code)

Registrant's telephone number, including area code: (978) 776-2000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at August 1, 2007 |
|-------------------------------|-------------------------------|
| Common Stock, \$.01 par value | 14,224,747 |

PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

KADANT INC.

Condensed Consolidated Balance Sheet
(Unaudited)

Assets

| (In thousands) | June 30, 2007 | December 30, 2006 |
|---|-------------------|----------------------|
| Current Assets: | | |
| Cash and cash equivalents | \$ 40,264 | \$ 39,634 |
| Accounts receivable, less allowances of \$2,604 and \$2,623 | 50,346 | 49,963 |
| Unbilled contract costs and fees | 31,851 | 24,087 |
| Inventories (Note 5) | 45,892 | 41,679 |
| Other current assets | 9,597 | 8,575 |
| Assets of discontinued operation (Note 14) | 2,406 | 4,461 |
| Total Current Assets | 180,356 | 168,399 |
| Property, Plant, and Equipment, at Cost | 100,117 | 97,995 |
| Less: accumulated depreciation and amortization | 59,937 | 57,056 |
| | 40,180 | 40,939 |
| Other Assets | 46,502 | 46,669 |
| Goodwill | 138,990 | 137,078 |
| Total Assets | \$ 406,028 | \$ 393,085 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

KADANT INC.

Condensed Consolidated Balance Sheet (continued)
(Unaudited)

Liabilities and Shareholders' Investment

| (In thousands, except share amounts) | June 30, 2007 | December 30, 2006 |
|---|-------------------|----------------------|
| Current Liabilities: | | |
| Current maturities of long-term obligations (Note 7) | \$ 10,717 | \$ 9,330 |
| Accounts payable | 36,422 | 32,934 |
| Accrued payroll and employee benefits | 13,395 | 15,685 |
| Other current liabilities | 30,851 | 28,449 |
| Liabilities of discontinued operation (Note 14) | 1,657 | 1,459 |
| Total Current Liabilities | 93,042 | 87,857 |
| Other Long-Term Liabilities | | |
| | 19,438 | 21,594 |
| Long-Term Obligations (Note 7) | | |
| | 39,492 | 44,652 |
| Minority Interest | | |
| | 1,182 | 1,017 |
| Shareholders' Investment: | | |
| Preferred stock, \$.01 par value, 5,000,000 shares authorized; none issued | - | - |
| Common stock, \$.01 par value, 150,000,000 shares authorized; 14,604,520 shares issued | 146 | 146 |
| Capital in excess of par value | 91,666 | 93,002 |
| Retained earnings | 161,651 | 153,147 |
| Treasury stock at cost, 435,273 and 616,737 shares | (10,385) | (14,401) |
| Accumulated other comprehensive items (Note 2) | 9,796 | 6,071 |
| | 252,874 | 237,965 |
| Total Liabilities and Shareholders' Investment | \$ 406,028 | \$ 393,085 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

KADANT INC.

Condensed Consolidated Statement of Income
(Unaudited)

| | Three Months Ended | |
|--|--------------------|-----------------|
| (In thousands, except per share amounts) | June 30, 2007 | July 1, 2006 |
| Revenues | \$ 89,107 | \$ 89,567 |
| Costs and Operating Expenses: | | |
| Cost of revenues | 54,964 | 56,847 |
| Selling, general, and administrative expenses | 23,087 | 22,498 |
| Research and development expenses | 1,493 | 1,496 |
| Loss on sale of subsidiary (Note 4) | 388 | - |
| | 79,932 | 80,841 |
| Operating Income | 9,175 | 8,726 |
| Interest Income | 342 | 251 |
| Interest Expense | (789) | (804) |
| Income from Continuing Operations Before Provision for Income Taxes and Minority Interest Expense | 8,728 | 8,173 |
| Provision for Income Taxes | 2,705 | 2,529 |
| Minority Interest Expense | 87 | 47 |
| Income from Continuing Operations | 5,936 | 5,597 |
| Loss from Discontinued Operation (net of income tax benefit of \$615 and \$417) (Note 14) | (1,022) | (627) |
| Net Income | \$ 4,914 | \$ 4,970 |
| Basic Earnings per Share (Note 3): | | |
| Continuing Operations | \$.42 | \$.41 |
| Discontinued Operation | (.07) | (.05) |
| Net Income | \$.35 | \$.36 |
| Diluted Earnings per Share (Note 3): | | |
| Continuing Operations | \$.42 | \$.40 |
| Discontinued Operation | (.07) | (.05) |
| Net Income | \$.35 | \$.35 |
| Weighted Average Shares (Note 3): | | |
| Basic | 14,012 | 13,702 |
| Diluted | 14,202 | 14,056 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

KADANT INC.

Condensed Consolidated Statement of Income
(Unaudited)

| (In thousands, except per share amounts) | Six Months Ended | |
|--|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Revenues | \$ 177,348 | \$ 165,158 |
| Costs and Operating Expenses: | | |
| Cost of revenues | 110,658 | 103,821 |
| Selling, general, and administrative expenses | 46,583 | 44,619 |
| Research and development expenses | 3,160 | 3,041 |
| Loss on sale of subsidiary (Note 4) | 388 | - |
| Restructuring costs | - | 138 |
| | 160,789 | 151,619 |
| Operating Income | 16,559 | 13,539 |
| Interest Income | 693 | 510 |
| Interest Expense | (1,595) | (1,598) |
| Income from Continuing Operations Before Provision for Income Taxes and Minority Interest Expense | 15,657 | 12,451 |
| Provision for Income Taxes | 4,895 | 3,984 |
| Minority Interest Expense | 135 | 105 |
| Income from Continuing Operations | 10,627 | 8,362 |
| Loss from Discontinued Operation (net of income tax benefit of \$852 and \$494) (Note 14) | (1,414) | (741) |
| Net Income | \$ 9,213 | \$ 7,621 |
| Basic Earnings per Share (Note 3): | | |
| Continuing Operations | \$.76 | \$.61 |
| Discontinued Operation | (.10) | (.05) |
| Net Income | \$.66 | \$.56 |
| Diluted Earnings per Share (Note 3): | | |
| Continuing Operations | \$.75 | \$.60 |
| Discontinued Operation | (.10) | (.05) |
| Net Income | \$.65 | \$.55 |
| Weighted Average Shares (Note 3): | | |
| Basic | 14,010 | 13,641 |
| Diluted | 14,208 | 13,948 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

KADANT INC.

Condensed Consolidated Statement of Cash Flows
(Unaudited)

| (In thousands) | Six Months Ended | |
|--|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Operating Activities: | | |
| Net income | \$ 9,213 | \$ 7,621 |
| Loss from discontinued operation (Note 14) | 1,414 | 741 |
| Income from continuing operations | 10,627 | 8,362 |
| Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 3,648 | 3,755 |
| Stock-based compensation expense | 530 | 804 |
| Loss on sale of subsidiary | 388 | - |
| Provision for losses on accounts receivable | 26 | 187 |
| Minority interest expense | 135 | 105 |
| Other, net | (1,554) | (280) |
| Changes in current accounts, net of effects of acquisitions and disposition: | | |
| Accounts receivable | 377 | (6,211) |
| Unbilled contract costs and fees | (7,683) | (15,729) |
| Inventories | (3,797) | (2,266) |
| Other current assets | (796) | (1,255) |
| Accounts payable | 3,040 | 17,198 |
| Other current liabilities | (1,173) | (5,026) |
| Net cash provided by (used in) continuing operations | 3,768 | (356) |
| Net cash used in discontinued operation | (1,096) | (3,461) |
| Net cash provided by (used in) operating activities | 2,672 | (3,817) |
| Investing Activities: | | |
| Purchases of property, plant, and equipment | (1,724) | (1,106) |
| Acquisitions and disposition, net | (1,268) | (5,574) |
| Proceeds from sale of property, plant, and equipment | 98 | 110 |
| Other, net | 19 | (5) |
| Net cash used in continuing operations | (2,875) | (6,575) |
| Net cash provided by discontinued operation | 660 | 4,195 |
| Net cash used in investing activities | (2,215) | (2,380) |
| Financing Activities: | | |
| Proceeds from issuances of Company common stock | 5,449 | 4,265 |
| Purchases of Company common stock | (5,185) | - |
| Proceeds from issuance of short- and long-term obligations | - | 15,008 |
| Repayments of short- and long-term obligations | (3,909) | (12,850) |
| Excess tax benefits from stock option exercises | 1,914 | 965 |
| Payment of debt issuance costs | (25) | (186) |
| Net cash (used in) provided by continuing operations | (1,756) | 7,202 |
| Net cash (used in) provided by discontinued operation | - | - |
| Net cash (used in) provided by financing activities | (1,756) | 7,202 |
| Exchange Rate Effect on Cash | 654 | 987 |
| Change in Cash from Discontinued Operation | 1,275 | 630 |
| Increase in Cash and Cash Equivalents | 630 | 2,622 |
| Cash and Cash Equivalents at Beginning of Period | 39,634 | 40,822 |
| Cash and Cash Equivalents at End of Period | \$ 40,264 | \$ 43,444 |
| Non-cash Financing Activities: | | |
| Issuance of Restricted Stock | \$ 232 | \$ 478 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. General

The interim condensed consolidated financial statements and related notes presented have been prepared by Kadant Inc. (also referred to in this document as “we,” “Kadant,” “the Company,” or “the Registrant”), are unaudited, and, in the opinion of management, reflect all adjustments of a normal recurring nature necessary for a fair statement of the Company’s financial position at June 30, 2007, and its results of operations for the three-and six-month periods ended June 30, 2007 and July 1, 2006 and cash flows for the six-month periods ended June 30, 2007 and July 1, 2006. Interim results are not necessarily indicative of results for a full year.

The condensed consolidated balance sheet presented as of December 30, 2006, has been derived from the consolidated financial statements that have been audited by the Company’s independent registered public accounting firm. The condensed consolidated financial statements and related notes are presented as permitted by Form 10-Q and do not contain certain information included in the annual consolidated financial statements and related notes of the Company. The condensed consolidated financial statements and notes included herein should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 30, 2006, filed with the Securities and Exchange Commission on March 13, 2007.

Certain prior-period amounts have been reclassified to conform to the 2007 presentation.

2. Comprehensive Income

Comprehensive income combines net income and other comprehensive items, which represent certain amounts that are reported as components of shareholders’ investment in the accompanying condensed consolidated balance sheet, including foreign currency translation adjustments, deferred gains and losses and unrecognized prior service loss associated with pension and other post-retirement plans, and deferred gains and losses on hedging instruments. The components of comprehensive income are as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Net Income | \$ 4,914 | \$ 4,970 | \$ 9,213 | \$ 7,621 |
| Other Comprehensive Items: | | | | |
| Foreign Currency Translation Adjustments | 2,743 | 2,788 | 3,787 | 3,216 |
| Deferred Gain on Hedging Instruments (net of income tax of \$138 and \$97 in the three and six months ended June 30, 2007, respectively, and \$46 and \$147 in the three and six months ended July 1, 2006, respectively) | 203 | 66 | 150 | 220 |
| Unrecognized Prior Service Loss (net of income tax of \$74 and \$148 in the three and six months ended June 30, 2007, respectively) | (111) | - | (222) | - |
| Deferred Gain on Pension and Other Post-Retirement Plans (net of income tax of \$4 and \$7 in the three and six months ended June 30, 2007, respectively) | 4 | - | 10 | - |
| | 2,839 | 2,854 | 3,725 | 3,436 |
| Comprehensive Income | \$ 7,753 | \$ 7,824 | \$ 12,938 | \$ 11,057 |

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

3. Earnings per Share

Basic and diluted earnings per share are calculated as follows:

| (In thousands, except per share amounts) | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Income from Continuing Operations | \$ 5,936 | \$ 5,597 | \$ 10,627 | \$ 8,362 |
| Loss from Discontinued Operation | (1,022) | (627) | (1,414) | (741) |
| Net Income | \$ 4,914 | \$ 4,970 | \$ 9,213 | \$ 7,621 |
| Basic Weighted Average Shares | 14,012 | 13,702 | 14,010 | 13,641 |
| Effect of Stock Options | 190 | 354 | 198 | 307 |
| Diluted Weighted Average Shares | 14,202 | 14,056 | 14,208 | 13,948 |
| Basic Earnings per Share: | | | | |
| Continuing Operations | \$.42 | \$.41 | \$.76 | \$.61 |
| Discontinued Operation | (.07) | (.05) | (.10) | (.05) |
| Net Income | \$.35 | \$.36 | \$.66 | \$.56 |
| Diluted Earnings per Share: | | | | |
| Continuing Operations | \$.42 | \$.40 | \$.75 | \$.60 |
| Discontinued Operation | (.07) | (.05) | (.10) | (.05) |
| Net Income | \$.35 | \$.35 | \$.65 | \$.55 |

Options to purchase approximately 51,700 and 74,000 shares of common stock for the second quarters of 2007 and 2006, respectively, and 62,900 and 157,800 shares of common stock for the first six months of 2007 and 2006, respectively, were not included in the computation of diluted earnings per share because the exercise prices of such options were greater than the average market price of the common stock and the effect of their inclusion would have been anti-dilutive.

4. Acquisition and Disposition

Acquisition

On June 2, 2006, the Company's subsidiary, Kadant Light Machinery (Jining) Co., Ltd. (Kadant Jining), assumed responsibility for the operation of Jining Huayi Light Industry Machinery Co., Ltd. (Huayi), and, by September 30, 2006, acquired substantially all of the assets of Huayi including cash, inventory, machinery, equipment, and buildings for \$21,153,000, net of assumed liabilities of \$2,253,000 related primarily to acquired customer deposits (Kadant Jining acquisition). Of the total consideration, \$17,331,000 was paid in cash, including \$1,032,000 for acquisition-related costs. To finance a portion of the purchase price, Kadant Jining borrowed 40 million Chinese renminbi, originally translated at \$5,072,000. Of the remaining purchase obligation totaling \$3,822,000, \$982,000 has been paid as of June 30, 2007 and the remaining \$2,840,000, which is included in other current liabilities in the accompanying condensed consolidated balance sheet, will be paid through January 2008 as certain post-closing and indemnification obligations are satisfied. The Company expects to fund the remaining purchase obligation through a combination of cash and borrowings in China. Pursuant to the asset purchase agreement, Kadant Jining issued bank payment guarantees of \$3,822,000 associated with the remaining purchase obligation, which may be drawn upon by the sellers through January 2008 as certain obligations are satisfied. Huayi was a supplier of stock-preparation equipment in China.

KADANT INC.Notes to Condensed Consolidated Financial Statements
(Unaudited)

4. Acquisition and Disposition (continued)

The Kadant Jining acquisition was accounted for under the purchase method of accounting and the operating results for Kadant Jining have been included in the accompanying condensed consolidated financial statements from the acquisition date of June 2, 2006. The following table summarizes the purchase method of accounting for this acquisition (in thousands):

| Allocation of Purchase Price as of June 30, 2007: | |
|---|-------------------------|
| Cash and Cash Equivalents | \$ 2,180 |
| Inventory | 2,312 |
| Other Current Assets | 415 |
| Property, Plant, and Equipment | 8,928 |
| Other Assets | 3,254 |
| Intangibles | 608 |
| Goodwill | <u>5,709</u> |
| Total Assets Acquired | 23,406 |
| Current Liabilities Assumed | <u>2,253</u> |
| Net Assets Acquired | <u>\$ 21,153</u> |
| Consideration: | |
| Cash | \$ 11,227 |
| Debt | 5,072 |
| Short- and Long-Term Obligations | 3,822 |
| Acquisition Costs | <u>1,032</u> |
| Total Consideration | <u>\$ 21,153</u> |

Intangibles of \$608,000 relate to customer relationships with a 5 year useful life. The excess of the purchase price over the tangible and identifiable intangible assets was recorded as goodwill and amounted to approximately \$5,709,000, which is fully deductible for tax purposes.

Pro forma disclosure of the results of operations as if the Kadant Jining acquisition had occurred at the beginning of 2006 has not been presented, as the acquisition did not meet the definition of a material business combination outlined in Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations."

Disposition

On April 30, 2007, the Company's Specialty Castings Inc. subsidiary sold substantially all the assets of its Casting Products business for \$390,000, consisting of \$250,000 received in cash and a \$140,000 note receivable. The note receivable bears interest at a rate of 8% annually and is to be repaid by the buyer on a monthly basis over a 5-year period, commencing on January 1, 2008. The Company recorded a pre-tax loss of \$388,000 (\$233,000 after-tax, or \$.02 per diluted share) on the sale in the second quarter of 2007.

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

5. Inventories

The components of inventories are as follows:

| (In thousands) | June 30, 2007 | December 30, 2006 |
|---|------------------|----------------------|
| Raw Materials and Supplies | \$ 23,744 | \$ 22,418 |
| Work in Process | 11,197 | 9,916 |
| Finished Goods (includes \$1,211 and \$624 at customer locations) | 10,951 | 9,345 |
| | <u>\$ 45,892</u> | <u>\$ 41,679</u> |

6. Income Taxes

The Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109," on December 31, 2006. In accordance with FIN 48, the Company recognized a cumulative-effect adjustment of \$709,000, increasing its liability for unrecognized tax benefits and reducing the December 31, 2006 balance of retained earnings. At December 31, 2006, the Company had \$3,364,000 of unrecognized tax benefits. Included in the balance of unrecognized tax benefits at December 31, 2006, is \$1,828,000 of tax positions, the disallowance of which would not affect the annual effective tax rate. The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. At December 31, 2006, the Company had accrued \$652,000 and \$490,000 for the potential payment of interest and penalties, respectively. There were no significant changes to any of the December 31, 2006 amounts during the six-month period ended June 30, 2007 and the Company does not anticipate that the total amount of unrecognized tax benefit related to any particular tax position will change significantly within the next 12 months.

As of December 31, 2006, the Company was subject to U.S. Federal income tax examinations for the stub period from January to August 2001 when the Company was part of its former parent company's tax return and for the tax years 2003 through 2006, and to non-U.S. income tax examinations for the tax years 2001 through 2006. In addition, the Company was subject to state and local income tax examinations for the tax years 2002 through 2006.

7. Long-Term Obligations and Other Financial Instruments

Long-term Obligations

Long-term obligations are as follows:

| (In thousands) | June 30, 2007 | December 30, 2006 |
|--|------------------|----------------------|
| Variable Rate Term Loan, due from 2007 to 2010 | \$ 35,324 | \$ 39,108 |
| Variable Rate Term Loan, due from 2007 to 2016 | 9,625 | 9,750 |
| Variable Rate Term Loan, due 2010 | 5,260 | 5,124 |
| Total Long-Term Obligations | 50,209 | 53,982 |
| Less: Current Maturities | (10,717) | (9,330) |
| Long-Term Obligations, less Current Maturities | <u>\$ 39,492</u> | <u>\$ 44,652</u> |

The weighted average interest rate for long-term obligations was 5.57% as of June 30, 2007.

Term Loan and Revolving Credit Facility

To fund a portion of the purchase price for the acquisition of Kadant Johnson, the Company entered into a term loan and revolving credit facility (the Credit Agreement) effective May 9, 2005 in the aggregate principal amount of up to \$95,000,000, including a \$35,000,000 revolver. The Credit Agreement is among the Company, as Borrower; the Foreign

KADANT INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

7. Long-Term Obligations and Other Financial Instruments (continued)

Subsidiary Borrowers from time to time parties thereto; the several banks and other financial institutions or entities from time to time parties thereto; and JPMorgan Chase Bank, N.A., as Administrative Agent. On May 11, 2005, the Company borrowed \$60,000,000 under the term loan facility, which is repayable in quarterly installments over a five-year period.

On May 9, 2007, the Company entered into a fourth amendment to its Credit Agreement to eliminate one of the restrictions on the payment of dividends and repurchases of the Company's common stock, which was limited to \$15 million plus 50% of net income earned after May 9, 2005. The Company is still required to comply with a maximum consolidated leverage ratio of total debt to earnings before interest, taxes, depreciation and amortization (EBITDA) (as defined in the Credit Agreement) of 2.5 to 1 prior to the payment of any dividend or the making of any stock repurchases.

Commercial Real Estate Loan

On May 4, 2006, the Company borrowed \$10,000,000 under a promissory note (Loan) from Citizens Bank of Massachusetts. The Loan is repayable in quarterly installments of \$125,000 over a ten-year period with the remaining principal balance of \$5,000,000 due upon maturity. The remaining balance as of June 30, 2007 is \$9,625,000.

Kadant Jining Loan

On June 6, 2006, Kadant Jining borrowed 40 million Chinese renminbi, or approximately \$5,260,000 as of June 30, 2007, under a 47-month interest-only loan with Bank of China Limited.

Financial Instruments

The Company entered into swap agreements in 2005 and 2006 to convert a portion of the Company's outstanding debt from floating to fixed rates of interest. As of June 30, 2007, \$34,825,000, or 69%, of the Company's outstanding debt was hedged through interest rate swap agreements. The swap agreements have the same terms and quarterly payment dates as the corresponding debt, and reduce proportionately in line with the amortization of the debt. The swap agreements have been designated as cash flow hedges and are carried at fair value with unrealized gains or losses reflected within other comprehensive items. As of June 30, 2007, the net unrealized gain associated with the swap agreements was \$385,000, consisting of a \$465,000 unrealized gain included in other assets and an \$80,000 unrealized loss included in other liabilities, with an offset to accumulated other comprehensive items (net of tax) in the accompanying condensed consolidated balance sheet. Management believes that any credit risk associated with the swap agreements is remote based on the creditworthiness of the financial institution issuing the swap agreements.

8. Warranty Obligations

The Company provides for the estimated cost of product warranties at the time of sale based on the actual historical return rates and repair costs. In the Pulp and Papermaking Systems (Papermaking Systems) segment, the Company typically negotiates the terms regarding warranty coverage and length of warranty depending on the products and applications. While the Company engages in extensive product quality programs and processes, the Company's warranty obligation is affected by product failure rates, repair costs, service delivery costs incurred in correcting a product failure, and supplier warranties on parts delivered to the Company. Should actual product failure rates, repair costs, service delivery costs, or supplier warranties on parts differ from the Company's estimates, adjustments to the estimated warranty liability would be required.

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

8. Warranty Obligations (continued)

The changes in the carrying amount of the Company's product warranties included in other current liabilities in the accompanying condensed consolidated balance sheet are as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|-----------------|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Balance at Beginning of Period | \$ 3,149 | \$ 2,787 | \$ 3,164 | \$ 2,836 |
| Provision charged to income | 906 | 800 | 1,420 | 1,033 |
| Usage | (958) | (369) | (1,504) | (659) |
| Currency translation | 27 | 80 | 44 | 88 |
| Balance at End of Period | \$ 3,124 | \$ 3,298 | \$ 3,124 | \$ 3,298 |

See Note 14 for warranty information related to the discontinued operation.

9. Restructuring Costs

2004 Restructuring Plan

In an effort to improve operating performance at the Papermaking Systems segment's Kadant Lamort subsidiary in France, the Company approved a restructuring of that subsidiary on November 18, 2004. This restructuring was initiated to strengthen Kadant Lamort's competitive position in the European paper industry. The restructuring primarily included the reduction of 97 full-time positions across all functions in France and was implemented in 2005. The Company accrued a restructuring charge, in accordance with SFAS No. 112, "Employers' Accounting for Postemployment Benefits," for severance and other termination costs in connection with the workforce reduction of \$9,235,000 in 2004 and reduced the estimate by \$71,000 in 2005. In addition, during 2004, the Company recorded restructuring costs of \$280,000 related to severance costs of 11 employees at one of the Papermaking Systems segment's U.S. subsidiaries.

2006 Restructuring Plan

The Company recorded restructuring costs of \$677,000 in the fourth quarter of 2006 associated with its 2006 Restructuring Plan. These restructuring costs were comprised of severance and associated costs related to the reduction of 15 full-time positions in Canada and France, all at the Company's Papermaking Systems segment.

A summary of the changes in accrued restructuring costs is as follows:

| (In thousands) | Severance and Other |
|--------------------------------|------------------------|
| <i>2004 Restructuring Plan</i> | |
| Balance at December 30, 2006 | \$ 365 |
| Usage | (35) |
| Currency Translation | 9 |
| Balance at June 30, 2007 | \$ 339 |
| <i>2006 Restructuring Plan</i> | |
| Balance at December 30, 2006 | \$ 606 |
| Usage | (177) |
| Currency Translation | 43 |
| Balance at June 30, 2007 | \$ 472 |

The specific restructuring measures and associated estimated costs are based on the Company's best judgments under prevailing circumstances. The Company believes that the restructuring reserve balance is adequate to carry out the restructuring activities formally identified and committed to as of June 30, 2007. The cash payments related to the Kadant Lamort restructuring initiated at the end of 2004 will extend through the remainder of 2007 due to the lengthy restructuring and legal process in France. For the remaining restructuring activities, the Company anticipates that all actions will be completed within a 12-month period.

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

10. Business Segment Information

The Company has combined its operating entities into one reportable operating segment, Papermaking Systems, and two separate product lines, Fiber-based Products and Casting Products, which are reported in Other. In classifying operational entities into a particular segment, the Company aggregated businesses with similar economic characteristics, products and services, production processes, customers, and methods of distribution.

| (In thousands) | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|-------------------|-------------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Revenues: | | | | |
| Papermaking Systems | \$ 86,609 | \$ 85,427 | \$ 170,643 | \$ 156,500 |
| Other (b) | 2,498 | 4,140 | 6,705 | 8,658 |
| | <u>\$ 89,107</u> | <u>\$ 89,567</u> | <u>\$ 177,348</u> | <u>\$ 165,158</u> |
| Income from Continuing Operations Before Provision for Income Taxes and Minority Interest Expense: | | | | |
| Papermaking Systems | \$ 12,238 | \$ 11,016 | \$ 21,808 | \$ 17,767 |
| Corporate and Other (a) (b) | (3,063) | (2,290) | (5,249) | (4,228) |
| Total Operating Income | 9,175 | 8,726 | 16,559 | 13,539 |
| Interest Expense, Net | (447) | (553) | (902) | (1,088) |
| | <u>\$ 8,728</u> | <u>\$ 8,173</u> | <u>\$ 15,657</u> | <u>\$ 12,451</u> |
| Capital Expenditures: | | | | |
| Papermaking Systems | \$ 846 | \$ 638 | \$ 1,621 | \$ 975 |
| Corporate and Other (b) | 40 | 85 | 103 | 131 |
| | <u>\$ 886</u> | <u>\$ 723</u> | <u>\$ 1,724</u> | <u>\$ 1,106</u> |

(a) Corporate primarily includes general and administrative expenses.

(b) "Other" includes the results from the Fiber-based Products business and the Casting Products business, the latter of which was sold on April 30, 2007.

11. Stock-Based Compensation

Stock Options - There were no stock options granted in the first and second quarters of 2007.

Restricted Stock - The Company grants restricted shares to its outside directors. For 2006 and prior periods, the restricted shares vested immediately, but were restricted from resale for three years from the date of award. On February 27, 2007, the Company granted an aggregate of 20,000 restricted shares to its outside directors with an aggregate value of \$464,000, which vest at a rate of 5,000 shares per quarter on the last day of each quarter. The vesting for these restricted shares would accelerate upon a change in control of the Company, as defined in the Company's equity incentive plans. As of June 30, 2007, there was \$232,000 of total unrecognized compensation cost related to these unvested awards, which will be recognized over the remainder of 2007 as the shares vest. On February 27, 2007, the Company also granted an aggregate of 40,000 restricted shares with an aggregate value of \$928,000 to its outside directors, which will only vest and compensation expense will only be recognized upon a change in control as defined in the Company's equity incentive plans. These restricted shares are forfeited if a change in control does not occur by the end of the first quarter of 2008.

Performance-Based Restricted Stock Units - On May 24, 2007, the Company granted 104,000 restricted stock units (RSU) (the target RSU amount) with a grant date fair value of \$28.21 per share to certain officers of the Company. Each RSU represents the right to receive one share of the Company's common stock upon vesting. The RSUs will cliff vest

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

11. Stock-Based Compensation (continued)

in their entirety on the last day of the Company's 2009 fiscal year, provided that certain performance requirements are met and the officer remains employed by the Company through the vesting date. The target RSU amount is subject to adjustment based on the achievement of certain performance requirements. The performance-based element of the RSU requires the Company to meet specified EBITDA targets generated from continuing operations for the nine-month period ended December 29, 2007. If the Company's actual EBITDA for the period is between 80% and 125% of the EBITDA target, the officer would receive between 50% and 150% of the target RSU amount. If actual EBITDA is below 80% of target EBITDA for the period, all RSUs will be forfeited. The Company is recognizing compensation expense associated with these RSUs ratably over the vesting period based on the grant date fair value. For the second and third quarters of 2007, the Company will recognize compensation expense based on the probable number of RSUs to be granted based on the estimated EBITDA for the nine-month period ended December 29, 2007. In the fourth quarter of 2007 if the actual EBITDA for the nine-month period ended December 29, 2007 is between 80% and 125% of the EBITDA target, compensation expense recognized to date will be adjusted to reflect the actual number of RSUs to be issued. If the actual EBITDA is below 80% of the target EBITDA, previously recognized compensation expense will be reversed in the fourth quarter of 2007.

The RSU agreement provides for forfeiture in certain events, such as voluntary or involuntary termination of employment, and for acceleration of vesting in certain events, such as death, disability or a change in control of the Company. If the officer dies or is disabled prior to the vesting date, then a ratable portion of the RSUs will vest. In the event of a change in control prior to the end of the 2007 fiscal year, the target number of RSUs will vest. If the change in control occurs after the end of the Company's 2007 fiscal year, the officer will receive the number of deliverable RSUs based on the achievement of the performance goal, as stated in the RSU agreement.

Unrecognized compensation expense related to the unvested performance-based restricted stock units totaled approximately \$2,820,000 as of June 30, 2007 and will be recognized over 2.5 years.

Time-Based Restricted Stock Units - On May 24, 2007, the Company granted 61,450 RSUs with a grant date fair value of \$28.21 per share to certain employees of the Company. Each RSU represents the right to receive one share of the Company's common stock upon vesting. The RSUs will cliff vest in their entirety on May 24, 2011, provided the recipient remains employed with the Company through the vesting date. The RSU agreement provides for forfeiture in certain events, such as voluntary or involuntary termination of employment, and for acceleration of vesting in certain events, such as death, disability or a change in control of the Company. The Company is recognizing compensation expense associated with these RSUs ratably over the vesting period based on the grant date fair value. Unrecognized compensation expense related to the time-based restricted stock units totaled approximately \$1,690,000 as of June 30, 2007 and will be recognized over the period ended May 24, 2011.

A summary of the status of the Company's unvested restricted share/unit awards for the six months ended June 30, 2007 is as follows:

| Unvested Restricted Share/Unit Awards | Shares/Units (In thousands) | Weighted Average Grant-Date Fair Value |
|--|--------------------------------|--|
| Unvested at December 30, 2006 | - | - |
| Granted (based on the target RSU amount) | 225 | \$ 26.88 |
| Vested | (10) | \$ 23.20 |
| Forfeited / Expired | - | - |
| Unvested at June 30, 2007 | <u>215</u> | <u>\$ 27.05</u> |

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

12. Employee Benefit Plans

Defined Benefit Pension Plans and Post-Retirement Welfare Benefit Plans

The Company's Kadant Web Systems subsidiary has a noncontributory defined benefit retirement plan. Benefits under the plan are based on years of service and employee compensation. Funds are contributed to a trustee as necessary to provide for current service and for any unfunded projected benefit obligation over a reasonable period. Effective December 31, 2005, this plan was closed to new participants. Effective January 1, 2007, the provision limiting lump sum distributions upon termination of employment to \$10,000 was removed. This same subsidiary also has a post-retirement welfare benefits plan (included in the table below in "Other Benefits"). No future retirees are eligible for this post-retirement welfare benefits plan, and the plans include limits on the subsidiary's contributions.

The Company's Kadant Lamort subsidiary sponsors a defined benefit pension plan (included in the table below in "Other Benefits"). Benefits under this plan are based on years of service and projected employee compensation.

The Company's Kadant Johnson subsidiary also offers a post-retirement welfare benefits plan (included in the table below in "Other Benefits") to its U.S. employees upon attainment of eligible retirement age. This post-retirement benefit plan was amended to reduce the annual subsidy provided under the plan effective January 1, 2007. In addition, this plan will be closed to employees who will not meet its retirement eligibility requirements on January 1, 2012.

The components of the net periodic benefit cost for the pension benefits and other benefits plans in the three-and six-month periods ended June 30, 2007 and July 1, 2006 are as follows:

| (In thousands) | Three Months Ended | | Three Months Ended | |
|--|--------------------|----------------|--------------------|----------------|
| | June 30, 2007 | | July 1, 2006 | |
| | Pension Benefits | Other Benefits | Pension Benefits | Other Benefits |
| Components of Net Periodic Benefit Cost (Income): | | | | |
| Service cost | \$ 201 | \$ 26 | \$ 181 | \$ 59 |
| Interest cost | 284 | 57 | 260 | 91 |
| Expected return on plan assets | (351) | - | (354) | - |
| Recognized net actuarial loss | 18 | 6 | 13 | 8 |
| Amortization of prior service cost (income) | 14 | (198) | 12 | (14) |
| Net periodic benefit cost (income) | \$ 166 | \$ (109) | \$ 112 | \$ 144 |

The weighted-average assumptions used to determine net periodic benefit cost (income) are as follows:

| | | | | |
|--|-------|-------|-------|-------|
| Discount rate | 5.75% | 5.45% | 5.75% | 5.30% |
| Expected long-term return on plan assets | 8.50% | - | 8.50% | - |
| Rate of compensation increase | 4.00% | 2.00% | 4.00% | 2.00% |

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

12. Employee Benefit Plans (continued)

| (In thousands) | Six Months Ended | | Six Months Ended | |
|---|------------------|-----------------|------------------|----------------|
| | June 30, 2007 | | July 1, 2006 | |
| | Pension Benefits | Other Benefits | Pension Benefits | Other Benefits |
| Components of Net Periodic Benefit Cost (Income): | | | | |
| Service cost | \$ 409 | \$ 51 | \$ 376 | \$ 118 |
| Interest cost | 560 | 114 | 524 | 182 |
| Expected return on plan assets | (721) | - | (707) | - |
| Recognized net actuarial loss | 18 | 15 | 30 | 16 |
| Amortization of prior service cost (income) | 28 | (394) | 24 | (28) |
| Net periodic benefit cost (income) | <u>\$ 294</u> | <u>\$ (214)</u> | <u>\$ 247</u> | <u>\$ 288</u> |

The weighted-average assumptions used to determine net periodic benefit cost (income) are as follows:

| | | | | |
|--|-------|-------|-------|-------|
| Discount rate | 5.75% | 5.45% | 5.75% | 5.30% |
| Expected long-term return on plan assets | 8.50% | - | 8.50% | - |
| Rate of compensation increase | 4.00% | 2.00% | 4.00% | 2.00% |

No cash contributions are expected for Kadant Web Systems' noncontributory defined benefit retirement plan. For the remaining pension and post-retirement welfare benefit plans, no cash contributions, other than to fund current benefit payments, are expected in 2007.

13. Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157 (SFAS 157), "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for the Company in the first quarter of 2008. The Company is currently analyzing the effect that SFAS 157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 (SFAS 159), "The Fair Value Option for Financial Assets and Financial Liabilities - including an Amendment of FASB Statement No. 115." SFAS 159 permits entities to measure eligible financial assets, financial liabilities and certain other assets and liabilities at fair value on an instrument-by-instrument basis. The fair value measurement election is irrevocable once made and subsequent changes in fair value must be recorded in earnings. The effect of adoption will be reported as a cumulative-effect adjustment to beginning retained earnings in the first quarter of 2008. The Company is currently analyzing the effect that SFAS 159 will have on its consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements
(Unaudited)

14. Discontinued Operation

On October 21, 2005, our Kadant Composites LLC subsidiary (Composites LLC) sold substantially all of its assets to LDI Composites Co. (the Buyer). As part of the sale transaction, Composites LLC retained the warranty obligations associated with products manufactured prior to the sale date. All activity related to this business is classified in the results of the discontinued operation in the accompanying condensed consolidated financial statements.

Operating results for the discontinued operation included in the accompanying condensed consolidated statement of income are as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|-------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Operating Loss | \$ (1,664) | \$ (1,140) | \$ (2,329) | \$ (1,432) |
| Interest Income | 27 | 96 | 63 | 197 |
| Loss Before Income Tax Benefit (including \$130 loss on disposal in the first six months of 2006) | (1,637) | (1,044) | (2,266) | (1,235) |
| Benefit from Income Taxes | 615 | 417 | 852 | 494 |
| Loss From Discontinued Operation | <u>\$ (1,022)</u> | <u>\$ (627)</u> | <u>\$ (1,414)</u> | <u>\$ (741)</u> |

In the first quarter of 2006, Composites LLC received \$786,000 from the Buyer for the settlement of post-closing adjustments resulting in a \$130,000 loss on disposal.

The major classes of assets and liabilities of the discontinued operation included in the accompanying condensed consolidated balance sheet are as follows:

| (In thousands) | June 30, 2007 | December 30, 2006 |
|----------------------------|------------------|----------------------|
| Cash and cash equivalents | \$ 1,322 | \$ 2,597 |
| Restricted cash | - | 660 |
| Other accounts receivable | 234 | 340 |
| Current deferred tax asset | 454 | 454 |
| Other assets | 396 | 410 |
| Total Assets | <u>2,406</u> | <u>4,461</u> |
| Accrued warranty costs | 1,447 | 1,135 |
| Other current liabilities | 210 | 324 |
| Total Liabilities | <u>1,657</u> | <u>1,459</u> |
| Net Assets | <u>\$ 749</u> | <u>\$ 3,002</u> |

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

14. Discontinued Operation (continued)

As part of the sale transaction, Composites LLC retained the warranty obligations associated with products manufactured prior to the sale date. Through the sale date of October 21, 2005, Composites LLC offered a standard limited warranty to the owner of its decking and roofing products, limited to repair or replacement of the defective product or a refund of the original purchase price.

Prior to the sale of the composites business, Composites LLC recorded an estimate for warranty-related costs at the time of sale based on its actual historical return rates and repair costs, as well as other analytical tools for estimating future warranty claims. These estimates were revised for variances between actual and expected claims rates. Composites LLC's analysis of expected warranty claims rates included detailed assumptions associated with potential product returns, including the type of product sold, temperatures at the location of installation, density of boards, and other factors. Certain assumptions, such as the effect of weather conditions and high temperatures on the product installed, included inherent uncertainties that were subject to fluctuation. Through the second quarter of 2006, Composites LLC continued to record an estimate for warranty-related costs based on this methodology.

During the third quarter of 2006, Composites LLC concluded that the highly subjective nature of the assumptions noted above were not accurately predicting the actual level of warranty claims, making it no longer possible to calculate a reasonable estimate of the future level of potential warranty claims. Accordingly, as no amount within the total range of loss represents a best estimate of the ultimate loss to be recorded, Composites LLC is required under SFAS No. 5, "Accounting for Contingencies" to record the minimum amount of the potential range of loss. The warranty obligation as of June 30, 2007 represents the low end of the estimated range of warranty reserve required based on the level of claims processed to date. The total potential warranty cost ranges from \$1,447,000 to approximately \$13,800,000. The high end of the range represents the estimated maximum level of warranty claims remaining based on the total sales of the products under warranty. Composites LLC records adjustments to the warranty obligation to reflect the minimum amount of the potential range of loss.

A summary of the changes in accrued warranty costs in the six months ended June 30, 2007 and July 1, 2006 are as follows:

| (In thousands) | Six Months Ended | |
|--------------------------------|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Balance at Beginning of Period | \$ 1,135 | \$ 5,276 |
| Provision | 2,188 | 969 |
| Usage | (1,876) | (2,682) |
| Balance at End of Period | \$ 1,447 | \$ 3,563 |

KADANT INC.

Notes to Condensed Consolidated Financial Statements
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15. Subsequent Event

On July 30, 2007, the Company's Kadant Jining subsidiary entered into a short-term credit facility that would allow Kadant Jining to borrow up to an aggregate principal amount of 45,000,000 Chinese renminbi, or approximately \$5,900,000 at current exchange rates, and the Company's Kadant Yanzhou subsidiary entered into a short-term credit facility that would allow Kadant Yanzhou to borrow up to an aggregate principal amount of 15,000,000 Chinese renminbi, or approximately \$2,000,000 at current exchange rates. Both credit facilities have a term of 364 days. Borrowings made under these facilities will bear interest at 90% of the applicable short-term interest rate for a Chinese renminbi loan of comparable term as published by The People's Bank of China. The facilities will be used for general working capital purposes and may include the cash collateralization of certain bank payment guarantees provided by Bank of China Ltd. in connection with the acquisition of the assets of Huayi in 2006.

The Company provided a guaranty, dated July 30, 2007, securing the payment of all obligations made under the credit facilities and providing a cross-default to the Company's existing Credit Agreement, dated as of May 9, 2005, as amended to date.

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

This Quarterly Report on Form 10-Q includes forward-looking statements that are not statements of historical fact, and may include statements regarding possible or assumed future results of operations. Forward-looking statements are subject to risks and uncertainties and are based on the beliefs and assumptions of our management, using information currently available to our management. When we use words such as “believes,” “expects,” “anticipates,” “intends,” “plans,” “estimates,” “should,” “likely,” “will,” “would,” or similar expressions, we are making forward-looking statements.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties, and assumptions. Our future results of operations may differ materially from those expressed in the forward-looking statements. Many of the important factors that will determine these results and values are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events, or otherwise. For a discussion of important factors that may cause our actual results to differ materially from those suggested by the forward-looking statements, you should read carefully the section captioned “Risk Factors” in Part II, Item 1A of this Report.

Overview

Company Background

We are a leading supplier of equipment used in the global papermaking and paper recycling industries and also a manufacturer of granules made from papermaking byproducts. Our continuing operations consist of one reportable operating segment, Pulp and Papermaking Systems (Papermaking Systems), and two separate product lines: Fiber-based Products and Casting Products, included in Other Businesses. In classifying operational entities into a particular segment, we considered how our management assesses performance and makes operating decisions, and aggregated businesses with similar economic characteristics, products and services, production processes, customers, and methods of distribution. In addition, prior to its sale on October 21, 2005, we operated a composite building products business (the composites business), which is presented as a discontinued operation in the accompanying condensed consolidated financial statements.

We were incorporated in Delaware in November 1991. On July 12, 2001, we changed our name to Kadant Inc. from Thermo Fibertek Inc. Our common stock is listed on the New York Stock Exchange, where it trades under the symbol “KAI.”

Papermaking Systems Segment

Our Papermaking Systems segment designs and manufactures stock-preparation systems and equipment, paper machine accessory equipment, water-management systems, and fluid-handling systems and equipment primarily for the paper and paper recycling industries. Our principal products include:

- *Stock-preparation systems and equipment:* custom-engineered systems and equipment, as well as standard individual components, for pulping, de-inking, screening, cleaning, and refining recycled and virgin fibers for preparation for entry into the paper machine during the production of recycled paper;
- *Paper machine accessory equipment:* doctoring systems and related consumables that continuously clean papermaking rolls to keep paper machines running efficiently; doctor blades made of a variety of materials to perform functions including cleaning, creping, web removal, and application of coatings; and profiling systems that control moisture, web curl, and gloss during paper production;
- *Water-management systems:* systems and equipment used to continuously clean paper machine fabrics, drain water from pulp mixtures, form the sheet or web, and filter the process water for reuse; and
- *Fluid-handling systems and equipment:* rotary joints, precision unions, steam and condensate systems, components, and controls used primarily in the dryer section of the papermaking process and during the production of corrugated boxboard, metals, plastics, rubber, textiles and food.

Overview (continued)

Other Businesses

Our other businesses include our Fiber-based Products business and our Casting Products business.

Our Fiber-based Products business produces biodegradable, absorbent granules from papermaking byproducts for use primarily as carriers for agricultural, home lawn and garden, and professional lawn, turf and ornamental applications, as well as for oil and grease absorption.

Our Casting Products business manufactured grey and ductile iron castings. This business was sold on April 30, 2007.

Discontinued Operation

On October 21, 2005, our Kadant Composites LLC subsidiary (Composites LLC) sold substantially all the assets comprising its composites business to LDI Composites Co. (the Buyer). As part of the sale transaction, Composites LLC retained the warranty obligations associated with products manufactured prior to the sale date.

Prior to the sale of the composites business, Composites LLC recorded an estimate for warranty-related costs at the time of sale based on its actual historical return rates and repair costs, as well as other analytical tools for estimating future warranty claims. These estimates were revised for variances between actual and expected claims rates. Composites LLC's analysis of expected warranty claims rates included detailed assumptions associated with potential product returns, including the type of product sold, temperatures at the location of installation, density of boards, and other factors. Certain assumptions, such as the effect of weather conditions and high temperatures on the product installed, included inherent uncertainties that were subject to fluctuation. Through the second quarter of 2006, Composites LLC continued to record an estimate for warranty-related costs based on this methodology.

During the third quarter of 2006, Composites LLC concluded that the highly subjective nature of the assumptions noted above were not accurately predicting the actual level of warranty claims, making it no longer possible to calculate a reasonable estimate of the future level of potential warranty claims. Accordingly, as no amount within the total range of loss represents a best estimate of the ultimate loss to be recorded, Composites LLC is required under SFAS No. 5, "Accounting for Contingencies" to record the minimum amount of the potential range of loss. As of June 30, 2007, the accrued warranty reserve associated with the composites business was \$1.4 million, which represents the low end of the range of potential loss for products under warranty based on the level of claims processed to date. Composites LLC has calculated the potential range of loss to be between \$1.4 million and approximately \$13.8 million. The high end of the range represents the estimated maximum level of warranty claims remaining based on the total sales of the products under warranty. Composites LLC records adjustments to the warranty obligation to reflect the minimum amount of the potential range of loss.

All future activity associated with this warranty reserve will continue to be classified in the results of the discontinued operation in our condensed consolidated financial statements.

International Sales

During the first six months of 2007 and 2006, approximately 61% and 59%, respectively, of our sales were to customers outside the United States, principally in China and Europe. We generally seek to charge our customers in the same currency in which our operating costs are incurred. However, our financial performance and competitive position can be affected by currency exchange rate fluctuations affecting the relationship between the U.S. dollar and foreign currencies. We seek to reduce our exposure to currency fluctuations through the use of forward currency exchange contracts. We may enter into forward contracts to hedge certain firm purchase and sale commitments denominated in currencies other than our subsidiaries' functional currencies. These contracts hedge transactions principally denominated in U.S. dollars.

Overview (continued)

Application of Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of our condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that reflect significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies, upon which our financial condition depends and which involve the most complex or subjective decisions or assessments, are those described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” under the section captioned “Application of Critical Accounting Policies and Estimates” in Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 30, 2006, filed with the Securities and Exchange Commission (SEC) on March 13, 2007. There have been no material changes to these critical accounting policies since fiscal year-end 2006 that warrant further disclosure, except for the adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), “Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109.”

Adoption of FIN 48 - Effective December 31, 2006, we adopted FIN 48. FIN 48 provides guidance for the recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In accordance with FIN 48, we recognized a cumulative-effect adjustment of \$0.7 million increasing our liability for unrecognized tax benefits to \$3.4 million and reducing the December 31, 2006 balance of retained earnings.

In the ordinary course of business, there is inherent uncertainty in quantifying our income tax positions. We assess our income tax positions and record tax benefits for all years subject to examination based upon management’s evaluation of the facts, circumstances, and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, we have recorded the largest amount of tax benefit with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. Where applicable, the associated interest and penalties have also been recognized.

Industry and Business Outlook

Our products are primarily sold to the global pulp and paper industry. The paper industry in North America and Europe has been in a prolonged down cycle for the past several years and has undergone important structural changes during that time. In contrast, the paper industry in China has experienced strong growth over the last several years. The performance of paper producers in North America and Europe has been generally improving over the past year. However, paper producers in those regions continue to be negatively affected by higher operating costs, especially higher energy and chemical costs. We believe paper companies are still cautious about increasing their capital and operating spending in the current market environment. As the financial performance of paper companies has improved, they have increased their capital and operating spending, which has had a positive effect on paper company suppliers, such as our Company. We continue to concentrate our efforts on several initiatives intended to improve our operating results, including: (i) increasing our use of low-cost manufacturing bases in China and Mexico, (ii) increasing aftermarket sales in China, and (iii) penetrating new markets outside the paper industry. In addition, we continue to focus our efforts on managing our operating costs, capital expenditures, and working capital.

In the last several years, China has become a significant market for our stock-preparation equipment. A large percentage of the world’s increases in paper production capacity are in China. Consequently, competition is intense and there is increasing pricing pressure, particularly for large systems. To capitalize on this growing market, we have begun manufacturing certain of our accessory products in our China facilities and have started sourcing the manufacture of our principal water management products in China in 2007. Currently, our stock-preparation revenues from China are primarily derived from large capital orders, the timing of which is often difficult to predict. At times, our customers in China have experienced delays in obtaining financing for their

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Overview (continued)

capital addition and expansion projects due to efforts by the Chinese government to control economic growth, which are generally reflected in a slowdown in financing approvals in China's banking system. These delays in receiving financing could delay our recognizing revenue on these projects to periods later than originally anticipated. We plan to use Kadant Jining as a base for increasing our aftermarket business, which we believe will be more predictable.

Our 2007 guidance reflects expected revenues and earnings per share from continuing operations, which exclude the results from our discontinued operation. For the third quarter of 2007, we expect to earn between \$.37 and \$.39 per diluted share, on revenues of \$90 to \$92 million. For the full year, including the \$.02 loss per diluted share on the sale of the Casting Products business, we expect to earn between \$1.49 and \$1.59 per diluted share, on revenues of \$360 to \$370 million.

Results of Operations

Second Quarter 2007 Compared With Second Quarter 2006

The following table sets forth our unaudited condensed consolidated statement of income expressed as a percentage of total revenues from continuing operations for the second fiscal quarters of 2007 and 2006. The results of operations for the fiscal quarter ended June 30, 2007 are not necessarily indicative of the results to be expected for the full fiscal year.

| | Three Months Ended | |
|---|--------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Revenues | 100% | 100% |
| Costs and Operating Expenses: | | |
| Cost of revenues | 62 | 63 |
| Selling, general, and administrative expenses | 26 | 25 |
| Research and development expenses | 2 | 2 |
| | <u>90</u> | <u>90</u> |
| Operating Income | 10 | 10 |
| Interest Income | 1 | - |
| Interest Expense | (1) | (1) |
| Income from Continuing Operations Before Provision for Income Taxes | 10 | 9 |
| Provision for Income Taxes | 3 | 3 |
| Income from Continuing Operations | 7 | 6 |
| Loss from Discontinued Operation | (1) | - |
| Net Income | <u>6%</u> | <u>6%</u> |

Revenues

Revenues decreased to \$89.1 million in the second quarter of 2007 from \$89.6 million in the second quarter of 2006, a decrease of \$0.5 million, or 1%. Revenues in the second quarter of 2007 include a \$2.7 million increase from the favorable effects of currency translation and a \$1.9 million increase from stock-preparation equipment sales in North America due to an increase in capital sales. Offsetting these increases was a \$1.7 million decrease, excluding the effect of currency translation, in stock-preparation equipment sales in China compared to near record sales in the second quarter of 2006, a \$1.7 million decrease, excluding the effect of currency translation, in stock-preparation sales in Europe due to weaker demand and the timing of large orders, and a \$1.6 million decrease from our Fiber-based Products and Casting Products businesses, the latter of which we sold in April 2007.

KADANT INC.

Results of Operations (continued)

Revenues for the second quarters of 2007 and 2006 from our Papermaking Systems segment and our other businesses are as follows:

| (In thousands) | Three Months Ended | |
|---------------------|--------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Revenues: | | |
| Papermaking Systems | \$ 86,609 | \$ 85,427 |
| Other Businesses | 2,498 | 4,140 |
| | \$ 89,107 | \$ 89,567 |

Papermaking Systems Segment. Revenues at the Papermaking Systems segment increased to \$86.6 million in the second quarter of 2007 from \$85.4 million in the second quarter of 2006, an increase of \$1.2 million, or 1%. Revenues in 2007 include a \$2.7 million increase from the favorable effects of currency translation, a \$1.9 million increase in stock-preparation equipment sales in North America due to an increase in capital sales, and a \$0.9 million increase, excluding the effect of currency translation, from Kadant Jining, acquired in June 2006. Offsetting these increases was a \$2.7 million decrease, excluding the effect of currency translation, in stock-preparation sales in China, excluding Kadant Jining, compared to near record sales in the second quarter of 2006 and a \$1.7 million decrease, excluding the effect of currency translation, in stock-preparation sales in Europe primarily due to weaker demand and the timing of large orders.

The following table presents revenues at the Papermaking Systems segment by product line, the changes in revenues by product line between the second quarters of 2007 and 2006, and the changes in revenues by product line between the second quarters of 2007 and 2006, excluding the effect of currency translation. The presentation of the changes in revenues by product line excluding the effect of currency translation is a non-GAAP (generally accepted accounting principles) measure. We believe this non-GAAP measure helps investors gain a better understanding of our underlying operations, consistent with how management measures and forecasts the Company's performance, especially when comparing such results to prior periods.

| (In millions) | Three Months Ended | | Increase (Decrease) | Increase (Decrease) Excluding Effect of Currency Translation |
|-----------------------------|--------------------|-----------------|------------------------|---|
| | June 30, 2007 | July 1, 2006 | | |
| Product Line: | | | | |
| Stock-Preparation Equipment | \$ 40.3 | \$ 40.9 | \$ (0.6) | \$ (1.6) |
| Fluid-Handling | 21.3 | 20.0 | 1.3 | 0.4 |
| Accessories | 15.9 | 14.4 | 1.5 | 0.9 |
| Water-Management | 8.5 | 9.5 | (1.0) | (1.2) |
| Other | 0.6 | 0.6 | - | - |
| | \$ 86.6 | \$ 85.4 | \$ 1.2 | \$ (1.5) |

Revenues from the segment's stock-preparation equipment product line decreased \$0.6 million, or 2%, in the second quarter of 2007 compared to the second quarter of 2006, including a \$1.0 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues from the segment's stock-preparation equipment product line decreased \$1.6 million due to a \$1.7 million, or 8%, decrease in sales in China in the second quarter of 2007 compared to near record sales in the second quarter of 2006. Also contributing to the decrease was a \$1.7 million, or 22%, decrease in sales in Europe due primarily to a decrease in sales of capital products. Offsetting these decreases was a \$1.9 million, or 16%, increase in sales in our North American-based business due to an increase in capital sales.

KADANT INC.

Results of Operations (continued)

Revenues from the segment's fluid-handling product line increased \$1.3 million, or 7%, in the second quarter of 2007 compared to the second quarter of 2006, including a \$0.9 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues from the segment's fluid-handling product line increased \$0.4 million, or 2%, primarily due to stronger demand for our products in Canada, the U.S., and China, offset in part by a decrease in sales in Latin America.

Revenues from the segment's accessories product line increased \$1.5 million, or 10%, in the second quarter of 2007 compared to the second quarter of 2006, including a \$0.6 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues from the segment's accessories product line increased \$0.9 million, or 6%, primarily due to an increase in sales in North America from stronger demand.

Revenues from the segment's water-management product line decreased \$1.0 million, or 10%, in the second quarter of 2007 compared to the second quarter of 2006, including a \$0.2 million increase from the favorable effect of currency translation, due primarily to a decrease in capital sales in North America.

Other Businesses. Revenues from the Fiber-based Products business decreased \$0.8 million, or 27%, to \$2.2 million in the second quarter of 2007 from \$3.0 million in the second quarter of 2006 due to weaker sales of Biodac™, our line of biodegradable granular products, from increased competition. Revenues from our Casting Products business decreased \$0.8 million, or 75%, to \$0.3 million in the second quarter of 2007 from \$1.1 million in the second quarter of 2006 due to the sale of this business in April 2007.

Gross Profit Margin

Gross profit margins for the second quarters of 2007 and 2006 are as follows:

| | Three Months Ended | |
|----------------------|--------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| <hr/> | | |
| Gross Profit Margin: | | |
| Papermaking Systems | 38% | 37% |
| Other | 34 | 31 |
| | 38% | 37% |

Gross profit margin was 38% and 37% in the second quarters of 2007 and 2006, respectively. The gross profit margin at the Papermaking Systems segment increased to 38% in the second quarter of 2007 from 37% in the second quarter of 2006. This increase was primarily due to higher margins in our capital products and, to a lesser extent, to a favorable product mix compared to last year. The gross profit margin at our other businesses increased to 34% in the second quarter of 2007 from 31% in the second quarter of 2006 due primarily to a higher gross profit margin at our Casting Products business partially offset by lower gross margins in the Fiber-based Products business.

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues were 26% and 25% in the second quarters of 2007 and 2006, respectively. Selling, general, and administrative expenses increased \$0.6 million, or 3%, to \$23.1 million in the second quarter of 2007 from \$22.5 million in the second quarter of 2006 primarily due to a \$0.7 million increase from the unfavorable effect of foreign currency translation.

Research and development expenses were \$1.5 million in both the second quarters of 2007 and 2006 and represented 2% of revenues in both periods.

Results of Operations (continued)

Loss on Sale of Subsidiary

On April 30, 2007, our Specialty Castings Inc. subsidiary sold its Casting Products business for \$0.4 million, resulting in a pre-tax loss of \$0.4 million on the sale.

Interest Income

Interest income was \$0.3 million in both the second quarters of 2007 and 2006.

Interest Expense

Interest expense was \$0.8 million in both the second quarters of 2007 and 2006.

Provision for Income Taxes

Our effective tax rate was 31% in both the second quarters of 2007 and 2006.

Income from Continuing Operations

Income from continuing operations increased to \$5.9 million in the second quarter of 2007 from \$5.6 million in the second quarter of 2006, an increase of \$0.3 million, or 6%. The increase in the 2007 period was primarily due to an increase in operating income of \$0.4 million (see *Revenues and Gross Profit Margin* discussed above), offset in part by an increase of \$0.2 million in the provision for income taxes.

Loss from Discontinued Operation

Loss from discontinued operation increased to \$1.0 million in the second quarter of 2007 from \$0.6 million in the second quarter of 2006 due primarily to a \$0.7 million pre-tax increase in warranty costs.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157 (SFAS 157), "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for us in the first quarter of 2008. We are currently analyzing the effect that SFAS 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 (SFAS 159), "The Fair Value Option for Financial Assets and Financial Liabilities - including an Amendment of FASB Statement No. 115." SFAS 159 permits entities to measure eligible financial assets, financial liabilities and certain other assets and liabilities at fair value on an instrument-by-instrument basis. The fair value measurement election is irrevocable once made and subsequent changes in fair value must be recorded in earnings. The effect of adoption will be reported as a cumulative-effect adjustment to beginning retained earnings in the first quarter of 2008. We are currently analyzing the effect that SFAS 159 will have on our consolidated financial statements.

KADANT INC.

Results of Operations (continued)

First Six Months 2007 Compared With First Six Months 2006

The following table sets forth our unaudited condensed consolidated statement of income expressed as a percentage of total revenues from continuing operations for the first six months of 2007 and 2006. The results of operations for the first six months of 2007 are not necessarily indicative of the results to be expected for the full fiscal year.

| | Six Months Ended | |
|---|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Revenues | 100% | 100% |
| Costs and Operating Expenses: | | |
| Cost of revenues | 63 | 63 |
| Selling, general, and administrative expenses | 26 | 27 |
| Research and development expenses | 2 | 2 |
| | <u>91</u> | <u>92</u> |
| Operating Income | 9 | 8 |
| Interest Income | 1 | 1 |
| Interest Expense | (1) | (1) |
| Income from Continuing Operations Before Provision for Income Taxes | 9 | 8 |
| Provision for Income Taxes | <u>3</u> | <u>3</u> |
| Income from Continuing Operations | 6 | 5 |
| Loss from Discontinued Operation | (1) | - |
| Net Income | <u>5%</u> | <u>5%</u> |

Revenues

Revenues increased to \$177.3 million in the first six months of 2007 from \$165.2 million in the first six months of 2006, an increase of \$12.1 million, or 7%. Revenues in the first six months of 2007 include a \$5.4 million increase in stock-preparation equipment sales in North America primarily due to higher percentage-of-completion revenues derived from several large systems orders, a \$5.1 million increase from the favorable effects of currency translation, and a \$3.7 million increase, excluding the effects of currency translation, from Kadant Jining, acquired in June 2006. Partially offsetting these increases was a \$1.4 million decrease in revenues from our Fiber-based Products business due to increased competition and a \$0.6 million decrease in revenues from our Casting Products business, which we sold in April 2007.

Revenues for the first six months of 2007 and 2006 from our Papermaking Systems segment and our other businesses are as follows:

| (In thousands) | Six Months Ended | |
|---------------------|-------------------|-------------------|
| | June 30, 2007 | July 1, 2006 |
| Revenues: | | |
| Papermaking Systems | \$ 170,643 | \$ 156,500 |
| Other Businesses | 6,705 | 8,658 |
| | <u>\$ 177,348</u> | <u>\$ 165,158</u> |

KADANT INC.

Results of Operations (continued)

Papermaking Systems Segment. Revenues at the Papermaking Systems segment increased to \$170.6 million in the first six months of 2007 from \$156.5 million in the first six months of 2006, an increase of \$14.1 million, or 9%. Revenues in 2007 include a \$5.4 million increase in stock-preparation equipment sales in North America primarily due to higher percentage-of-completion revenues derived from several large systems orders, a \$5.1 million increase from the favorable effects of currency translation, and a \$3.7 million increase, excluding the effects of currency translation, from Kadant Jining, acquired in June 2006.

The following table presents revenues at the Papermaking Systems segment by product line, the changes in revenues by product line between the first six months of 2007 and 2006, and the changes in revenues by product line between the first six months of 2007 and 2006, excluding the effect of currency translation. The presentation of the changes in revenues by product line excluding the effect of currency translation is a non-GAAP (generally accepted accounting principles) measure. We believe this non-GAAP measure helps investors gain a better understanding of our underlying operations, consistent with how management measures and forecasts the Company's performance, especially when comparing such results to prior periods.

| (In millions) | Six Months Ended | | Increase (Decrease) | Increase (Decrease) Excluding Effect of Currency Translation |
|-----------------------------|------------------|-----------------|------------------------|---|
| | June 30, 2007 | July 1, 2006 | | |
| Product Line: | | | | |
| Stock-Preparation Equipment | \$ 80.2 | \$ 71.8 | \$ 8.4 | \$ 6.6 |
| Fluid-Handling | 41.4 | 39.0 | 2.4 | 0.7 |
| Accessories | 31.4 | 28.5 | 2.9 | 1.7 |
| Water-Management | 16.5 | 16.0 | 0.5 | 0.1 |
| Other | 1.1 | 1.2 | (0.1) | (0.1) |
| | <u>\$ 170.6</u> | <u>\$ 156.5</u> | <u>\$ 14.1</u> | <u>\$ 9.0</u> |

Revenues from the segment's stock-preparation equipment product line increased \$8.4 million, or 12%, in the first six months of 2007 compared to the first six months of 2006, including a \$1.8 million increase from the favorable effect of currency translation. Excluding the effect of currency translation revenues from the segment's stock-preparation equipment line increased \$6.6 million, or 9%, due primarily to a \$5.4 million, or 22%, increase in capital equipment sales in North America due to higher percentage-of-completion revenues derived from several large systems orders and a \$3.7 million increase from Kadant Jining, acquired in June 2006. Partially offsetting these increases was a \$1.8 million decrease in sales in Europe due primarily to a decrease in sales of capital products.

Revenues from the segment's fluid-handling product line increased \$2.4 million, or 6%, in the first six months of 2007 compared to the first six months of 2006, including a \$1.7 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues from the segment's fluid-handling product line increased \$0.7 million, or 2%, due to stronger demand for our products in China and Canada, offset in part by a decrease in sales in Latin America.

Revenues from the segment's accessories product line increased \$2.9 million, or 10%, in the first six months of 2007 compared to the first six months of 2006, including a \$1.2 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues from the segment's accessories product line increased \$1.7 million, or 6%, due primarily to a \$2.3 million increase in sales in North America related primarily to stronger demand for capital equipment.

Revenues from the segment's water-management product line increased \$0.5 million, or 3%, in the first six months of 2007 compared to the first six months of 2006, including a \$0.4 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues from the segment's water-management product line increased \$0.1 million, or 1%.

Other Businesses. Revenues from the Fiber-based Products business decreased \$1.4 million, or 21%, to \$5.2 million in the first six months of 2007 from \$6.6 million in the first six months of 2006 due to weaker sales of Biodac™, our line of biodegradable

KADANT INC.

Results of Operations (continued)

granular products, from increased competition. Revenues from our Casting Products business decreased \$0.6 million, or 27%, to \$1.5 million in the first six months of 2007 from \$2.1 million in the first six months of 2006 due primarily to the sale of this business in April 2007.

Gross Profit Margin

Gross profit margins for the first six months of 2007 and 2006 are as follows:

| | Six Months Ended | |
|----------------------|------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Gross Profit Margin: | | |
| Papermaking Systems | 38% | 38% |
| Other | 34 | 30 |
| | 38% | 37% |

Gross profit margin was 38% and 37% in the first six months of 2007 and 2006, respectively. The gross profit margin at the Papermaking Systems segment was 38% in the first six months of 2007 and 2006. The gross profit margin at our other businesses increased to 34% in the first six months of 2007 from 30% in the first six months of 2006 due primarily to a higher gross profit margin at our Casting Products business.

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues were 26% and 27% in the first six months of 2007 and 2006, respectively. Selling, general, and administrative expenses increased \$2.0 million, or 4%, to \$46.6 million in the first six months of 2007 from \$44.6 million in the first six months of 2006. This increase included a \$1.4 million increase from the unfavorable effect of foreign currency translation and a \$0.8 million increase in selling, general, and administrative expenses from Kadant Jining, acquired in June 2006.

Unrecognized compensation expense related to unvested restricted share/unit awards totaled approximately \$4.7 million as of June 30, 2007 and is expected to be recognized over a weighted average period of 3 years.

Research and development expenses increased \$0.1 million to \$3.2 million in the first six months of 2007 compared to \$3.0 million in the first six months of 2006 and represented 2% of revenues in both periods.

Loss on Sale of Subsidiary

On April 30, 2007, our Specialty Castings Inc. subsidiary sold its Casting Products business for \$0.4 million, resulting in a pre-tax loss of \$0.4 million on the sale.

Interest Income

Interest income increased to \$0.7 million in the first six months of 2007 compared to \$0.5 million in the first six months of 2006 due primarily to higher prevailing interest rates.

Interest Expense

Interest expense was \$1.6 million in both the first six months of 2007 and 2006.

KADANT INC.

Results of Operations (continued)

Provision for Income Taxes

Our effective tax rate was 31% and 32% in the first six months of 2007 and 2006, respectively. The 1% decrease in our effective tax rate in 2007 was primarily due to a greater portion of our operating profits occurring in lower tax jurisdictions in 2007 compared to 2006.

Income from Continuing Operations

Income from continuing operations increased to \$10.6 million in the first six months of 2007 from \$8.4 million in the first six months of 2006, an increase of \$2.2 million, or 27%. The increase in the 2007 period was primarily due to an increase in operating income of \$3.0 million (see *Revenues, Gross Profit Margin, and Operating Expenses* discussed above), offset in part by an increase of \$0.9 million in the provision for income taxes.

Loss from Discontinued Operation

Loss from discontinued operation increased to \$1.4 million in the first six months of 2007 from \$0.7 million in the first six months of 2006 due primarily to a \$1.2 million pre-tax increase in warranty costs.

Liquidity and Capital Resources

Consolidated working capital, including the discontinued operation, was \$87.3 million at June 30, 2007, compared with \$80.5 million at December 30, 2006. Included in working capital are cash and cash equivalents of \$40.3 million at June 30, 2007, compared with \$39.6 million at December 30, 2006. At June 30, 2007, \$34.2 million of cash and cash equivalents were held by our foreign subsidiaries.

First Six Months of 2007

Our operating activities provided cash of \$2.7 million in the first six months of 2007, including \$3.8 million provided by our continuing operations and \$1.1 million used by the discontinued operation. The cash provided by our continuing operations in the first six months of 2007 was primarily due to income from continuing operations of \$10.6 million, a non-cash charge of \$3.6 million for depreciation and amortization expense, and an increase in accounts payable of \$3.0 million. These sources of cash were offset in part by an increase in unbilled contract costs and fees of \$7.7 million and an increase in inventories of \$3.8 million. The increase in unbilled contract costs and fees and inventories was primarily due to the timing of contracts recognized under the percentage-of-completion method of accounting. The \$1.1 million used in our discontinued operation was related primarily to the payment of \$1.9 million in warranty claims in the first six months of 2007.

Our investing activities used cash of \$2.2 million in the first six months of 2007, including \$2.9 million used by our continuing operations and \$0.7 million provided by our discontinued operation. We used cash in our continuing operations of \$1.7 million to purchase property, plant, and equipment. We also used cash in our continuing operations as consideration in acquisitions, including \$0.9 million associated with the Kadant Johnson acquisition and \$0.6 million associated with the Kadant Jining acquisition. These uses of cash were offset in part by cash received of \$0.3 million associated with the sale of our Casting Products business. The discontinued operation received \$0.7 million in cash related to funds released from escrow as certain indemnification obligations were satisfied.

Our financing activities used cash of \$1.8 million in the first six months of 2007 related entirely to our continuing operations. We used cash of \$5.2 million to repurchase our common stock on the open market, and \$3.9 million for principal payments on our debt obligations. These uses of cash were largely offset by \$5.4 million of proceeds from the issuance of common stock in connection with the exercise of employee stock options and \$1.9 million of related tax benefits.

First Six Months of 2006

Our operating activities used cash of \$3.8 million in the first six months of 2006, including \$0.3 million used by continuing operations and \$3.5 million used by the discontinued operation. The cash used by operating activities in the first six months of

KADANT INC.

Liquidity and Capital Resources (continued)

2006 was primarily due to an increase in unbilled contract costs and fees of \$15.7 million, an increase in accounts receivable of \$6.2 million, and an increase in inventories of \$2.3 million. These increases were primarily associated with an increase in contracts in our stock preparation product line recognized under the percentage-of-completion method. An additional \$5.0 million of cash was used in the first six months of 2006 due to a reduction of other current liabilities. The reduction of other current liabilities was due primarily to a decrease of \$4.4 million in billings in excess of contract costs and fees due to the timing of contracts recognized under the percentage-of-completion method and a decrease of \$4.1 million in accrued restructuring costs due to payments made in the first six months of 2006, offset by an increase in other current liabilities of \$3.5 million. Offsetting these uses of cash in the first six months of 2006 was a \$17.2 million source of cash associated with an increase in accounts payable. In addition, cash was provided in the first six months of 2006 from \$8.4 million of income from continuing operations, and a non-cash charge of \$3.8 million for depreciation and amortization expense. The \$3.5 million of cash used by the discontinued operation was primarily related to the payment of \$2.7 million for warranty claims and the payment of \$1.2 million in accrued expenses to reimburse the Buyer for claims paid on our behalf.

Our investing activities used cash of \$2.4 million in the first six months of 2006, including \$6.6 million used by continuing operations and \$4.2 million provided by the discontinued operation. We used cash of \$5.6 million in our continuing operations to complete the purchase of certain fixed assets as part of the Kadant Jining acquisition. We also used \$1.1 million in our continuing operations to purchase property, plant, and equipment. The cash provided by the discontinued operation of \$4.2 million relates to the reduction of restricted cash of \$3.4 million held in escrow to satisfy warranty claims and the cash proceeds of \$0.8 million received in the first quarter of 2006 from the Buyer of the assets of Composites LLC for post-closing adjustments.

Our financing activities provided cash of \$7.2 million in the first six months of 2006 related entirely to our continuing operations. We received \$10.0 million in proceeds from a commercial real estate loan entered into in May 2006 and \$5.0 million in loan proceeds in June 2006 associated with the Kadant Jining acquisition. In addition, we received \$4.3 million of proceeds from the issuance of common stock in connection with the exercise of employee stock options. We used cash of \$12.3 million in the first six months of 2006 for principal payments on our term loan. We also paid \$0.6 million to the sellers of Kadant Johnson associated with the first installment due for additional consideration related to anticipated tax benefits.

Additional Liquidity and Capital Resources

We completed our acquisition of Kadant Johnson on May 11, 2005 for approximately \$114.0 million, of which \$101.5 million was paid in cash at closing, \$1.6 million was paid in the fourth quarter of 2006 in settlement of post-closing adjustments, \$4.8 million was paid for acquisition-related costs, and \$6.1 million we expect to pay in annual installments through 2010 related to certain tax assets of Kadant Johnson, the value of which we expect to realize. In both 2006 and 2007, we paid \$0.9 million of this additional consideration. The remaining balance, of which \$0.9 million is included in other current liabilities and \$3.4 million is included in other long-term liabilities in the accompanying condensed consolidated balance sheet, is due over the next three years as follows: \$0.9 million in each of 2008 and 2009 and \$2.5 million in 2010. To fund \$60 million of the purchase price, we entered into a term loan and revolving credit facility (Credit Agreement) effective as of May 9, 2005, as subsequently amended, in the aggregate principal amount of up to \$95 million, including a \$35 million revolver. The Credit Agreement includes a \$60 million term loan (Term Loan), which is repayable in quarterly installments over a five-year period. The remaining principal amount outstanding at June 30, 2007 is \$35.3 million and is to be repaid each year as follows: \$5.0 million, \$11.4 million, \$12.6 million and \$6.3 million in 2007, 2008, 2009, and 2010, respectively.

The amount we are able to borrow under the revolving line of credit is the total borrowing capacity less any outstanding letters of credit and multi-currency borrowings issued under the Credit Agreement. As of June 30, 2007, there were no outstanding borrowings under the revolving line of credit and we had \$14.4 million of borrowing capacity.

Our obligations under the Credit Agreement may be accelerated upon the occurrence of an event of default under the Credit Agreement, which include customary events of default including, without limitation, payment defaults, defaults in the performance of affirmative and negative covenants, the inaccuracy of representations or warranties, bankruptcy- and insolvency-related defaults, defaults relating to such matters as ERISA, uninsured judgments and the failure to pay certain indebtedness, and a change-of-control default.

KADANT INC.

Liquidity and Capital Resources (continued)

In addition, the Credit Agreement contains negative covenants applicable to us and our subsidiaries, including financial covenants requiring us to comply with a maximum consolidated leverage ratio of 3.0, which is lowered to 2.5 in certain circumstances, including when we make a material acquisition, pay dividends, or repurchase our stock. We are also required to comply with a minimum consolidated fixed charge coverage ratio of 1.5. In addition to the financial covenants, we are also required to comply with covenants related to restrictions on liens, indebtedness, fundamental changes, dispositions of property, making certain restricted payments (including dividends and stock repurchases), investments, transactions with affiliates, sale and leaseback transactions, swap agreements, changing our fiscal year, negative pledges, arrangements affecting subsidiary distributions, and entering into new lines of business. As of June 30, 2007, we were in compliance with these covenants. On May 9, 2007, we entered into a fourth amendment to our Credit Agreement to eliminate one of the restrictions on the payment of dividends and repurchases of our common stock, which was limited to \$15 million plus 50% of net income earned after May 9, 2005.

The loans under the Credit Agreement are guaranteed by certain of our domestic subsidiaries and secured by a pledge of 65% of the stock of our first-tier foreign subsidiaries and our subsidiary guarantors pursuant to a guarantee and pledge agreement effective May 9, 2005 in favor of JPMorgan Chase Bank, N.A., as agent on behalf of the lenders.

We entered into swap agreements in 2005 and 2006 to convert a portion of our outstanding debt from floating to fixed rates of interest. As of June 30, 2007, \$34.8 million, or 69%, of our outstanding debt was hedged through interest rate swap agreements. The swap agreements have the same terms and quarterly payment dates as the corresponding debt and reduce proportionately in line with the amortization of the debt.

On July 30, 2007, our Kadant Jining subsidiary entered into a short-term credit facility that would allow Kadant Jining to borrow up to an aggregate principal amount of 45 million Chinese renminbi, or approximately \$5.9 million at current exchange rates, and our Kadant Yanzhou subsidiary entered into a short-term credit facility that would allow Kadant Yanzhou to borrow up to an aggregate principal amount of 15 million Chinese renminbi, or approximately \$2.0 million at current exchange rates. Both credit facilities have a term of 364 days. Borrowings made under the facilities will bear interest at 90% of the applicable short-term interest rate for a Chinese renminbi loan of comparable term as published by The People's Bank of China. The facilities will be used for general working capital purposes and may include the cash collateralization of certain bank payment guarantees provided by Bank of China Ltd. in connection with the acquisition of the assets of Jining Huayi Light Industry Machinery Co., Ltd. (Huayi) in 2006. We have provided a guaranty, dated July 30, 2007, securing the payment of all obligations made under these credit facilities and providing a cross-default to our existing Credit Agreement, dated as of May 9, 2005, as amended to date.

On June 2, 2006, our Kadant Jining subsidiary assumed responsibility for the operation of Huayi, and, by September 30, 2006, acquired the assets of Huayi including cash, inventory, machinery, equipment, and buildings for approximately \$21.2 million, net of assumed liabilities of \$2.3 million. Of the total consideration, \$17.3 million was paid in cash, including \$1.0 million for acquisition-related costs. To finance a portion of the acquisition, on June 6, 2006, Kadant Jining borrowed 40 million Chinese renminbi, or \$5.1 million, under a 47-month interest-only loan with Bank of China Limited. Interest on this loan accrues and is payable quarterly in arrears based on the interest rate published by Bank of China Limited for a loan of the same term less 10%. Of the remaining purchase obligation totaling \$3.8 million, \$1.0 million has been paid to date and the remaining \$2.8 million will be paid through January 2008 as certain obligations are satisfied, through a combination of cash and borrowings in China.

On May 3, 2006, our board of directors authorized the repurchase of up to \$15.0 million of our equity securities during the period from May 18, 2006 through May 18, 2007. We purchased 508,500 shares for \$12.4 million under this authorization. On May 2, 2007, our board of directors approved the repurchase by us of up to \$20 million of our equity securities during the period from May 2, 2007 through May 2, 2008. Repurchases under the May 2007 authorization may be made in public or private transactions, including under Securities Exchange Act Rule 10b-5-1 trading plans. As of June 30, 2007, no purchases had been made under the May 2007 authorization.

It is our practice to reinvest indefinitely the earnings of our international subsidiaries, except in instances in which we can remit such earnings without a significant associated tax cost. Through June 30, 2007, we have not provided for U.S. income taxes on approximately \$68.1 million of unremitted foreign earnings. We believe that any U.S. tax liability due upon remittance of such earnings would be immaterial due to the availability of U.S. foreign tax credits generated from such remittance. The related foreign tax withholding, which would be required if we remitted the foreign earnings to the U.S., would be approximately \$2.7 million.

KADANT INC.

Liquidity and Capital Resources (continued)

On October 21, 2005, Composites LLC sold its composites business, presented as a discontinued operation in the accompanying condensed consolidated financial statements. As part of the transaction, Composites LLC retained the warranty obligation associated with products manufactured prior to the sale date. At June 30, 2007, the warranty reserve for the composites business was \$1.4 million. Our liquidity and consolidated results will continue to be impacted by future cash payments for warranty claims and any adjustments to this warranty obligation. Adjustments to our results for these items will continue to be classified within the results for the discontinued operation in our condensed consolidated financial statements.

Although we currently have no material commitments for capital expenditures, we plan to make expenditures of approximately \$4.9 million during the remainder of 2007 for property, plant, and equipment.

In the future, our liquidity position will be primarily affected by the level of cash flows from operations, cash paid to satisfy the remaining purchase obligation for the Kadant Jining and Kadant Johnson acquisitions, debt repayments, capital projects, stock repurchases, or additional acquisitions, if any. We believe that our existing resources, together with the cash available from our Credit Agreement, cash proceeds from additional borrowings we anticipate entering into in China to complete the Kadant Jining acquisition, and the cash we expect to generate from continuing operations, will be sufficient to meet the capital requirements of our current operations for the foreseeable future.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk from changes in interest rates and foreign currency exchange rates has not changed materially from our exposure at year-end 2006 as disclosed in Item 7A of our Annual Report on Form 10-K for the fiscal year ended December 30, 2006 filed with the SEC.

Item 4 - Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2007. The term "disclosure controls and procedures," as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based upon the evaluation of our disclosure controls and procedures as of June 30, 2007, our Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2007, our disclosure controls and procedures were effective at the reasonable assurance level.

(b) Changes in Internal Control Over Financial Reporting

There have not been any changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the fiscal quarter ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1A - Risk Factors

In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, we wish to caution readers that the following important factors, among others, in some cases have affected, and in the future could affect, our actual results and could cause our actual results in 2007 and beyond to differ materially from those expressed in any forward-looking statements made by us, or on our behalf.

Our business is dependent on the condition of the pulp and paper industry.

We sell products primarily to the pulp and paper industry, which is a cyclical industry. Generally, the financial condition of the global pulp and paper industry corresponds to the condition of the general economy, as well as to a number of other factors, including pulp and paper production capacity relative to demand. In recent years, the paper industry in certain geographic regions, notably Europe and North America, has undergone a number of structural changes, including decreased spending, mill closures, consolidations, and bankruptcies, all of which have adversely affected our business. In addition, paper producers have been and continue to be negatively affected by higher operating costs, especially higher energy and chemical costs. We believe paper companies are still cautious about increasing their capital and operating spending in the current market environment. As paper companies consolidate in response to market weakness, they frequently reduce capacity and postpone or even cancel capacity addition or expansion projects. These actions can adversely affect our revenue and profitability globally or in a particular region or product line.

A significant portion of our international sales has, and may in the future, come from China and we operate several manufacturing facilities in China which exposes us to political, economic, operational and other risks.

In 2006, we experienced a significant increase in revenues from China and acquired manufacturing facilities in Jining and Yanzhou, China. Through our acquisition of Kadant Johnson in May 2005, we also have a manufacturing operation in Wuxi, China. We have begun manufacturing accessory products at our Chinese facilities for the Chinese market in 2007. During the first six months of 2007 and 2006, approximately \$38.7 million, or 22%, and \$33.2 million, or 20%, respectively, of our revenues were from customers in China. Our manufacturing facilities in China, as well as the significant level of revenues from China, expose us to increased risk in the event of changes in the policies of the Chinese government, political unrest, unstable economic conditions, or other developments in China or in U.S.-China relations that are adverse to trade, including enactment of protectionist legislation or trade or currency restrictions. In addition, orders from customers in China, particularly for large stock-preparation systems that have been tailored to a customer's specific requirements, have credit risks higher than we generally incur elsewhere, and some orders are subject to the receipt of financing approvals from the Chinese government. For this reason, we do not record signed contracts from customers in China for large stock-preparation systems as orders until we receive the down payments for such contracts. The timing of the receipt of these orders and the down payments are uncertain and there is no assurance that we will be able to recognize revenue on these contracts. We may experience a loss if the contract is cancelled prior to the receipt of a down payment in the event we commence engineering or other work associated with the contract. In addition, we may experience a loss if the contract is cancelled prior to the receipt of a letter of credit covering the remaining balance of the contract.

Our business is subject to economic, currency, political, and other risks associated with international sales and operations.

During the first six months of 2007 and 2006, approximately 61% and 59%, respectively, of our sales were to customers outside the United States, principally in China and Europe. In addition, we operate several manufacturing operations worldwide, including in China, Mexico, and Brazil. International revenues and operations are subject to a number of risks, including the following:

- agreements may be difficult to enforce and receivables difficult to collect through a foreign country's legal system,
- foreign customers may have longer payment cycles,
- foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs, or adopt other restrictions on foreign trade,
- it may be difficult to repatriate funds, due to unfavorable tax consequences or other restrictions or limitations imposed by foreign governments, and
- the protection of intellectual property in foreign countries may be more difficult to enforce.

Although we seek to charge our customers in the same currency in which our operating costs are incurred, fluctuations in currency exchange rates may affect product demand and adversely affect the profitability in U.S. dollars of products we provide in international markets where payment for our products and services is made in their local currencies. In addition, our inability to repatriate funds could adversely affect our ability to service our debt obligations. Any of these factors could have a material adverse impact on our business and results of operations.

KADANT INC.

We are subject to intense competition in all our markets.

We believe that the principal competitive factors affecting the markets for our products include quality, price, service, technical expertise, and product innovation. Our competitors include a number of large multinational corporations that may have substantially greater financial, marketing, and other resources than we do. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements, or to devote greater resources to the promotion and sale of their services and products. Competitors' technologies may prove to be superior to ours. Our current products, those under development, and our ability to develop new technologies may not be sufficient to enable us to compete effectively. Competition, especially in China, has increased as new companies enter the market and existing competitors expand their product lines and manufacturing operations.

Our debt may adversely affect our cash flow and may restrict our investment opportunities.

In 2005, we entered into a Credit Agreement, as subsequently amended, consisting of a \$60 million five-year term loan and a \$35 million revolver, and borrowed \$60 million to fund the acquisition of Kadant Johnson under the term loan. We have also borrowed additional amounts to fund other acquisitions and grow our business, and may also obtain additional long-term debt and working capital lines of credit to meet future financing needs, which would have the effect of increasing our total leverage.

Our leverage could have negative consequences, including:

- increasing our vulnerability to adverse economic and industry conditions,
- limiting our ability to obtain additional financing,
- limiting our ability to pay dividends on or to repurchase our capital stock,
- limiting our ability to acquire new products and technologies through acquisitions or licensing agreements, and
- limiting our flexibility in planning for, or reacting to, changes in our business and the industries in which we compete.

Our existing indebtedness bears interest at floating rates and as a result, our interest payment obligations on our indebtedness will increase if interest rates increase. To reduce the exposure to floating rates, \$34.8 million, or 69%, of our outstanding floating rate debt as of June 30, 2007 was hedged through interest rate swap agreements.

Our ability to satisfy our obligations and to reduce our total debt depends on our future operating performance and on economic, financial, competitive, and other factors beyond our control. Our business may not generate sufficient cash flows to meet these obligations or to successfully execute our business strategy. If we are unable to service our debt and fund our business, we may be forced to reduce or delay capital expenditures or research and development expenditures, seek additional financing or equity capital, restructure or refinance our debt, or sell assets. We may not be able to obtain additional financing or refinance existing debt or sell assets on terms acceptable to us or at all.

Restrictions in our Credit Agreement may limit our activities.

Our Credit Agreement contains, and future debt instruments to which we may become subject may contain, restrictive covenants that limit our ability to engage in activities that could otherwise benefit us, including restrictions on our ability and the ability of our subsidiaries to:

- incur additional indebtedness,
- pay dividends on, redeem, or repurchase our capital stock,
- make investments,
- create liens,
- sell assets,
- enter into transactions with affiliates, and
- consolidate, merge, or transfer all or substantially all of our assets and the assets of our subsidiaries.

We are also required to meet specified financial ratios under the terms of our Credit Agreement. Our ability to comply with these financial restrictions and covenants is dependent on our future performance, which is subject to prevailing economic conditions and other factors, including factors that are beyond our control such as foreign exchange rates, interest rates, changes in technology, and changes in the level of competition.

Our failure to comply with any of these restrictions or covenants may result in an event of default under our Credit Agreement and other loan obligations, which could permit acceleration of the debt under those instruments and require us to repay the debt before its scheduled due date.

If an event of default occurs, we may not have sufficient funds available to make the required payments under our indebtedness. If we are unable to repay amounts owed under our debt agreements, those lenders may be entitled to foreclose on and sell the collateral that secures our borrowings under the agreements.

KADANT INC.

The total liabilities associated with the discontinued operation are expected to exceed the total assets of the discontinued operation by the end of 2007.

On October 21, 2005, Composites LLC sold its composites business, but retained the warranty obligation associated with products manufactured prior to the sale date. All future activity associated with this warranty obligation will be classified in the results of the discontinued operation in our condensed consolidated financial statements. The discontinued operation has experienced significant liabilities associated with warranty claims related to its composite decking products manufactured prior to the sale date. Our consolidated results will continue to be negatively impacted by these warranty obligations. The assets and liabilities of the discontinued operation are held in our Composites LLC subsidiary. If Composites LLC continues to experience the same level of warranty claims, we expect that the total liabilities of Composites LLC will exceed the total assets of Composites LLC by the end of 2007. In addition, it is expected that Composites LLC will not have sufficient cash to satisfy all warranty claims.

During the third quarter of 2006, Composites LLC concluded that the highly subjective nature of the assumptions used in estimating the warranty obligation were not accurately predicting the actual level of warranty claims, making it no longer possible to calculate a reasonable estimate of the future level of potential warranty claims. Accordingly, as no amount within the total range of loss represents a best estimate of the ultimate loss to be recorded, we are required under Statement of Financial Accounting Standards (SFAS) No. 5, "Accounting for Contingencies" to record the minimum amount of the potential range of loss as the warranty obligation in our consolidated results. The warranty obligation as of June 30, 2007 represents the low end of the estimated range of warranty reserve required based on the level of claims processed to date. The total potential warranty cost ranges from \$1.4 million to approximately \$13.8 million. The high end of the range represents the estimated maximum level of warranty claims remaining based on the total sales of the products under warranty. Going forward, adjustments to the warranty obligation will be recorded to reflect the minimum amount of the potential range of loss for products under warranty which will adversely affect our consolidated results.

Our inability to successfully identify and complete acquisitions or successfully integrate any new or previous acquisitions could have a material adverse effect on our business.

Our strategy includes the acquisition of technologies and businesses that complement or augment our existing products and services. Our most recent acquisition was the Kadant Jining acquisition in June 2006. Any such acquisition involves numerous risks that may adversely affect our future financial performance and cash flows. These risks include:

- competition with other prospective buyers resulting in our inability to complete an acquisition or in us paying substantial premiums over the fair value of the
 - net assets of the acquired business,
- inability to obtain regulatory approval, including antitrust approvals,
- difficulty in assimilating operations, technologies, products and the key employees of the acquired business,
- inability to maintain existing customers or to sell the products and services of the acquired business to our existing customers,
- diversion of management's attention away from other business concerns,
- inability to improve the revenues and profitability or realize the cost savings and synergies expected in the acquisition,
- assumption of significant liabilities, some of which may be unknown at the time,
- potential future impairment of the value of goodwill and intangible assets acquired, and
- identification of internal control deficiencies of the acquired business.

We may be required to reorganize our operations in response to changing conditions in the paper industry, and such actions may require significant expenditures and may not be successful.

In the past few years, we have undertaken various restructuring measures in response to changing market conditions in the paper industry. For example, in 2004 we incurred costs of approximately \$9.2 million in connection with the restructuring of our subsidiary in France and in 2006 implemented a restructuring plan in our Papermaking Systems segment. We may engage in additional cost reduction programs in the future. We may not recoup the costs of programs we have already initiated, or other programs in which we may decide to engage in the future, the costs of which may be significant. In connection with any future plant closures, delays or failures in the transition of production from existing facilities to our other facilities in other geographic regions could also adversely affect our financial operations. In addition, our profitability may decline if our restructuring efforts do not sufficiently reduce our future costs and position us to maintain or increase our sales.

KADANT INC.

Our fiber-based products business is subject to a number of factors that may adversely influence its profitability, including high costs of natural gas and dependence on a few suppliers of raw materials.

We use natural gas in the production of our fiber-based granular products, the price of which is subject to fluctuation. We seek to manage our exposure to natural gas price fluctuations by entering into short-term forward contracts to purchase specified quantities of natural gas from a supplier. We may not be able to effectively manage our exposure to natural gas price fluctuations. Although the cost of natural gas has fallen recently, we may not realize the benefit of lower prices due to the short-term forward contracts we have entered into. Higher costs of natural gas will adversely affect our consolidated results if we are unable to effectively manage our exposure or pass these costs on to customers in the form of surcharges.

We are dependent on two paper mills for the fiber used in the manufacture of our fiber-based granular products. These mills have the exclusive right to supply the papermaking byproducts used in the manufacturing process. Due to process changes at the mills, we have experienced some difficulty obtaining sufficient raw material to operate at optimal production levels. We continue to work with the mills to ensure a stable supply of raw material. To date, we have been able to meet all of our customer delivery requirements, but there can be no assurance that we will be able to meet future delivery requirements. Although we believe our relationship with the mills is good, the mills could decide not to renew the contract when it expires at the end of 2007, or may not agree to renew on commercially reasonable terms. If the mills were unable or unwilling to supply us sufficient fiber, we would be forced to find an alternative supply for this raw material. We may be unable to find an alternative supply on commercially reasonable terms or could incur excessive transportation costs if an alternative supplier were found, which would increase our manufacturing costs and might prevent prices for our products from being competitive.

Our inability to protect our intellectual property could have a material adverse effect on our business. In addition, third parties may claim that we infringe their intellectual property, and we could suffer significant litigation or licensing expense as a result.

We seek patent and trade secret protection for significant new technologies, products, and processes because of the length of time and expense associated with bringing new products through the development process and into the marketplace. We own numerous U.S. and foreign patents, and we intend to file additional applications, as appropriate, for patents covering our products. Patents may not be issued for any pending or future patent applications owned by or licensed to us, and the claims allowed under any issued patents may not be sufficiently broad to protect our technology. Any issued patents owned by or licensed to us may be challenged, invalidated, or circumvented, and the rights under these patents may not provide us with competitive advantages. In addition, competitors may design around our technology or develop competing technologies. Intellectual property rights may also be unavailable or limited in some foreign countries, which could make it easier for competitors to capture increased market share. We could incur substantial costs to defend ourselves in suits brought against us, including for alleged infringement of third party rights, or in suits in which we may assert our intellectual property rights against others. An unfavorable outcome of any such litigation could have a material adverse effect on our business and results of operations. In addition, as our patents expire, we rely on trade secrets and proprietary know-how to protect our products. We cannot be sure the steps we have taken or will take in the future will be adequate to deter misappropriation of our proprietary information and intellectual property. Of particular concern are developing economies such as China, where the laws, courts, and administrative agencies may not protect our intellectual property rights as fully as in other countries.

We seek to protect trade secrets and proprietary know-how, in part, through confidentiality agreements with our collaborators, employees, and consultants. These agreements may be breached, we may not have adequate remedies for any breach, and our trade secrets may otherwise become known or be independently developed by our competitors or our competitors may otherwise gain access to our intellectual property.

Fluctuations in our quarterly operating results may cause our stock price to decline.

Given the nature of the markets in which we participate and the effect of Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition," we may not be able to reliably predict future revenues and profitability, and unexpected changes may cause us to adjust our operations. A large proportion of our costs are fixed, due in part to our significant selling, research and development, and manufacturing costs. Thus, small declines in revenues could disproportionately affect our operating results. Other factors that could affect our quarterly operating results include:

- failure of our products to pass contractually agreed upon acceptance tests, which would delay or prohibit recognition of revenues under SAB No. 104,
- changes in the assumptions used for revenue recognized under the percentage-of-completion method of accounting,
- failure of a customer, particularly in China, to comply with an order's contractual obligations,
- adverse changes in demand for and market acceptance of our products,
- competitive pressures resulting in lower sales prices of our products,
- adverse changes in the pulp and paper industry,
- delays or problems in our introduction of new products,
- delays or problems in the manufacture of our products,
- our competitors' announcements of new products, services, or technological innovations,
- contractual liabilities incurred by us related to guarantees of our product performance,
- increased costs of raw materials or supplies, including the cost of energy,
- changes in the timing of product orders, and
- fluctuations in our effective tax rate.

KADANT INC.

Anti-takeover provisions in our charter documents, under Delaware law, and in our shareholder rights plan could prevent or delay transactions that our shareholders may favor.

Provisions of our charter and bylaws may discourage, delay, or prevent a merger or acquisition that our shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares. For example, these provisions:

- authorize the issuance of “blank check” preferred stock without any need for action by shareholders,
- provide for a classified board of directors with staggered three-year terms,
- require supermajority shareholder voting to effect various amendments to our charter and bylaws,
- eliminate the ability of our shareholders to call special meetings of shareholders,
- prohibit shareholder action by written consent, and
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by shareholders at shareholder meetings.

In addition, our board of directors has adopted a shareholder rights plan intended to protect shareholders in the event of an unfair or coercive offer to acquire our company and to provide our board of directors with adequate time to evaluate unsolicited offers. Preferred stock purchase rights have been distributed to our common shareholders pursuant to the rights plan. This rights plan may have anti-takeover effects. The rights plan will cause substantial dilution to a person or group that attempts to acquire us on terms that our board of directors does not believe are in our best interests and those of our shareholders and may discourage, delay, or prevent a merger or acquisition that shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares.

KADANT INC.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about purchases by us of our common stock during the second quarter of 2007:

| Issuer Purchases of Equity Securities | | | | |
|---------------------------------------|---|---------------------------------|---|---|
| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans (2) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans |
| 4/1/07 - 4/30/07 | - | - | - | \$ 2,633,980 |
| 5/1/07 - 5/31/07 | - | - | - | \$ 20,000,000 |
| 6/1/07 - 6/30/07 | - | - | - | \$ 20,000,000 |
| Total: | - | - | - | |

- (1) On May 3, 2006, our board of directors approved the repurchase by us of up to \$15 million of our equity securities during the period from May 18, 2006 through May 18, 2007. Under this authorization, we repurchased 508,500 shares of our common stock for \$12.4 million.
- (2) On May 2, 2007, our board of directors approved the repurchase by us of up to \$20 million of our equity securities during the period from May 2, 2007 through May 2, 2008. Repurchases may be made in public or private transactions, including under Securities Exchange Act Rule 10b-5-1 trading plans. As of June 30, 2007, no purchases had been made under this authorization.

Item 4 - Submission of Matters to a Vote of Security Holders

On May 24, 2007, at the annual meeting of shareholders, the shareholders re-elected one incumbent director. Mr. William A. Rainville was elected to the class of directors whose three-year term expires at Kadant's annual meeting of shareholders in 2010. Mr. Rainville received 12,077,323 shares voted in favor of his election and 938,096 shares voted against.

At the annual meeting, stockholders also approved a proposal to adopt our cash incentive plan. The plan received 12,209,301 shares voted in favor of adoption, 623,876 shares voted against and 182,244 shares abstained. There were no broker non-votes.

Item 6 - Exhibits

See Exhibit Index on the page immediately preceding exhibits.

KADANT INC.

SIGNATURE

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 as of the 8th day of August, 2007.

KADANT INC.

/s/ Thomas M. O'Brien

Thomas M. O'Brien

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)

KADANT INC.

EXHIBIT INDEX

| Exhibit Number | Description of Exhibit |
|----------------|--|
| 10.1 * | Form of Performance-Based Restricted Stock Unit Award Agreement dated May 24, 2007 between the Company and its executive officers. |
| 10.2 | Short-Term Advised Credit Line Facility Agreement dated as of July 30, 2007 between Kadant Jining Light Machinery Co., Ltd. and JPMorgan Chase Bank, N.A., Shanghai Branch. |
| 10.3 | Short-Term Advised Credit Line Facility Agreement dated as of July 30, 2007 between Kadant Pulp and Paper Equipment (Yanzhou) Co., Ltd. and JPMorgan Chase Bank, N.A., Shanghai Branch. |
| 10.4 | Guaranty Agreement dated July 30, 2007 between Kadant Inc. and JPMorgan Chase Bank, N.A., Shanghai Branch. |
| 31.1 | Certification of the Principal Executive Officer of the Registrant Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of the Principal Financial Officer of the Registrant Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32 | Certification of the Chief Executive Officer and the Chief Financial Officer of the Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Management contract or compensatory plan or arrangement.

**Notice of Grant of Award
and Award Agreement**

Kadant Inc.
ID: 52-1762325
One Technology Park Drive
Westford, MA 01886

| | | |
|----------------------------|----------------------|-------------|
| [Recipient name] | Award Number: | [##] |
| [Recipient address] | Plan: | [##] |
| | ID: | [##] |

Effective 5/24/2007, you have been granted an award of [##] restricted stock units. These units are restricted until the vest date(s) shown below, at which time you will receive shares of Kadant Inc. (the Company) common stock.

The current total value of the award is \$[##].

The award will vest in increments on the date(s) shown.

| | |
|---------------|------------------|
| <u>Shares</u> | <u>Full Vest</u> |
| [##] | 1/2/2010 |

By your signature and the Company's signature below, you and the Company agree that this award is granted under and governed by the terms and conditions of the Company's Award Plan as amended and the Award Agreement, all of which are attached and made a part of this document.

| | |
|-------------|---------------------|
| _____ | <u>May 24, 2007</u> |
| Kadant Inc. | Date |

| | |
|------------------|---------------------|
| _____ | <u>May 24, 2007</u> |
| [Recipient name] | Date |

KADANT INC.

**AWARD AGREEMENT FOR
PERFORMANCE-BASED RESTRICTED STOCK UNITS
("Award Agreement")**

- Preamble.** On the effective date shown on the first page of this Award Agreement ("Award Date"), the Company granted to the Recipient restricted stock units ("RSUs") with respect to the number of shares of common stock of the Company identified on the first page of this Award Agreement ("Award Shares"), subject to the terms, conditions and restrictions set forth in this Award Agreement and the provisions of the Company's 2006 Equity Incentive Plan ("Plan"). The RSUs represent a promise by the Company to deliver the Award Shares upon vesting. Any consideration due to the Company on the issuance of Award Shares pursuant to this Award Agreement will be deemed to have been satisfied by services rendered by the Recipient to the Company during the vesting period.
- Restrictions on Transfer.** Unless and until the Award Shares shall have vested as provided in Section 3 below, the Recipient shall not sell, transfer, pledge, hypothecate, assign or otherwise dispose of, by operation of law or otherwise, any RSUs, or any interest therein.
- Vesting Date.** Subject to the terms, conditions and restrictions of this Award Agreement, including the Forfeiture provisions described in Section 4 below, the Recipient shall vest in all RSUs on January 2, 2010 (the "Vesting Date"), provided that the performance measure set forth in this Section 3 is met.

The Company has established as the performance measure earnings before interest, taxes, depreciation and amortization (EBITDA) generated by its continuing operations during the nine-month period beginning April 1, 2007 and ending December 29, 2007 (the "Measurement Period"), equal to the amount set forth in Exhibit A to this Award Agreement and as such amount may be adjusted as set forth in such Exhibit A (the "Target EBITDA"). Upon the conclusion of the Measurement Period, the Company shall calculate and determine the actual EBITDA generated by its continuing operations during the Measurement Period as set forth in Exhibit A ("Actual EBITDA"). The number of Award Shares deliverable to the Recipient will be adjusted and determined by a continuous line graph based on the following data points, which graph is included as Exhibit B:

| <u>Actual EBITDA is:</u> | <u>Number of Award Shares Deliverable</u> |
|----------------------------------|---|
| Less than 80% of Target EBITDA | 0% of Award Shares |
| 80% of Target EBITDA | 50% of Award Shares |
| 100% of Target EBITDA | 100% of Award Shares |
| 125% or greater of Target EBITDA | 150% of Award Shares |

In the event that the Company does not generate Actual EBITDA equal to or more than 80% of Target EBITDA, then all of the RSUs shall be automatically forfeited to the Company. The Compensation Committee of the Company's Board of Directors shall be responsible for

certifying the extent to which the performance measure has been met, prior to the release of the Company's earnings for the full 2007 fiscal year.

As soon as administratively practicable after the Vesting Date, but in any event within the period ending on the later to occur of the date that is 75 days from the end of the (i) Recipient's tax year that includes the Vesting Date, or (ii) the Company's fiscal year that includes the Vesting Date, the Company shall instruct its transfer agent to issue the Award Shares in the name of the Recipient, subject to payment of all applicable withholding taxes pursuant to Section 6 below.

4. **Forfeiture.**

(a) Definitions. For purposes of this Award Agreement, "Forfeiture" shall mean any forfeiture of RSUs pursuant to Section 4(b) below. For purposes of this Award Agreement, "employ" or "employment" with the Company shall include employment with a parent or subsidiary of the Company, which controls, is controlled by, or under common control of the Company.

(b) Termination of Employment.

- (i) In the event that the Recipient ceases to be employed by the Company prior to the Vesting Date for any reason or no reason (except for death or disability), with or without cause, then all of the Recipient's RSUs shall be automatically and immediately forfeited and returned to the Company as of the date employment ceases.
- (ii) In the event that the Recipient ceases to be employed by the Company by reason of death or disability, then the Company shall deliver to the Recipient a pro rata portion of the Award Shares covered by the RSUs determined in accordance with the schedule set forth below. The balance of the Recipient's RSUs and Award Shares that are not so delivered shall be automatically and immediately forfeited and returned to the Company as of the date of the Recipient's death or disability. For purposes of this Award Agreement, "disability" means that you are receiving disability benefits under the Company's Long Term Disability Coverage, as then in effect, on the date employment ceases.

| Event occurs: | <u>% of Award Shares Delivered</u> |
|-------------------------------|---|
| Prior to December 29, 2007 | 0% |
| On or after December 29, 2007 | 33 1/3% |
| On or after January 3, 2009 | 66 2/3% |
| On or after January 2, 2010 | 100% |

(c) Change in Control. In the event of a "Change in Control" that occurs (i) prior to the Vesting Date and before the last day of the Measurement Period and (ii) on a date on which the Recipient is employed by the Company, then 100% of the Recipient's RSUs that have not previously been forfeited shall become immediately vested and shall no longer be subject to the Forfeiture provisions in this Section 4, and the Company shall

immediately issue that number of Award Shares to the Recipient equal to the number shown on the first page of this Award Agreement, without adjustment. In the event of a "Change in Control" that occurs (i) prior to the Vesting Date and on or after the last day of the Measurement Period and (ii) on a date on which the Recipient is employed by the Company, then 100% of the Recipient's RSUs that have not previously been forfeited shall become immediately vested and shall no longer be subject to the Forfeiture provisions in this Section 4, and the Company shall immediately issue that number of Award Shares to the Recipient equal to the number of Award Shares deliverable based on the achievement of the performance measures, as adjusted and determined in Section 3. A "Change in Control" shall have the same meaning for the purposes of this Award Agreement as set forth in Section 8 of the Plan, as the same may be amended from time to time.

5. **No Stockholder Rights.** Except as set forth in the Plan, neither the Recipient nor any person claiming under or through the Recipient shall be, or have any rights or privileges of, a stockholder of the Company in respect of the Award Shares issuable pursuant to the RSUs until the Award Shares are issued in the name of the Recipient.
6. **Withholding Taxes.** The Company's obligation to deliver Award Shares to the Recipient upon the vesting of the RSUs shall be subject to the satisfaction of all income tax (including federal, state, local and foreign taxes), social insurance, payroll tax, payment on account or other tax-related withholding requirements of any applicable jurisdiction, based on minimum statutory withholding rates for all tax purposes, including payroll and social security taxes ("Withholding Taxes"). In order to satisfy all Withholding Taxes due in connection with the award or vesting of the RSUs or the delivery of the Award Shares, the Recipient hereby irrevocably agrees to the following actions by the Company, at the Company's sole election:
- (a) The Company may sell, or arrange for the sale of, such number of the Award Shares that the Recipient is entitled to receive on the Vesting Date, with no further action by the Recipient, as is sufficient to generate net proceeds at least equal to the value of the Withholding Taxes, and the Company shall retain such net proceeds in satisfaction of such Withholding Taxes. The Company shall remit to the Recipient in cash any portion of such net proceeds in excess of the value of such Withholding Taxes.
 - (b) The Company may retain such number of the Award Shares that the Recipient is otherwise entitled to receive on the Vesting Date, with no further action by the Recipient, by deducting and retaining from the number of Award Shares to which the Recipient is entitled that number of Award Shares as is equal to the value of the Withholding Taxes. The Recipient understands that the fair market value of the surrendered Award Shares will be determined in accordance with the Company's Stock Option and Equity Award Grant and Exercise Procedures as then in effect.
 - (c) The Recipient hereby appoints each of the Chief Financial Officer, General Counsel and the Secretary of the Company as his or her attorney in fact to sell or transfer the Recipient's Award Shares in accordance with this Section 6. The Recipient agrees to execute and deliver such documents, instruments and certificates as may reasonably be

required in connection with the sale, transfer or retention of Award Shares pursuant to this Section 6, including an irrevocable order to sell shares authorizing a brokerage firm selected by the Company to sell the Recipient's Award Shares.

7. **No Compensation Deferral.** Neither the Plan nor this Award Agreement is intended to provide for an elective deferral of compensation that would be subject to Section 409A ("Section 409A") of the U.S. Internal Revenue Code of 1986, as amended. The Company reserves the right, to the extent the Company deems necessary or advisable in its sole discretion, to unilaterally amend or modify the Plan and/or this Award Agreement to ensure that no awards (including, without limitation, the RSUs) become subject to the requirements of Section 409A.
8. **Administration.** The Compensation Committee of the Company's Board of Directors or other committee designated in the Plan, shall have the authority to manage and control the operation and administration of this Award Agreement. Any interpretation of the Award Agreement by any of the entities specified in the preceding sentence and any decision made by any of them with respect to the Award Agreement is final and binding.
9. **Plan Definitions.** Notwithstanding anything in this Award Agreement to the contrary, the terms of this Award Agreement shall be subject to the terms of the Plan, a copy of which has already been provided to the Recipient.
10. **Recipient's Undertakings.** In signing this Award Agreement and accepting the RSU, the Recipient acknowledges that:
 - (a) The Plan and this Award were established voluntarily by the Company, each is discretionary in nature, and each may be modified, amended, suspended or terminated by the Company at any time, unless otherwise provided in the Plan and this Award Agreement;
 - (b) The grant of RSUs is voluntary and occasional and does not create any contractual or other right to receive future awards of RSUs, or benefits in lieu of RSUs even if RSUs have been awarded repeatedly in the past or future;
 - (c) All decisions with respect to future grants of RSUs, if any, will be at the sole discretion of the Company;
 - (d) The Recipient's participation in the Plan and receipt and acceptance of the Award is voluntary;
 - (e) RSUs are an extraordinary item that do not constitute compensation of any kind for services of any kind rendered to the Company or to the Recipient's employer, and RSUs are outside the scope of the Recipient's employment contract, if any;
 - (f) RSUs are not part of normal or expected compensation or salary for any purpose, including, but not limited to, calculation of any severance, resignation, termination,

redundancy, end of service payments, bonuses, long-service awards, pension or retirement benefits or similar payments and in no event should be considered as compensation for, or relating in any way to, past services for the Company or the Recipient's employer;

- (g) The future value of the underlying Award Shares is unknown and cannot be predicted with certainty;
- (h) The value of the Award Shares underlying the RSUs may increase or decrease in value during the period from the Award Date to the Vesting Date;
- (i) In consideration of the grant of RSUs, no claim or entitlement to compensation or damages arises from termination of the RSUs or diminution in value of the RSUs or Award Shares received upon vesting of RSUs resulting from termination of the Recipient's employment by the Company or the Recipient's employer (for any reason whatsoever and whether or not in breach of local labor laws) and the Recipient irrevocably releases the Company and his or her employer from any such claim that may arise; and if, notwithstanding the foregoing, any such claim is found by a court of competent jurisdiction to have arisen, then, by signing this Award Agreement, the Recipient shall be deemed irrevocably to have waived his or her entitlement to pursue such claim; and
- (j) Further, if the Recipient ceases to be an employee (whether or not in breach of local labor laws), the Recipient's right to receive RSUs and vest under the Award Agreement or Plan, if any, will terminate effective as of the date that the Recipient is no longer actively employed by the Company and will not be extended by any notice period mandated under local law (e.g., active employment would not include a period of "garden leave" or similar period pursuant to local law); and the Compensation Committee of the Company's Board of Directors shall have the exclusive discretion to determine when the Recipient is no longer actively employed for purposes of this Award Agreement and the Plan.

11. **Data Privacy Notice and Consent.** The Recipient hereby explicitly and unambiguously consents to the collection, use and transfer, in electronic or other form, of his or her personal data as described in this paragraph, by and among, as applicable, the Recipient's employer and the Company and its subsidiaries and affiliates for, among other purposes, implementing, administering and managing the Recipient's participation in the Plan. The Recipient understands that the Company and its subsidiaries hold or will hold certain personal information about the Recipient, including the Recipient's name, home address and telephone number, date of birth, social security number or identification number, salary, nationality, job title, any shares or directorships held in the Company, details of all options or awards or any other interests in shares awarded, canceled, exercised, vested, unvested or outstanding in the Recipient's name, for the purposes of managing and administering the Plan ("Data"). The Recipient further understands that the Company and its subsidiaries will transfer Data amongst themselves as necessary for employment purposes, including implementation, administration and management of the Recipient's participation in the Plan,

and that the Company and any of its subsidiaries may each further transfer Data to a broker or other stock plan service provider or other third parties assisting the Company with the processing of Data. The Recipient understands that these third parties may be located in the United States, and that the third party's country may have different data privacy laws and protections than in the Recipient's country. The Recipient authorizes them to receive, possess, use, retain and transfer the Data, in electronic or other form, for the purposes described in this Section, including any requisite transfer to a broker or other stock plan service provider or other third party as may be required for the administration of the Plan and the subsequent holding of Award Shares on the Recipient's behalf. The Recipient understands that he or she may, at any time, request access to the Data, request any necessary amendments to it or refuse or withdraw the consents herein, in any case without cost, by contacting in writing the Company's Stock Option Manager at the Company's headquarters address. The Recipient understands, however, that withdrawal of consent may affect the Recipient's ability to participate in or realize the benefits of the Plan and this Award Agreement. For more information on the consequences of refusal to consent or withdrawal of consent, the Recipient understands that he or she may contact the Company's Stock Option Manager.

12. Miscellaneous.

- (a) No Rights to Employment. The Recipient acknowledges and agrees that the vesting of the RSUs pursuant to this Award Agreement is earned only in accordance with the terms hereof. The Recipient further acknowledges and agrees that the transactions contemplated hereunder and the vesting schedule set forth herein do not constitute an express or implied promise of continued engagement as an employee for the vesting period, for any period, or at all.
- (b) Unfunded Rights. The right of the Recipient to receive Award Shares pursuant to this Award Agreement is an unfunded and unsecured obligation of the Company. The Recipient shall have no rights under this Award Agreement other than those of an unsecured general creditor of the Company.
- (c) Severability. The invalidity or unenforceability of any provision of this Award Agreement shall not affect the validity or enforceability of any other provision of this Award Agreement, and each other provision of this Award Agreement shall be severable and enforceable to the extent permitted by law.
- (d) Waiver. Any provision for the benefit of the Company contained in this Award Agreement may be waived, either generally or in any particular instance, by the Compensation Committee of the Board of Directors of the Company.
- (e) Binding Effect. This Award Agreement shall be binding upon and inure to the benefit of the Company and the Recipient and their respective heirs, executors, administrators, legal representatives, successors and assigns, subject to the restrictions on transfer set forth in this Award Agreement.

- (f) Language. The English version of this Award Agreement, the Plan and any other document delivered pursuant to either the Award Agreement or the Plan, will control over any translated version of any such document in the event such translated version is different from the English version.
- (g) Entire Agreement. This Award Agreement and the Plan constitute the entire agreement between the parties, and supercedes all prior agreements and understandings, relating to the subject matter of this Award Agreement.
- (h) Governing Law. This Award Agreement shall be construed, interpreted and enforced in accordance with the internal laws of the State of Delaware without regard to any applicable conflicts of laws.
- (i) Amendment. This Award Agreement may be amended only by written agreement between the Recipient and the Company, without the consent of any other person.

Date: July 30, 2007

Short-Term Advised Credit Line Facility Agreement

1. Facility

JPMorgan Chase Bank, N.A., Shanghai Branch (the "**Bank**") is pleased to make available to Kadant Jining Light Machinery Co., Ltd. (凯登昊工机械或济宁有禧公司), a company incorporated in P.R. China having its principal office at No.99 Jidian Road 1, High and New Technologies Industry Development Zone, Jining, Shandong, 272023, P.R. China (the "**Borrower**") a short term advised credit line facility ("**Facility**") up to an aggregate principal amount not at any time exceeding RMB Forty-five million Only (RMB45,000,000) (the "**Advised Amount**") subject to the terms and conditions of this Agreement.

2. Purpose

The Borrower will apply the proceeds of the Loan towards its general working capital requirements. The Loan will not be used for other purposes without the prior consent of the Bank provided that the Bank is not obliged to monitor or verify the application of the Loan.

3. Availability

The Facility offered by the Bank is uncommitted. No Advance will be available for drawdown and no Bank Guarantee will be available for issuance after the expiration of the Drawdown Period after which time the Facility will automatically lapse. In any event, the availability of the Facility even during such Drawdown Period will be at the sole discretion of the Bank. The Bank may, in its sole and absolute discretion, agree to provide the Facility on such terms and conditions as the Bank deems appropriate.

4. Loans

4.1 Subject to the terms and conditions of this Agreement (including without limitation, clause 3 hereof), the Facility may be used by one or more Advances and or Bank Guarantees to the Borrower following receipt by the Bank of an irrevocable duly completed Request in respect of the particular Advance no later than 10:00am (Shanghai) time, three (3) Business Days immediately preceding the proposed Drawdown Date, provided that the aggregate amount of any and all Loans which may from time to time be outstanding, will not in any case exceed the Advised Amount (unless otherwise agreed by the Bank) and provided further that the Term of any Advance or Bank Guarantee will not exceed the Specified Period. The Borrower may at any time during the Drawdown Period re-borrow the Loan or any part thereof which may at that time have been repaid subject to and in accordance with the terms and conditions of this Agreement.

4.2 The Request will not be regarded as having been duly completed unless:-

- (a) the proposed Drawdown Date is a Business Day falling on or before the expiration of the Drawdown Period;

- (b) the amount of the relevant Advance is:
 - (i) a minimum of RMB One million (RMB1,000,000) and an integral multiple of RMB One hundred thousand (RMB100,000); or
 - (ii) such other amount as the Bank may agree; and
- (c) the amount selected under sub-clause 4.2(b) does not cause clause 4.1 to be contravened.

5. Conditions Precedent

5.1 In addition to the terms of clause 3, the availability of the Facility will be subject to the availability of funds, the availability of room within the Bank's regulatory ceiling and completion or performance, as applicable, of each of the following conditions precedent to the satisfaction of the Bank:

- (a) receipt by the Bank of each of the following documents in form and substance acceptable to it not less than three (3) Business Days immediately preceding the earlier date on which (i) the first Advance is intended to be made or (ii) the first Bank Guarantee is intended to be issued (each such document (other than an original) being duly certified by an authorised officer of the Borrower as true, complete and up-to-date):
 - (i) the original of this Agreement duly executed by the Borrower;
 - (ii) copies of the constitutional documents of the Borrower and/or other relevant corporate documents, and the relevant internal rules of the Borrower;
 - (iii) copy of each of the Borrower's current valid business license and IC Card (Credit Information Card) issued by the People's Bank of China;
 - (iv) copy of the supporting board resolution/s of the Borrower with respect to this Agreement, authorising the execution, delivery and performance of this Agreement and any Request;
 - (v) the names and specimen signatures of the persons authorised to sign, on behalf of the Borrower, this Agreement, each Request and any other documents in connection with this Agreement;
 - (vi) the original of each approval, authorisation, permit, registration and/or filing and any other document required by any applicable law for the Borrower to enter into and perform any and all terms of this Agreement, including the drawing of any Loans, issued by the applicable regulatory authority, entity or body, including without limitation, the relevant government authorities of the People's Republic of China;
 - (vii) original guarantee issued by Kadant Inc., parent company of the Borrower (the "**Guarantor**"), in favour of the Bank, in respect of the obligations of the Borrower under this Agreement, in form and substance satisfactory to the Bank (the "**Guarantee**");

- (viii) Evidence that the Borrower has paid all the stamp duties chargeable on this Agreement (including the renewal or extension thereof);
 - (ix) any other authorisation or other document, opinion or assurance which the Bank considers necessary or desirable in connection with the entry into and performance of, and the transactions contemplated by, any Finance Document or for the validity and enforceability of any Finance Document; and
 - (x) the Borrower's current financial information (including without limitation audited annual and unaudited semi-annual financial statements, promptly prepared and received), in form and substance satisfactory to the Bank; which information will be furnished to the Bank as it may from time to time reasonably request; and
- (b) the Bank's satisfaction with the business affairs, financial condition and prospects of the Borrower or the Guarantor; and there being in the opinion of the Bank no material adverse change in the financial condition of the Borrower or the Guarantor, in the financial, banking or capital market conditions, or in the international financial environment.
- 5.2 In addition to the terms of clauses 3 and 5.1, the availability of each Advance or Bank Guarantee subsequent to the initial Advance or Bank Guarantee is subject to each of the documents delivered or to be delivered under clause 5.1 remaining true complete and up to date as at the date upon which that relevant Advance or Bank Guarantee is made or issued by the Bank and to the Bank continuing to be satisfied as that date in relation to each of the matters referred to in sub-clauses 5.1 (b).

6. Borrowings in excess of the Advised Amount/Other Purposes

Should the Bank, in its sole discretion, allow the aggregate drawings under the Facility at any time to exceed the Advised Amount or allow the Facility to be used for any purposes other than as set out in clause 2, such drawings will be subject to the same terms and conditions stipulated in this Agreement and for the purpose of such drawings, the Borrower shall from time to time at the request of the Bank, execute, sign, perfect, do and procure the doing of and if required, register every document, act or thing as, in the opinion of the Bank, may be necessary or desirable for the preservation and the perfection of all rights and powers of the Bank. The terms of this clause should not, however, be construed as agreement on the part of the Bank to make any modifications whatsoever to this Agreement or the Facility.

7. Covenants

In consideration of the Bank entering into this Agreement, the Borrower undertakes to the Bank during the period while any sum is due or payable under this Agreement that it shall:

- (i) obtain and maintain in full force, validity and effect all governmental and other approvals, authorizations, licences, consents and registrations required in connection with the Facility and do or cause to be done all other acts and things necessary or desirable for the performance of its obligations under this Agreement;
- (ii) within 120 days after the end of each fiscal year, supply to the Bank audited financial statements of the Borrower of such fiscal year, provided that as to

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Guarantor, the filing of the Guarantor's Annual Report on Form 10-K with the U.S. Securities and Exchange Commission on the Electronic Data Gathering, Analysis and Retrieval computer system ("EDGAR") shall be deemed to satisfy such requirement;

- (iii) cause the Guarantor to comply with its obligations under (x) the Credit Agreement dated May 9, 2005, entered into between JPMorgan Chase Bank, N.A. as Agent, the Lenders named therein, the Foreign Subsidiary Borrowers from time to time parties thereto, and the Guarantor as Borrower, (as the same may be amended, supplemented, modified or extended from time to time, the "US Credit Agreement"); (y) any credit agreement that in whole substantially replaces the US Credit Agreement and in which JPMorgan Chase Bank, N.A. is a participant (the "Successor US Credit Agreement") or (z) in the event of the termination of the US Credit Agreement or the Successor US Credit Agreement prior to the repayment of the loans hereunder, Sections 6, 7 and 8 of the US Credit Agreement or their equivalent sections of the Successor US Credit Agreement, as the same shall be in effect immediately prior to such termination (the agreements referred to in subclauses (x), (y) and (z) are collectively referred to as the "**Guarantor Credit Agreement**"). Any event of default which is continuing under the Guarantor Credit Agreement shall be deemed an event of default hereunder;
- (iv) ensure that at all times the claims of the Bank against it under this Agreement rank at least *pari passu* with the claims of all its other unsecured creditors, except the claims of Bank of China Limited, Jining Branch under the Existing Facility Agreement.;
- (v) notify the Bank immediately if the Guarantor ceases to hold a beneficial interest of greater than fifty per cent (50%) in the Borrower;
- (vi) on demand from the Bank, provide the Bank with full cash cover satisfactory to the Bank in immediately available funds in respect of any actual or contingent liability incurred by the Bank under the Facility; and
- (vii) other than Permitted Security Interests, not create or allow to exist any Security Interest on any of its assets;

other than Permitted Security Interests, the Borrower may not:

- (1) sell, transfer or otherwise dispose of any of its assets on terms where it is or may be leased to or re-acquired or acquired by it or any of its related entities;
- (2) sell, transfer or otherwise dispose of any of its receivables on recourse terms;
- (3) enter into any arrangement under which money or the benefit of a bank or other account may be applied, set-off or made subject to a combination of accounts; or
- (4) enter into any other preferential arrangement having a similar effect, in circumstances where the transaction is entered into primarily as a method of raising financial indebtedness or of financing the acquisition of an asset.

8. Representations and Warranties

8.1 The Borrower represents and warrants to the Bank that:

- a) the Borrower is an enterprise duly registered and validly existing in accordance with the laws of The People's Republic of China;
- b) the Borrower, pursuant to applicable laws and its articles of association, has full power to enter into and perform, and has taken all necessary legal and other action to authorise the entry into, performance and delivery of, this Agreement, the relevant documents in connection herewith and the transactions contemplated by this Agreement;
- c) all verifications, business license, approvals, authorizations and other documents and permits required or desirable in connection with the entry into, performance, validity and enforceability of the Finance Documents and the transactions contemplated by, and the admissibility in evidence of, the Finance Documents have been obtained or effected and are in full force and effect;
- d) the Finance Documents constitute valid and legally binding obligations of the Borrower, enforceable in accordance with their respective terms;
- e) the Borrower's obligations under each Finance Document constitute its direct, unconditional, unsubordinated and unsecured obligations and rank and will rank at least pari passu with all its other existing and future unsecured and unsubordinated obligations, except for obligations mandatorily preferred by law applying to companies generally and the Borrower's obligations to Bank of China Limited, Jining Branch under the Existing Facility Agreement;
- f) the entry into and performance by it of, and the transactions contemplated by, the Finance Documents do not and will not conflict with (a) any law or regulation or judicial or official order applicable to the Borrower; (b) the constitutional documents of the Borrower, or (c) any document which is binding upon the Borrower or any of its assets;
- g) it will use the Loan according to the purpose provided under this Agreement. The Borrower specifically warrants that it will not use any Advance outside the legal business scope of its business licence issued by the State Administration of Industry and Commerce, PRC;
- h) No litigation, arbitration or administrative proceedings are current or, to its knowledge, pending or threatened, which might, if adversely determined, have a material adverse effect on the Borrower;
- i) No breach of this Agreement by the Borrower has occurred or may result from the making of any Loan and no other event is outstanding which constitutes (or with the giving of notice, lapse of time, determination of materiality or the fulfilment of any other applicable condition or any combination of the foregoing, might constitute) a default under any document which is

binding on the Borrower or any of its assets to an extent or in a manner which might have a material adverse effect on the Borrower; and

j) All amounts payable by the Borrower under the Finance Documents may be made free and clear of and without deduction for or on account of any tax.

8.2 The representations and warranties set out in clause 8.1 (a) are made on the date of this Agreement and (b) are deemed to be repeated by the Borrower on the date of each Request, the date of any Advance being made and the first day of each Interest Period with reference to the facts and circumstances then existing.

9. Repayment

Each Advance or Bank Guarantee together with all interest accrued thereon to the date of repayment and all fees and other amounts due and payable under this Agreement are repayable upon the expiry of the Term of that Advance or Bank Guarantee or within 3 Business Days of any written demand for repayment thereof made by the Bank, whichever is earlier.

10. Prepayment

The Borrower may prepay the Loan in full or any part thereof subject to the Borrower providing the Bank with not less than 15 Business Days' prior written notice of such intention to prepay and obtaining the prior written consent of the Bank (such consent shall not be unreasonably withheld or delayed) and any necessary government approval thereto. In the event that a prepayment is accepted, the Bank reserves the right to charge penalties, break funding costs and fees arising from such prepayment at its sole discretion. Break funding costs are the amounts (if any) determined by the Bank which would indemnify the Bank against any loss or liability that it incurs as a consequence of any part of the Loan is prepaid on a date other than the expiry date of the Term of such Loan and includes any costs incurred as a result of the Bank terminating all or any part of its fixed rate, swap or other hedging arrangements. The Bank will supply to the Borrower applicable rate of break funding costs after claiming such break funding costs.

11. Modification and Cancellation of Facility and Terms

The Bank has the right to revise, modify or cancel the un-drawn portion of the Facility at any time without prior notice to the Borrower. Further, the Bank has the right to review and supervise the Facility drawn by the Borrower and shall be entitled to accelerate the Loan pursuant to the provisions of this Agreement and PRC laws, rules and regulations.

12. Interest and Fees

12.1 Interest Periods

Each Interest Period will be three months or such periods as the Bank and Borrower may mutually agree from time to time, provided that the first Interest Period for any Advance will commence on and include its Drawdown Date and extend up to and excluding the immediately succeeding Interest Settlement Date. Each subsequent Interest Period for that Advance will commence on and include Interest Settlement Date of the immediately preceding Interest Period for that Advance and extend up to and excluding the immediately

succeeding Interest Settlement Date. If an Interest Period for a particular Advance would otherwise overrun the expiry date of the Term of that Advance, it will be shortened so that it ends on that expiry date.

12.2 Interest

- (i) The rate of interest per annum on each Advance shall be ninety per cent (90) % of the applicable short term interest rate for an RMB loan having a term equal to the Term of that Advance as published by The People's Bank of China prevailing as at the Drawdown Date of that Advance.
- (ii) The Borrower shall pay the due and payable interest for each Advance on each Interest Settlement Date, and upon the expiry date of the Term of that Advance.
- (iii) If the Borrower fails to pay any sum on its due date for payment under this Agreement or applies the proceeds of the Loan other than the purposes provided in clause 2 hereunder, the Borrower will pay interest at the rate per annum determined by the Bank according to the regulations issued by the People's Bank of China.

12.3 Commission

The Borrower shall, in respect of each Bank Guarantee requested by it, pay to the Bank a commission in the amount of the higher of the following: (i) RMB1,200 flat; and (ii) at the rate of 1.25% per annum on the maximum actual and contingent liability of the Bank under that Bank Guarantee. Such commission shall be paid on the issuance date of that Bank Guarantee.

12.4 Fees for Bank Guarantee

Notwithstanding otherwise provided in this Agreement, if the Borrower intends to amend any Bank Guarantee, the Borrower shall pay to the Bank an amendment fee in the amount of RMB600 flat. If any cable fee or postage or such other fees as customary from time to time is incurred by the Bank, the Borrower shall pay to the Bank a cable fee in the amount of RMB150 per page and shall reimburse the Bank with all postage or such other fees incurred.

13. Set-Off

With notice to the Borrower and the Guarantor, the Bank may set off credits in any accounts at any time held by the Borrower with the Bank or any of its affiliates located anywhere in the world, whether in transit or for safe keeping, custody, pledge, transmission, collection, deposit or otherwise, which set off may be exercised at any time in satisfaction of all or any part of the amounts due and payable by the Borrower under the Facility.

The Borrower waives any rights of set-off it may have at law or otherwise against the Bank with respect to amounts owed by the Borrower to the Bank from time to time.

14. Increased Costs

The Borrower will forthwith on demand by the Bank pay to the Bank the amount of any increased cost incurred by the Bank as a result of the introduction of, or any change in, the interpretation or application of, any law or regulation or compliance with any regulation made after the date of this Agreement provided that this clause 14 does not apply to any change in the rate of, or change in the basis of calculating, tax on the overall net income of the Bank or any of its branches.

The term "increased cost" when used in this Agreement means an additional cost incurred by the Bank as a result of it having entered into, or performing, maintaining or funding its obligations under the Finance Documents or a reduction in any amount payable to the Bank or in the effective return to the Bank under this Agreement (or to the extent that it is attributable to this Agreement) on its capital but does not include any increased cost compensated for under clause 15.

15. Taxes

All payments made by the Borrower under the Finance Documents will be made without any deduction and free and clear of and without deduction for or on account of any taxes, except to the extent that the Borrower is required by law to make payment subject to any taxes. If any tax or amounts in respect of tax must be deducted, or any other deductions must be made, from any amounts payable or paid by the Borrower under the Finance Documents, the Borrower will pay such additional amounts as may be necessary to ensure that the Bank receives a net amount equal to the full amount which it would have received had payment not been made subject to tax or any other deduction. The Borrower will:

- a) pay when due all taxes required by law to be deducted or withheld by it from any amounts paid or payable under the Finance Documents;
- b) within 15 days of the payment being made, deliver to the Bank evidence satisfactory to the Bank (including all relevant tax receipts) that the payment has been duly remitted to the appropriate authority; and
- c) forthwith on demand indemnify the Bank against any loss or liability which the Bank incurs as a consequence of the payment or non-payment of those taxes.

16. Indemnity

The Borrower will indemnify the Bank against any cost, liability, damage, loss or expense (including without limitation legal fees, costs and expenses) which the Bank may suffer, incur or sustain directly or indirectly, as a consequence, of or in connection with (a) any default or shortfall in payment by the Borrower of any sum due under this Agreement (including where the amount received by the Bank in a currency other than RMB when converted into RMB at a market rate in the usual course of the Bank's business is less than the amount owed in RMB under this Agreement); (b) any prepayment of the Loan or an overdue amount being received otherwise than on the Interest Settlement Date; (c) a change in currency of the PRC; (d) any breach by the Borrower of any term of this Agreement or (e) an Advance not being made for any reason (excluding any default or negligence of the Bank) after a Request has been delivered or made by the Borrower.

17. Expenses

The Borrower will pay the Bank upon demand all costs, charges and expenses (including any stamp taxes) incurred by the Bank in connection with the negotiation, preparation, execution, performance and enforcement of this Agreement (or any amendment, variation, extension or renewal thereof).

18. Disclosure

The Bank may disclose confidential information and documents relating to the Borrower in connection with the Facility which are in the Bank's possession if required under court orders or in order to comply with requests or orders made under applicable laws and regulations or in order to, in the Bank's sole and absolute discretion, pass on such information and documents to bank examiners, the Bank's head office and other branch offices, its affiliates and associates, assignees and prospective assignees and the Bank's auditors, counsel and other professional advisers.

19. SAFE registration upon claim

Unless otherwise provided by the applicable laws and regulations, if the Guarantee is claimed, the Borrower shall register with State Admin. of Foreign Exchange for actual foreign debt registration according to the Notice regarding the Perfection of Foreign Debt Management (《国家外汇管理局关于完善外债管理有关问题的通知》) issued by State Admin. of Foreign Exchange on 21 October 2005, whereby the same quota system (total investment of the Borrower minus registered capital of the Borrower) shall apply.

20. Notices

20.1 General Requirements for Notices

- a) Any communication in connection with this Agreement must be in writing and, unless otherwise stated, may be given in person, by post or fax. All communications and notices shall be written in English, or in Chinese if any law or regulation of the PRC requires, provided that any such notice provided to the Guarantor shall be translated into English.
- b) Unless it is agreed to the contrary, any consent or agreement required under this Agreement must be given in writing.
- c) In the event that (i) the Borrower fails to pay on the due date any amount payable by it under this Agreement; (ii) the Bank declares that all or part of any amounts outstanding under the Facility are immediately due and payable; (iii) the Bank provides any notice or communication relating to the Guaranty; or (iv) the Bank provides any notice or consent relating to prepayment and break funding costs under Section 10, the notices addressed to the Borrower in relation to the above-mentioned matters shall be copied to the Guarantor via air courier and provided in English.

20.2 Contact details

The contact details of the Borrower are:

Address: No. 99 Jidian Road 1
High and New Technologies Industry Development Zone
Jining, Shandong 272023
P.R. China
Fax number: 0537-2073189
Attention: Chairman

The contact details of the Guarantor are:

Address: One Technology Park Drive
Westford, MA 01886 USA
Fax number: 978-635-1593
Attention: Treasurer

The contact details of the Bank are:

Address: 31F, HSBC Building
1000 Lu Jia Zui Ring Road
Shanghai 200120
People's Republic of China
Fax number: 86-21-6160 2707
Attention: Betty Wang/Christine Lin/Carol CZ Cai
Commercial Banking

Any party may change its contact details by giving five (5) Business Days' notice to the other parties.

21. Miscellaneous

21.1 Certificates

A certificate by the Bank shall be conclusive evidence of the indebtedness of the Borrower under this Agreement save in the case of manifest error on the Bank's part.

21.2 No waivers

Any delay or omission by the Bank in enforcing its rights under this Agreement will not constitute a waiver of any of its rights at any time.

21.3 Assignment, Transfer and Participation

The Borrower hereby consents that the Bank may at any time assign or transfer to one or more banks or other entities all or a portion of its rights and/or obligations under the Facility and any Finance Documents without any further consent from the Borrower in relation thereto.

The Borrower hereby consents that the Bank may at any time sell participations to one or more banks or other entities of all or a portion of its rights and obligations under the Facility without any further consent from the Borrower in relation thereto.

The Bank may, in connection with (i) any assignment, or any proposed assignment, under the Facility; (ii) any participation, or any proposed participation, under the Facility; (iii) the purchase or sale of any credit insurance or any other contractual protection or hedging with respect to the Borrower's obligations under the Facility; or (iv) the processing and management of data relating to the Facility, disclose to third parties any information relating to the Borrower furnished to the Bank by the Borrower, provided that, prior to such disclosure, such third party shall agree in writing to preserve the confidentiality of any confidential information relating to the Borrower received by it from the Bank.

The Borrower may not assign, transfer or otherwise dispose of any of its rights, benefits or obligations under the Facility.

21.4. Severance

If at any time any of the terms and conditions of the Offer Letter is or becomes illegal, invalid or unenforceable in any respect, the legality, validity or enforceability of the remaining terms and conditions shall not be affected thereby.

21.5 Language

This Agreement is written in both Chinese and English. If there is any inconsistency between the two versions in the interpretation or otherwise, the English version shall prevail.

22. Governing Law and Jurisdiction

This Agreement shall be governed by and construed in all respects in accordance with the laws of the PRC and each of the parties to this Agreement, for the benefit of the Bank, hereby submits to the non-exclusive jurisdiction of the courts of the PRC.

23. Effectiveness

This Agreement shall be effective on the date that the authorized representatives of the Bank and the Borrower have duly executed this Agreement (If the execution by the Bank and the Borrower is not at the same date, the effective date shall be the later date that this Agreement is executed).

24. Definitions and Interpretation

24.1 The following terms have the following meanings when used in this Agreement:

“Advance” means the borrowing under the Facility of all or any portion of the Advised Amount by the Borrower or as the context may require, the principal amount of such borrowing;

“Advised Amount” means RMB Forty-five million Only (RMB45,000,000);

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“Agreement” means the agreement constituted by the acceptance by the Borrower of the terms and conditions of this Offer Letter, as the same may be amended, varied or extended from time to time;

“Business Day” means a day (other than a Saturday, a Sunday or a public holiday) on which Banks are open for general business in Shanghai;

“Drawdown Date” means in relation to any Advance, the date of that Advance or in relation to any Bank Guarantee, the date of issuance of that Bank Guarantee;

“Drawdown Period” means in the period from the date of acceptance of this Offer Letter by the Borrower up to and including eleven (11) calendar months from the date of such acceptance;

“Existing Facility Agreement” means the RMB loan agreement dated 6 June 2006, entered into between Bank of China Limited, Jining Branch as lender and the Borrower as borrower, under which Bank of China Limited, Jining Branch agrees to make available a term loan facility up to RMB40,000,000;

“Facility” means the short term advised credit line facility consisting of performance/financial guarantee (the “**Bank Guarantee**”), and Advance made available under this Agreement;

“Finance Documents” means this Agreement, the Guarantee referred to in clause 5.1(a)(vii); each Request and any other document designated as such by the Bank;

“First Drawdown Date” means the date upon which the Borrower makes the first drawdown of the Loan under this Agreement;

“Interest Period” means each period determined in accordance with clause 12.1;

“Interest Settlement Date” means in relation to any Advance, the 20th day of the last calendar month of each calendar quarter falling during each Interest Period for that relevant Advance provided that if such day is not a Business Day, the Business Day immediately after that day;

“Loan” means the aggregate principal amount of the borrowing from time to time under any Advance or Bank Guarantee by the Borrower under this Agreement or the aggregate principal amount outstanding of that borrowing;

“Offer Letter” means this letter;

“Permitted Security Interest” means:

- (i) any Security Interest comprising a netting or set-off arrangement entered into by the Borrower in the ordinary course of its banking arrangements for the purpose of netting debit and credit balances;
- (ii) any Security Interest arising by operation of law and in the ordinary course of business;

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- (iii) any Security Interest entered into pursuant to a Finance Document;
- (iv) any Security Interest created in favour of Bank of China Limited, Jining Branch for the performance of the Borrower's obligations under the Existing Facility Agreement;
- (v) any Security Interest created over real property (whether by mortgage or lien) owned by the Borrower and aggregate principal amount secured by all such Security Interest does not, at any time, exceed RMB30,000,000 (or its equivalent in any other currencies);
- (vi) any Security Interest created over the fixed assets acquired by the Borrower provided that aggregate principal amount secured by all such Security Interest is for the purpose of acquiring such fixed assets and does not, at any time, exceed RMB42,000,000 (or its equivalent in any other currencies);
- (vii) any Security Interests created over assets of the Borrower and aggregate principal amount secured by all such Security Interest does not, at any time, exceed RMB15,000,000 (or its equivalent in any other currencies); and
- (viii) any other Security Interest with the prior written consent of the Bank;

"PRC" means The People's Republic of China;

"Request" means a request in writing made by the Borrower for an Advance, in the form of the Schedule to this Agreement;

"RMB" means the lawful currency of the PRC;

"Security Interest" means any mortgage, pledge, lien, charge, assignment, hypothecation or security interest or any other agreement or arrangement having a similar effect, whether created pursuant to PRC law or any other applicable law.

"Term" means the term of each Advance, not exceeding the Specified Period, as specified in the Request delivered in relation to that Advance and agreed by the Bank; and

"Specified Period" means in relation to each Advance or Bank Guarantee, the period of one year from and including the date of acceptance of this Offer Letter by the Borrower.

24.2 In this Agreement, to the extent not inconsistent with the subject or context, words importing the singular number shall include the plural number and vice versa, words importing any gender shall include other genders; references to "**persons**" shall include any body of persons, corporate or unincorporate and references to a "**year**" will mean a period of 365 days. The headings are inserted for reference only and shall not affect the construction of the terms and conditions of this Agreement.

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Kindly acknowledge your acceptance and agreement with the terms of this Offer Letter by signing where indicated below and returning your duly completed acknowledgement to the Bank at the place indicated above. We look forward to being of service to you.

Yours faithfully

/s/ Q.C. Hua..... [Legal Chop]

JPMorgan Chase Bank, N.A.

Shanghai Branch

Name: Q. C. Hua

Title: Managing Director & General Manager

Date: July 30, 2007

Acknowledged and agreed:

/s/ Peter J. Flynn.....[Legal Chop]

For and on behalf of

Kadant Jining Light Machinery Co., Ltd.

Name: Peter J. Flynn

Title: Legal Representative

Date: July 30, 2007

JPMorgan

SCHEDULE

FORM OF REQUEST

To: JPMorgan Chase Bank,N.A.
Shanghai Branch

From: Kadant Jining Light Machinery Co., Ltd.

Short Term Advised Credit Line Facility Agreement dated July 30, 2007

1. We wish to borrow a Loan as follows:-

- (a) Drawdown Date: []
- (b) Type: Advance / Bank Guarantee
- (b) Amount: []
- (c) Payment instructions / Beneficiary: []
- (d) Term: []

2. We confirm that each condition specified in Clause 5 is satisfied on the date of this Request.

3. This request is irrevocable.

By:

[]
Authorised Signatory

JPMorgan

Date: July 30, 2007

Short-Term Advised Credit Line Facility Agreement**1. Facility**

JPMorgan Chase Bank, N.A., Shanghai Branch (the “**Bank**”) is pleased to make available to Kadant Pulp and Paper Equipment (Yanzhou) Co., Ltd. (凱登制漿濠紙瑠備兗州有棧公司), a company incorporated in P.R. China having its principal office at Chuang Ye Road (N), Yanzhou Economic Development Zone, Yanzhou, Shandong Province, P.R. China (the “**Borrower**”) a short term advised credit line facility (“**Facility**”) up to an aggregate principal amount not at any time exceeding RMB Fifteen million Only (RMB15,000,000) (the “**Advised Amount**”) subject to the terms and conditions of this Agreement.

2. Purpose

The Borrower will apply the proceeds of the Loan towards its general working capital requirements. The Loan will not be used for other purposes without the prior consent of the Bank provided that the Bank is not obliged to monitor or verify the application of the Loan.

3. Availability

The Facility offered by the Bank is uncommitted. No Advance will be available for drawdown and no Bank Guarantee will be available for issuance after the expiration of the Drawdown Period after which time the Facility will automatically lapse. In any event, the availability of the Facility even during such Drawdown Period will be at the sole discretion of the Bank. The Bank may, in its sole and absolute discretion, agree to provide the Facility on such terms and conditions as the Bank deems appropriate.

4. Loans

- 4.1 Subject to the terms and conditions of this Agreement (including without limitation, clause 3 hereof), the Facility may be used by one or more Advances and or Bank Guarantees to the Borrower following receipt by the Bank of an irrevocable duly completed Request in respect of the particular Advance no later than 10:00am (Shanghai) time, three (3) Business Days immediately preceding the proposed Drawdown Date, provided that the aggregate amount of any and all Loans which may from time to time be outstanding, will not in any case exceed the Advised Amount (unless otherwise agreed by the Bank) and provided further that the Term of any Advance or Bank Guarantee will not exceed the Specified Period. The Borrower may at any time during the Drawdown Period re-borrow the Loan or any part thereof which may at that time have been repaid subject to and in accordance with the terms and conditions of this Agreement.
- 4.2 The Request will not be regarded as having been duly completed unless:-
- (a) the proposed Drawdown Date is a Business Day falling on or before the expiration of the Drawdown Period;

- (b) the amount of the relevant Advance is:
 - (i) a minimum of RMB One million (RMB1,000,000) and an integral multiple of RMB One hundred thousand (RMB100,000); or
 - (ii) such other amount as the Bank may agree; and
- (c) the amount selected under sub-clause 4.2(b) does not cause clause 4.1 to be contravened.

5. Conditions Precedent

5.1 In addition to the terms of clause 3, the availability of the Facility will be subject to the availability of funds, the availability of room within the Bank's regulatory ceiling and completion or performance, as applicable, of each of the following conditions precedent to the satisfaction of the Bank:

- (a) receipt by the Bank of each of the following documents in form and substance acceptable to it not less than three (3) Business Days immediately preceding the earlier date on which (i) the first Advance is intended to be made or (ii) the first Bank Guarantee is intended to be issued (each such document (other than an original) being duly certified by an authorised officer of the Borrower as true, complete and up-to-date):
 - (i) the original of this Agreement duly executed by the Borrower;
 - (ii) copies of the constitutional documents of the Borrower and/or other relevant corporate documents, and the relevant internal rules of the Borrower;
 - (iii) copy of each of the Borrower's current valid business license and IC Card (Credit Information Card) issued by the People's Bank of China;
 - (iv) copy of the supporting board resolution/s of the Borrower with respect to this Agreement, authorising the execution, delivery and performance of this Agreement and any Request;
 - (v) the names and specimen signatures of the persons authorised to sign, on behalf of the Borrower, this Agreement, each Request and any other documents in connection with this Agreement;
 - (vi) the original of each approval, authorisation, permit, registration and/or filing and any other document required by any applicable law for the Borrower to enter into and perform any and all terms of this Agreement, including the drawing of any Loans, issued by the applicable regulatory authority, entity or body, including without limitation, the relevant government authorities of the People's Republic of China;
 - (vii) original guarantee issued by Kadant Inc., parent company of the Borrower (the "**Guarantor**"), in favour of the Bank, in respect of the obligations of the Borrower under this Agreement, in form and substance satisfactory to the Bank (the "**Guarantee**");

- (viii) Evidence that the Borrower has paid all the stamp duties chargeable on this Agreement (including the renewal or extension thereof);
 - (ix) any other authorisation or other document, opinion or assurance which the Bank considers necessary or desirable in connection with the entry into and performance of, and the transactions contemplated by, any Finance Document or for the validity and enforceability of any Finance Document; and
 - (x) the Borrower's current financial information (including without limitation audited annual and unaudited semi-annual financial statements, promptly prepared and received), in form and substance satisfactory to the Bank; which information will be furnished to the Bank as it may from time to time reasonably request; and
- (b) the Bank's satisfaction with the business affairs, financial condition and prospects of the Borrower or the Guarantor; and there being in the opinion of the Bank no material adverse change in the financial condition of the Borrower or the Guarantor, in the financial, banking or capital market conditions, or in the international financial environment.
- 5.2 In addition to the terms of clauses 3 and 5.1, the availability of each Advance or Bank Guarantee subsequent to the initial Advance or Bank Guarantee is subject to each of the documents delivered or to be delivered under clause 5.1 remaining true complete and up to date as at the date upon which that relevant Advance or Bank Guarantee is made or issued by the Bank and to the Bank continuing to be satisfied as that date in relation to each of the matters referred to in sub-clauses 5.1 (b).

6. Borrowings in excess of the Advised Amount/Other Purposes

Should the Bank, in its sole discretion, allow the aggregate drawings under the Facility at any time to exceed the Advised Amount or allow the Facility to be used for any purposes other than as set out in clause 2, such drawings will be subject to the same terms and conditions stipulated in this Agreement and for the purpose of such drawings, the Borrower shall from time to time at the request of the Bank, execute, sign, perfect, do and procure the doing of and if required, register every document, act or thing as, in the opinion of the Bank, may be necessary or desirable for the preservation and the perfection of all rights and powers of the Bank. The terms of this clause should not, however, be construed as agreement on the part of the Bank to make any modifications whatsoever to this Agreement or the Facility.

7. Covenants

In consideration of the Bank entering into this Agreement, the Borrower undertakes to the Bank during the period while any sum is due or payable under this Agreement that it shall:

- (i) obtain and maintain in full force, validity and effect all governmental and other approvals, authorizations, licences, consents and registrations required in connection with the Facility and do or cause to be done all other acts and things necessary or desirable for the performance of its obligations under this Agreement;
- (ii) within 120 days after the end of each fiscal year, supply to the Bank audited financial statements of the Borrower of such fiscal year, provided that as to Guarantor, the filing of the Guarantor's Annual Report on Form 10-K with the U.S. Securities and Exchange Commission on the Electronic Data Gathering, Analysis and Retrieval computer system ("EDGAR") shall be deemed to satisfy such requirement;

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- (iii) cause the Guarantor to comply with its obligations under (x) the Credit Agreement dated May 9, 2005, entered into between JPMorgan Chase Bank, N.A. as Agent, the Lenders named therein, the Foreign Subsidiary Borrowers from time to time parties thereto, and the Guarantor as Borrower, (as the same may be amended, supplemented, modified or extended from time to time, the "US Credit Agreement"); (y) any credit agreement that in whole substantially replaces the US Credit Agreement and in which JPMorgan Chase Bank, N.A. is a participant (the "Successor US Credit Agreement") or (z) in the event of the termination of the US Credit Agreement or the Successor US Credit Agreement prior to the repayment of the loans hereunder, Sections 6, 7 and 8 of the US Credit Agreement or their equivalent sections of the Successor US Credit Agreement, as the same shall be in effect immediately prior to such termination (the agreements referred to in subclauses (x), (y) and (z) are collectively referred to as the "**Guarantor Credit Agreement**"). Any event of default which is continuing under the Guarantor Credit Agreement shall be deemed an event of default hereunder;
- (iv) ensure that at all times the claims of the Bank against it under this Agreement rank at least *pari passu* with the claims of all its other unsecured creditors;
- (v) notify the Bank immediately if the Guarantor ceases to hold a beneficial interest of greater than fifty per cent (50%) in the Borrower;
- (vi) on demand from the Bank, provide the Bank with full cash cover satisfactory to the Bank in immediately available funds in respect of any actual or contingent liability incurred by the Bank under the Facility; and
- (vii) other than Permitted Security Interests, not create or allow to exist any Security Interest on any of its assets;

other than Permitted Security Interests, the Borrower may not:

- (1) sell, transfer or otherwise dispose of any of its assets on terms where it is or may be leased to or re-acquired or acquired by it or any of its related entities;
- (2) sell, transfer or otherwise dispose of any of its receivables on recourse terms;
- (3) enter into any arrangement under which money or the benefit of a bank or other account may be applied, set-off or made subject to a combination of accounts; or
- (4) enter into any other preferential arrangement having a similar effect, in circumstances where the transaction is entered into primarily as a method of raising financial indebtedness or of financing the acquisition of an asset.

8. Representations and Warranties

- 8.1 The Borrower represents and warrants to the Bank that:
- a) the Borrower is an enterprise duly registered and validly existing in accordance with the laws of The People's Republic of China;
 - b) the Borrower, pursuant to applicable laws and its articles of association, has full power to enter into and perform, and has taken all necessary legal and other action to authorise the entry into, performance and delivery of, this Agreement, the relevant documents in connection herewith and the transactions contemplated by this Agreement;
 - c) all verifications, business license, approvals, authorizations and other documents and permits required or desirable in connection with the entry into, performance, validity and enforceability of the Finance Documents and the transactions contemplated by, and the admissibility in evidence of, the Finance Documents have been obtained or effected and are in full force and effect;
 - d) the Finance Documents constitute valid and legally binding obligations of the Borrower, enforceable in accordance with their respective terms;
 - e) the Borrower's obligations under each Finance Document constitute its direct, unconditional, unsubordinated and unsecured obligations and rank and will rank at least pari passu with all its other existing and future unsecured and unsubordinated obligations, except for obligations mandatorily preferred by law applying to companies generally;
 - f) the entry into and performance by it of, and the transactions contemplated by, the Finance Documents do not and will not conflict with (a) any law or regulation or judicial or official order applicable to the Borrower; (b) the constitutional documents of the Borrower; or (c) any document which is binding upon the Borrower or any of its assets;
 - g) it will use the Loan according to the purpose provided under this Agreement. The Borrower specifically warrants that it will not use any Advance outside the legal business scope of its business licence issued by the State Administration of Industry and Commerce, PRC;
 - h) No litigation, arbitration or administrative proceedings are current or, to its knowledge, pending or threatened, which might, if adversely determined, have a material adverse effect on the Borrower;
 - i) No breach of this Agreement by the Borrower has occurred or may result from the making of any Loan and no other event is outstanding which constitutes (or with the giving of notice, lapse of time, determination of materiality or the fulfilment of any other applicable condition or any combination of the foregoing, might constitute) a default under any

document which is binding on the Borrower or any of its assets to an extent or in a manner which might have a material adverse effect on the Borrower; and

j) All amounts payable by the Borrower under the Finance Documents may be made free and clear of and without deduction for or on account of any tax.

8.2 The representations and warranties set out in clause 8.1 (a) are made on the date of this Agreement and (b) are deemed to be repeated by the Borrower on the date of each Request, the date of any Advance being made and the first day of each Interest Period with reference to the facts and circumstances then existing.

9. Repayment

Each Advance or Bank Guarantee together with all interest accrued thereon to the date of repayment and all fees and other amounts due and payable under this Agreement are repayable upon the expiry of the Term of that Advance or Bank Guarantee or within 3 Business Days of any written demand for repayment thereof made by the Bank, whichever is earlier.

10. Prepayment

The Borrower may prepay the Loan in full or any part thereof subject to the Borrower providing the Bank with not less than 15 Business Days' prior written notice of such intention to prepay and obtaining the prior written consent of the Bank (such consent shall not be unreasonably withheld or delayed) and any necessary government approval thereto. In the event that a prepayment is accepted, the Bank reserves the right to charge penalties, break funding costs and fees arising from such prepayment at its sole discretion. Break funding costs are the amounts (if any) determined by the Bank which would indemnify the Bank against any loss or liability that it incurs as a consequence of any part of the Loan is prepaid on a date other than the expiry date of the Term of such Loan and includes any costs incurred as a result of the Bank terminating all or any part of its fixed rate, swap or other hedging arrangements. The Bank will supply to the Borrower applicable rate of break funding costs after claiming such break funding costs.

11. Modification and Cancellation of Facility and Terms

The Bank has the right to revise, modify or cancel the un-drawn portion of the Facility at any time without prior notice to the Borrower. Further, the Bank has the right to review and supervise the Facility drawn by the Borrower and shall be entitled to accelerate the Loan pursuant to the provisions of this Agreement and PRC laws, rules and regulations.

12. Interest and Fees

12.1 Interest Periods

Each Interest Period will be three months or such periods as the Bank and Borrower may mutually agree from time to time, provided that the first Interest Period for any Advance will commence on and include its Drawdown Date and extend up to and excluding the immediately succeeding Interest Settlement Date. Each subsequent Interest Period for that Advance will commence on and include Interest Settlement Date of the immediately

preceding Interest Period for that Advance and extend up to and excluding the immediately succeeding Interest Settlement Date. If an Interest Period for a particular Advance would otherwise overrun the expiry date of the Term of that Advance, it will be shortened so that it ends on that expiry date.

12.2 Interest

- (i) The rate of interest per annum on each Advance shall be ninety per cent (90) % of the applicable short term interest rate for an RMB loan having a term equal to the Term of that Advance as published by The People's Bank of China prevailing as at the Drawdown Date of that Advance.
- (ii) The Borrower shall pay the due and payable interest for each Advance on each Interest Settlement Date, and upon the expiry date of the Term of that Advance.
- (iii) If the Borrower fails to pay any sum on its due date for payment under this Agreement or applies the proceeds of the Loan other than the purposes provided in clause 2 hereunder, the Borrower will pay interest at the rate per annum determined by the Bank according the regulations issued by the People's Bank of China.

12.3 Commission

The Borrower shall, in respect of each Bank Guarantee requested by it, pay to the Bank a commission in the amount of the higher of the following: (i) RMB1,200 flat; and (ii) at the rate of 1.25% per annum on the maximum actual and contingent liability of the Bank under that Bank Guarantee. Such commission shall be paid on the issuance date of that Bank Guarantee.

12.4 Fees for Bank Guarantee

Notwithstanding otherwise provided in this Agreement, if the Borrower intends to amend any Bank Guarantee, the Borrower shall pay to the Bank an amendment fee in the amount of RMB600 flat. If any cable fee or postage or such other fees as customary from time to time is incurred by the Bank, the Borrower shall pay to the Bank a cable fee in the amount of RMB150 per page and shall reimburse the Bank with all postage or such other fees incurred.

13. Set-Off

With notice to the Borrower and the Guarantor, the Bank may set off credits in any accounts at any time held by the Borrower with the Bank or any of its affiliates located anywhere in the world, whether in transit or for safe keeping, custody, pledge, transmission, collection, deposit or otherwise, which set off may be exercised at any time in satisfaction of all or any part of the amounts due and payable by the Borrower under the Facility.

The Borrower waives any rights of set-off it may have at law or otherwise against the Bank with respect to amounts owed by the Borrower to the Bank from time to time.

14. Increased Costs

The Borrower will forthwith on demand by the Bank pay to the Bank the amount of any increased cost incurred by the Bank as a result of the introduction of, or any change in, the interpretation or application of, any law or regulation or compliance with any regulation made after the date of this Agreement provided that this clause 14 does not apply to any change in the rate of, or change in the basis of calculating, tax on the overall net income of the Bank or any of its branches.

The term "increased cost" when used in this Agreement means an additional cost incurred by the Bank as a result of it having entered into, or performing, maintaining or funding its obligations under the Finance Documents or a reduction in any amount payable to the Bank or in the effective return to the Bank under this Agreement (or to the extent that it is attributable to this Agreement) on its capital but does not include any increased cost compensated for under clause 15.

15. Taxes

All payments made by the Borrower under the Finance Documents will be made without any deduction and free and clear of and without deduction for or on account of any taxes, except to the extent that the Borrower is required by law to make payment subject to any taxes. If any tax or amounts in respect of tax must be deducted, or any other deductions must be made, from any amounts payable or paid by the Borrower under the Finance Documents, the Borrower will pay such additional amounts as may be necessary to ensure that the Bank receives a net amount equal to the full amount which it would have received had payment not been made subject to tax or any other deduction. The Borrower will:

- a) pay when due all taxes required by law to be deducted or withheld by it from any amounts paid or payable under the Finance Documents;
- b) within 15 days of the payment being made, deliver to the Bank evidence satisfactory to the Bank (including all relevant tax receipts) that the payment has been duly remitted to the appropriate authority; and
- c) forthwith on demand indemnify the Bank against any loss or liability which the Bank incurs as a consequence of the payment or non-payment of those taxes.

16. Indemnity

The Borrower will indemnify the Bank against any cost, liability, damage, loss or expense (including without limitation legal fees, costs and expenses) which the Bank may suffer, incur or sustain directly or indirectly, as a consequence, of or in connection with (a) any default or shortfall in payment by the Borrower of any sum due under this Agreement (including where the amount received by the Bank in a currency other than RMB when converted into RMB at a market rate in the usual course of the Bank's business is less than the amount owed in RMB under this Agreement); (b) any prepayment of the Loan or an overdue amount being received otherwise than on the Interest Settlement Date; (c) a change in currency of the PRC; (d) any breach by the Borrower of any term of this Agreement or (e) an Advance not being made for any reason (excluding any default or negligence of the Bank) after a Request has been delivered or made by the Borrower.

17. Expenses

The Borrower will pay the Bank upon demand all costs, charges and expenses (including any stamp taxes) incurred by the Bank in connection with the negotiation, preparation, execution, performance and enforcement of this Agreement (or any amendment, variation, extension or renewal thereof).

18. Disclosure

The Bank may disclose confidential information and documents relating to the Borrower in connection with the Facility which are in the Bank's possession if required under court orders or in order to comply with requests or orders made under applicable laws and regulations or in order to, in the Bank's sole and absolute discretion, pass on such information and documents to bank examiners, the Bank's head office and other branch offices, its affiliates and associates, assignees and prospective assignees and the Bank's auditors, counsel and other professional advisers.

19. SAFE registration upon claim

Unless otherwise provided by the applicable laws and regulations, if the Guarantee is claimed, the Borrower shall register with State Admin. of Foreign Exchange for actual foreign debt registration according to the Notice regarding the Perfection of Foreign Debt Management (《国家外汇管理局关于完善外债管理有关问题的通知》) issued by State Admin. of Foreign Exchange on 21 October 2005, whereby the same quota system (total investment of the Borrower minus registered capital of the Borrower) shall apply.

20. Notices

20.1 General Requirements for Notices

- a) Any communication in connection with this Agreement must be in writing and, unless otherwise stated, may be given in person, by post or fax. All communications and notices shall be written in English, or in Chinese if any law or regulation of the PRC requires, provided that any such notice provided to the Guarantor shall be translated into English.
- b) Unless it is agreed to the contrary, any consent or agreement required under this Agreement must be given in writing.
- c) In the event that (i) the Borrower fails to pay on the due date any amount payable by it under this Agreement; (ii) the Bank declares that all or part of any amounts outstanding under the Facility are immediately due and payable; (iii) the Bank provides any notice or communication relating to the Guaranty; or (iv) the Bank provides any notice or consent relating to prepayment and break funding costs under Section 10, the notices addressed to the Borrower in relation to the above-mentioned matters shall be copied to the Guarantor via air courier and provided in English.

20.2 Contact details

The contact details of the Borrower are:

Address: Chuang Ye Road (N)
Yanzhou Economic Development Zone
Yanzhou, Shandong Province
P.R. China
Fax number: 0537-2073189
Attention: Chairman

The contact details of the Guarantor are:

Address: One Technology Park Drive
Westford, MA 01886 USA
Fax number: 978-635-1593
Attention: Treasurer

The contact details of the Bank are:

Address: 31F, HSBC Building
1000 Lu Jia Zui Ring Road
Shanghai 200120
People's Republic of China
Fax number: 86-21-6160 2707
Attention: Betty Wang/Christine Lin/Carol CZ Cai
Commercial Banking

Any party may change its contact details by giving five (5) Business Days' notice to the other parties.

21. Miscellaneous

21.1 Certificates

A certificate by the Bank shall be conclusive evidence of the indebtedness of the Borrower under this Agreement save in the case of manifest error on the Bank's part.

21.2 No waivers

Any delay or omission by the Bank in enforcing its rights under this Agreement will not constitute a waiver of any of its rights at any time.

21.3 Assignment, Transfer and Participation

The Borrower hereby consents that the Bank may at any time assign or transfer to one or more banks or other entities all or a portion of its rights and/or obligations under the Facility and any Finance Documents without any further consent from the Borrower in relation thereto.

The Borrower hereby consents that the Bank may at any time sell participations to one or more banks or other entities of all or a portion of its rights and obligations under the Facility without any further consent from the Borrower in relation thereto.

The Bank may, in connection with (i) any assignment, or any proposed assignment, under the Facility; (ii) any participation, or any proposed participation, under the Facility; (iii) the purchase or sale of any credit insurance or any other contractual protection or hedging with respect to the Borrower's obligations under the Facility; or (iv) the processing and management of data relating to the Facility, disclose to third parties any information relating to the Borrower furnished to the Bank by the Borrower, provided that, prior to such disclosure, such third party shall agree in writing to preserve the confidentiality of any confidential information relating to the Borrower received by it from the Bank.

The Borrower may not assign, transfer or otherwise dispose of any of its rights, benefits or obligations under the Facility.

21.4. Severance

If at any time any of the terms and conditions of the Offer Letter is or becomes illegal, invalid or unenforceable in any respect, the legality, validity or enforceability of the remaining terms and conditions shall not be affected thereby.

21.5 Language

This Agreement is written in both Chinese and English. If there is any inconsistency between the two versions in the interpretation or otherwise, the English version shall prevail.

22. Governing Law and Jurisdiction

This Agreement shall be governed by and construed in all respects in accordance with the laws of the PRC and each of the parties to this Agreement, for the benefit of the Bank, hereby submits to the non-exclusive jurisdiction of the courts of the PRC.

23. Effectiveness

This Agreement shall be effective on the date that the authorized representatives of the Bank and the Borrower have duly executed this Agreement (If the execution by the Bank and the Borrower is not at the same date, the effective date shall be the later date that this Agreement is executed).

24. Definitions and Interpretation

24.1 The following terms have the following meanings when used in this Agreement:

"Advance" means the borrowing under the Facility of all or any portion of the Advised Amount by the Borrower or as the context may require, the principal amount of such borrowing;

"Advised Amount" means RMB Fifteen million Only (RMB15,000,000);

JPMorgan

“Agreement” means the agreement constituted by the acceptance by the Borrower of the terms and conditions of this Offer Letter, as the same may be amended, varied or extended from time to time;

“Business Day” means a day (other than a Saturday, a Sunday or a public holiday) on which Banks are open for general business in Shanghai;

“Drawdown Date” means in relation to any Advance, the date of that Advance or in relation to any Bank Guarantee, the date of issuance of that Bank Guarantee;

“Drawdown Period” means in the period from the date of acceptance of this Offer Letter by the Borrower up to and including eleven (11) calendar months from the date of such acceptance;

“Facility” means the short term advised credit line facility consisting of performance/financial guarantee (the “**Bank Guarantee**”), and Advance made available under this Agreement;

“Finance Documents” means this Agreement, the Guarantee referred to in clause 5.1(a)(vii); each Request and any other document designated as such by the Bank;

“First Drawdown Date” means the date upon which the Borrower makes the first drawdown of the Loan under this Agreement;

“Interest Period” means each period determined in accordance with clause 12.1;

“Interest Settlement Date” means in relation to any Advance, the 20th day of the last calendar month of each calendar quarter falling during each Interest Period for that relevant Advance provided that if such day is not a Business Day, the Business Day immediately after that day;

“Loan” means the aggregate principal amount of the borrowing from time to time under any Advance or Bank Guarantee by the Borrower under this Agreement or the aggregate principal amount outstanding of that borrowing;

“Offer Letter” means this letter;

“Permitted Security Interest” means:

- (i) any Security Interest comprising a netting or set-off arrangement entered into by the Borrower in the ordinary course of its banking arrangements for the purpose of netting debit and credit balances;
- (ii) any Security Interest arising by operation of law and in the ordinary course of business;
- (iii) any Security Interest entered into pursuant to a Finance Document;
- (iv) any Security Interest created over real property (whether by mortgage or lien) owned by the Borrower and aggregate principal amount secured by all such

Security Interest does not, at any time, exceed RMB10,000,000 (or its equivalent in any other currencies);

- (v) any Security Interest created over the fixed assets acquired by the Borrower provided that aggregate principal amount secured by all such Security Interest is for the purpose of acquiring such fixed assets and does not, at any time, exceed RMB14,000,000 (or its equivalent in any other currencies);
- (vi) any Security Interests created over assets of the Borrower and aggregate principal amount secured by all such Security Interest does not, at any time, exceed RMB5,000,000 (or its equivalent in any other currencies); and
- (vii) any other Security Interest with the prior written consent of the Bank;

“PRC” means The People’s Republic of China;

“Request” means a request in writing made by the Borrower for an Advance, in the form of the Schedule to this Agreement;

“RMB” means the lawful currency of the PRC;

“Security Interest” means any mortgage, pledge, lien, charge, assignment, hypothecation or security interest or any other agreement or arrangement having a similar effect, whether created pursuant to PRC law or any other applicable law.

“Term” means the term of each Advance, not exceeding the Specified Period, as specified in the Request delivered in relation to that Advance and agreed by the Bank; and

“Specified Period” means in relation to each Advance or Bank Guarantee, the period of one year from and including the date of acceptance of this Offer Letter by the Borrower.

24.2 In this Agreement, to the extent not inconsistent with the subject or context, words importing the singular number shall include the plural number and vice versa, words importing any gender shall include other genders; references to “**persons**” shall include any body of persons, corporate or unincorporate and references to a “**year**” will mean a period of 365 days. The headings are inserted for reference only and shall not affect the construction of the terms and conditions of this Agreement.

JPMorgan

Kindly acknowledge your acceptance and agreement with the terms of this Offer Letter by signing where indicated below and returning your duly completed acknowledgement to the Bank at the place indicated above. We look forward to being of service to you.

Yours faithfully

/s/ Q.C. Hua.....[Legal Chop]

JPMorgan Chase Bank, N.A.

Shanghai Branch

Name: Q.C. Hua

Title: Managing Director & General Manager

Date: July 30, 2007

Acknowledged and agreed:

/s/ Peter J. Flynn.....[Legal Chop]

For and on behalf of

Kadant Pulp and Paper Equipment (Yanzhou) Co., Ltd.

Name: Peter J. Flynn

Title: Legal Representative

Date: July 30, 2007

JPMorgan

SCHEDULE

FORM OF REQUEST

To: JPMorgan Chase Bank,N.A.
Shanghai Branch

From: Kadant Pulp and Paper Equipment (Yanzhou) Co., Ltd.

Short Term Advised Credit Line Facility Agreement dated July 30, 2007

1. We wish to borrow a Loan as follows:-
 - (a) Drawdown Date: []
 - (b) Type: Advance / Bank Guarantee
 - (c) Amount: []
 - (d) Payment instructions / Beneficiary: []
 - (e) Term: []
2. We confirm that each condition specified in Clause 5 is satisfied on the date of this Request.
3. This request is irrevocable.

By:

[]
Authorised Signatory

GUARANTY

Dated as of July 30, 2007.

Guaranty. To induce **JPMORGAN CHASE BANK, N.A., SHANGHAI BRANCH**, with an address of 31F, HSBC Tower, 1000 Lu Jia Zui Ring Road, Shanghai, P.R. China, 200120 Attn: Betty Wang, Fax No.:8621-61602707, its successors and assigns, directly or through any of its branches, offices, subsidiaries, or affiliates (collectively, the "**Bank**"), to provide: (a) a credit facility in the original principal amount of up to RMB Forty Million (RMB40,000,000) to be entered into with **KADANT JINING LIGHT MACHINERY CO., LTD.**, a company incorporated in Jining, China ("**K-Jining**") pursuant to a RMB40,000,000 Term Loan Agreement, among K-Jining and the Bank ("**Term Credit Agreement**"), (b) a credit facility in the original principal amount of up to RMB Forty Five Million (RMB45,000,000) to K-Jining pursuant to a Short-Term Advised Credit Line Facility Agreement, dated as of July 30, 2007, among K-Jining and the Bank ("**364 Day KJ Credit Agreement**"), (c) a credit facility in the original principal amount of up to RMB Fifteen Million (RMB15,000,000) to **KADANT PULP AND PAPER EQUIPMENT (YANZHOU) CO. LTD.**, a company incorporated in Yanzhou, China ("**K-Yanzhou**") pursuant to a Short-Term Advised Credit Line Facility Agreement, dated as of July 30, 2007, among K-Jining and the Bank ("**364 Day KY Credit Agreement**") and (d) foreign exchange facilities and cash management services to **KADANT JOHNSON (WUXI) TECHNOLOGY CO. LTD.**, a company incorporated in Wuxi, China ("**K-Wuxi**"; together with K-Jining and K-Yanzhou, the "**Borrowers**") pursuant to (i) in the case of foreign exchange facilities, any agreement with respect to any swap, forward, future or derivative transaction or option or similar agreement involving, or settled by reference to, one or more rates, currencies, commodities, equity or debt instruments or securities, or economic, financial or pricing indices or measures of economic, financial or pricing risk or value or any similar transaction or any combination of these transactions ("**Foreign Exchange Facility**") and (ii) in the case of cash management services, any agreement providing for treasury, depository or cash management services, including in connection with any automated clearing house transfers of funds or any similar transactions ("**Cash Management Facility**"; together with the Term Credit Agreement, 364 Day KJ Credit Agreement, 364 Day KY Credit Agreement and Foreign Exchange Facility, the "**Loan Documents**"), and because the undersigned (the "**Guarantor**") has determined that executing this Guaranty is in its interest and to its financial benefit, the Guarantor absolutely, unconditionally and irrevocably guarantees to the Bank, as primary obligor and not merely as surety, the full and prompt payment of the Liabilities when due (whether on demand, at stated maturity, by acceleration or otherwise) in accordance with the Facility Documents. The Guarantor will not only pay the Liabilities when due in accordance with the Facility Documents, but will also reimburse the Bank for any fees, charges, costs and expenses, including reasonable attorneys' fees, that the Bank may pay in collecting from the Borrower or the Guarantor, and for liquidating any Collateral or this Guaranty. Subject to the provisions in "Payments Generally" below, the Guarantor's obligations under this Guaranty shall be payable in the currency or currencies specified in the Facility Documents (as defined below). Unless otherwise defined herein, terms used in this Guaranty have the meanings provided in the Loan Documents. As used herein, the term "Collateral" in this Guaranty means all real or personal property of each of the Borrowers described in (if any) all security agreements, pledge agreements, mortgages, deeds of trust, assignments, or other instruments previously, concurrently, or hereafter executed in connection with any of the Liabilities.

Liabilities. The term "Liabilities" in this Guaranty means all obligations, indebtedness, and liabilities of the Borrowers to the Bank, now existing or later arising, related to certain credit facilities being provided by the Bank to each of the Borrowers, as described in the Loan Documents; all monetary obligations of each of the Borrowers to the Bank incurred or accrued during the pendency of any bankruptcy, insolvency, receivership

or similar proceedings related to the Loan Documents, regardless of whether allowed or allowable in such proceeding, and all renewals, extensions, modifications, consolidations or substitutions of any of the foregoing, whether the Borrowers may be liable jointly with others or individually liable as a debtor, maker, co-maker, drawer, endorser, guarantor, surety or otherwise, and whether voluntarily or involuntarily incurred, due or not due, absolute or contingent, direct or indirect, liquidated or unliquidated. The Guarantor acknowledges that, without limiting the scope of the foregoing or any other provision of this Guaranty, including any provisions in the paragraph below captioned "Payments Generally," the term "Liabilities" in addition to the above definition, includes, but is not limited to, any loss that the Bank may incur on account of prohibitions or limitations that may exist under the laws or regulations of the State Administration of Foreign Exchange or other regulatory authorities in the Peoples Republic of China regarding the conversion into RMB of U.S. dollars that may be paid by the Guarantor to the Bank to satisfy any of the Guarantor's obligations under this Guaranty.

Facility Documents. All writings evidencing, supporting, securing, or otherwise executed in connection with any of the Liabilities, including but not limited to this Guaranty and the Loan Documents, as such writings may be amended, modified, replaced, or supplemented from time to time, are referred to collectively as the "Facility Documents" and individually as a "Facility Document".

Continued Reliance. Subject to the provisions in "Reinstatement" below, this Guaranty shall in all respects be a continuing, absolute, unconditional and irrevocable guaranty of payment, and shall remain in full force and effect until the Liabilities under the Loan Documents by the Borrowers have been paid and satisfied in full. In the event of any future termination for any reason (including as a result of a prepayment by the Guarantor) of (i) the Credit Agreement, dated as of May 9, 2005 (as may be amended, supplemented, modified or extended from time to time), among the Guarantor, the Foreign Subsidiary Borrowers from time to time parties thereto, the several Lenders from time to time parties thereto and JPMorgan Chase Bank, N.A., as Administrative Agent (the "US Credit Agreement") or (ii) any credit agreement that in whole substantially replaces the Credit Agreement and in which JPMorgan Chase Bank, N.A., is a participant (the "Successor US Credit Agreement"), prior to the satisfaction of all the obligations as provided for in the Loan Documents, then Sections 6, 7 and 8 of the US Credit Agreement or their equivalent sections of the Successor US Credit Agreement, as the same shall be in effect immediately prior to such termination, shall be incorporated herein by reference and shall remain in full force and effect until the Liabilities under the Loan Documents by the Borrowers have been paid and satisfied in full.

Bank's Right of Setoff. The Bank is authorized to setoff and apply, all Accounts, Securities and Other Property, and Bank Debt against any and all obligations of the Guarantor under this Guaranty in accordance with the provisions of this paragraph. Subject to applicable law, this right of setoff may be exercised at any time and from time to time, without prior notice to the Guarantor, after demand has been made under any of the Liabilities (if any such Liabilities are payable on demand) or after a default has occurred and is continuing under any of the Liabilities and there has been a failure to cure any such default within any applicable cure period, in each case, the giving effect to any grace or cure periods for payments under "Payments Generally" below. This security interest and right of setoff may be enforced or exercised by the Bank regardless of whether or not the Bank has made any demand on the Guarantor under this paragraph or whether the Liabilities are contingent, matured, or unmatured, so long as demand has been made under any of the Liabilities (if any such Liabilities are payable on demand) or after a default has occurred and is continuing under any of the Liabilities and there has been a failure to cure any such default within any applicable cure period. Any delay, neglect or conduct by the Bank in exercising its rights under this paragraph will not be a waiver of the right to exercise this right of setoff. The rights of the Bank under this paragraph are in addition to other rights the Bank may have by law. In this paragraph: (a) the term "Accounts" means any and all accounts and deposits of the Guarantor (whether general, special, time, demand, provisional or final), in U.S. dollars or any other currency, regardless of whether such accounts or deposits are then due to the Guarantor, at any time held by the Bank or any Lending Installation (as defined below) (including all Accounts held

jointly with another, but excluding any IRA or Keogh Account, or any trust or other type of Account in which a right of setoff would be prohibited by law); (b) the term "Securities and Other Property" means any and all securities and other property of the Guarantor in the custody, possession or control of the Bank or any Lending Installation (other than property held by the Bank or any Lending Installation in a fiduciary capacity); and (c) the term "Bank Debt" means all indebtedness at any time owing by the Bank or any Lending Installation to or for the credit or account of the Guarantor.

Remedies. If the Guarantor fails to pay any amount owing under this Guaranty, the Bank shall have all of the rights and remedies provided by law or under any other agreement. The Guarantor is liable to the Bank for all reasonable costs and expenses of any kind incurred in the making and collection of this Guaranty, including without limitation reasonable attorneys' fees and court costs. These costs and expenses include without limitation any costs or expenses incurred by the Bank in any bankruptcy, reorganization, insolvency or other similar proceeding.

Permissible Actions. If any monies become available from any source other than the Guarantor that the Bank can apply to the Liabilities, the Bank may apply them in any manner it chooses, including but not limited to applying them against obligations, indebtedness or liabilities which are not covered by this Guaranty. The Bank may take any action against the Borrower, the Collateral, or any other person liable for any of the Liabilities. The Bank may release the Borrower or anyone else from the Liabilities, either in whole or in part, or release the Collateral, and need not perfect a security interest in or lien on the Collateral. The Bank does not have to exercise any rights that it has against the Borrower or anyone else, or make any effort to realize on the Collateral or any other collateral for the Liabilities, or exercise any right of set-off. The Guarantor authorizes the Bank, without notice or demand and without affecting the Guarantor's obligations hereunder, from time to time, to: (a) renew, modify, compromise, extend, accelerate or otherwise change the time for payment of, or otherwise change the terms of the Liabilities or any part thereof, including increasing or decreasing the rate of interest thereon; (b) release, substitute or add any one or more endorsers, Guarantor or other guarantors; (c) take and hold Collateral for the payment of the Liabilities, and enforce, exchange, substitute, subordinate, waive or release any such Collateral; (d) proceed against such Collateral and direct the order or manner of sale of such Collateral as the Bank in its discretion may determine; and (e) apply any and all payments from the Borrower, the Guarantor or any other guarantor, or recoveries from such Collateral, in such order or manner as the Bank in its discretion may determine. The Guarantor's obligations under this Guaranty shall not be released, diminished or affected by (i) any act or omission of the Bank, (ii) the voluntary or involuntary liquidation, sale or other disposition of all or substantially all of the assets of the Borrower, or any receivership, insolvency, bankruptcy, reorganization, or other similar proceedings affecting the Borrower or any of its assets, (iii) any change in the composition or structure of the Borrower or the Guarantor, including a merger or consolidation with any other person or entity, or (iv) any payments (other than payment in full) made upon the Liabilities. The Guarantor hereby expressly consents to any impairment of Collateral, including, but not limited to, failure to perfect a security interest and release Collateral and any such impairment or release shall not affect the Guarantor's obligations hereunder.

Nature of Guaranty. This Guaranty is a guaranty of performance and payment when due and not of collectibility. Therefore, the Bank may insist that the Guarantor pay immediately, and the Bank is not required to attempt to collect first from the Borrower, the Collateral, or any other person liable for the Liabilities. The obligation of the Guarantor shall be unconditional and absolute even if all or any part of any agreement between the Bank and the Borrower is unenforceable, void, voidable or illegal, and regardless of the existence of any defense, setoff or counterclaim which the Borrower may assert. If the Borrower is a corporation, limited liability company, partnership or trust, it is not necessary for the Bank to inquire into the powers of the Borrower or the officers, directors, members, managers, partners, trustees or agents acting or purporting to act on its behalf, and any of the Liabilities made or created in reliance upon the professed exercise of such powers shall be guaranteed hereunder.

Rights of Subrogation. The Guarantor waives and agrees not to enforce any rights of subrogation, contribution or indemnification that it may have against the Borrower, any person liable on the Liabilities, or the Collateral, in each case, arising from payments under this Guaranty, until the Borrower and the Guarantor have fully performed all their obligations to the Bank under the Loan Documents and the Loan Documents have been terminated and all amounts due thereunder have been paid and satisfied in full.

Waivers. The Guarantor waives (a) to the extent permitted by law, all rights and benefits under any laws or statutes regarding sureties, as may be amended, and (b) any right the Guarantor may have to receive notice of the following matters before the Bank enforces any of its rights: (i) the Bank's acceptance of this Guaranty, (ii) any credit that the Bank extends to the Borrower, (iii) the Borrower's default, (iv) any demand, diligence, presentment, dishonor and protest, or (v) any action that the Bank takes regarding the Borrower, anyone else, the Collateral, or any of the Liabilities, which it might be entitled to by law or under any other agreement, (c) any right it may have to require the Bank to proceed against the Borrower, any other obligor or guarantor of the Liabilities, or the Collateral for the Liabilities or the Guarantor's obligations under this Guaranty, or pursue any remedy in the Bank's power to pursue, (d) any defense based on any claim that the Guarantor's obligations exceed or are more burdensome than those of the Borrower, (e) any defense arising by reason of any disability or other defense of the Borrower or by reason of the cessation from any cause whatsoever (other than payment in full) of the obligation of the Borrower for the Liabilities, and (f) any defense based on or arising out of any defense that the Borrower may have to the payment or performance (other than payment in full) of the Liabilities. The Bank may waive or delay enforcing any of its rights without losing them. Any waiver affects only the specific terms and time period stated in the waiver. No modification or waiver of this Guaranty is effective unless it is in writing and signed by the party against whom it is being enforced.

Payments Generally. Upon demand by the Bank or otherwise when such payments are due and payable, all payments by the Guarantor shall be made in (i) U.S. dollars to the Bank at its principal office the equivalent amount in U.S. dollars computed at the selling rate of the Bank or a selling rate chosen by the Bank, most recently in effect on or prior to the date the Liability becomes due, for cable transfers of the Payment Currency to the place where the Liability is payable or (ii) in the absence of any Event of Default (as defined by the US Credit Agreement or the Successor US Credit Agreement) by the Guarantor, RMB; provided that, such payment shall be made within 60 days after such demand or otherwise and when such payments are due and payable; provided further that, the Guarantor shall use State Administration of Foreign Exchange ("SAFE") system for making such payments, including but not limited to, registering with SAFE for actual foreign debt registration according to the Notice regarding the Perfection of Foreign Debt Management (《国家外汇管理局关于完善外债管理有关操作的通知》) issued by SAFE on 21 October 2005 (as may be amended from time to time), whereby the same quota system (total investment of the Borrower minus registered capital of the Borrower) shall apply. Notwithstanding anything else stated in this Agreement, the Guarantor shall hold the Bank harmless from any loss incurred by the Bank arising from any change in the value of U.S. dollars in relation to RMB between the date the Liability becomes due and the date the Bank is actually able, following the conversion of the U.S. dollars paid by the Guarantor into RMB and remittance of RMB to the place where such Liability is payable, to apply such Payment Currency to such Liability

Judgment Currency. Notwithstanding anything else stated to the contrary in this Agreement, if, for the purpose of obtaining judgment in any court, it is necessary to convert a sum owing hereunder in one currency into another currency, each party hereto agrees, to the fullest extent that it may effectively do so, that the rate of exchange used shall be that at which, in accordance with normal banking procedures in the relevant jurisdiction, the first currency could be purchased with such other currency on the business day immediately preceding the day on which final judgment is given. The obligations of the Guarantor in respect of any sum due to any party hereto or any holder of the obligations owing hereunder (the "Applicable Creditor") shall, notwithstanding any judgment in a currency (the "Judgment Currency") other than the currency in which such sum is stated to be due hereunder (the "Agreement Currency"), be discharged only to the extent that, on the business day following

receipt by the Applicable Creditor of any sum adjudged to be so due in the Judgment Currency, the Applicable Creditor may in accordance with normal banking procedures in the relevant jurisdiction purchase the Agreement Currency with the Judgment Currency; if the amount of the Agreement Currency so purchased is less than the sum originally due to the Applicable Creditor in the Agreement Currency, the Guarantor as a separate obligation and notwithstanding any such judgment, agrees to indemnify the Applicable Creditor against such loss. The obligations of the relevant contained in herein shall survive the termination of this Agreement and the payment of all other amounts owing hereunder.

Certain Taxes. The Guarantor further agrees that all payments to be made hereunder shall be made without setoff or counterclaim and free and clear of, and without deduction for, any taxes, levies, imposts, duties, charges, fees, deductions, withholdings or restrictions or conditions of any nature whatsoever now or hereafter imposed, levied, collected, withheld or assessed by any country or by any political subdivision or taxing authority thereof or therein ("Tax" or "Taxes"). If any Tax is required to be withheld from any amounts payable to the Bank hereunder, the amounts so payable to the Bank shall be increased to the extent necessary to yield to the Bank (after payment of the Tax) the amounts payable hereunder in the full amounts so to be paid. Whenever any Tax is paid by the Guarantor, as promptly as possible thereafter, the Guarantor shall send the Bank an official receipt showing payment thereof, together with such additional documentary evidence as may be required from time to time by the Bank.

Lending Installations. Each of the Liabilities may be booked at any office, branch, subsidiary, or affiliate of the Bank, as selected by the Bank (each, a "Lending Installation"). All terms of this Guaranty apply to and may be enforced by or on behalf of any Lending Installation.

Reinstatement. The Guarantor agrees that to the extent any payment by a Borrower is received by the Bank in connection with the Liabilities, and all or any part of such payment is subsequently invalidated, declared to be fraudulent or preferential, set aside or required to be repaid by the Bank or paid over to a trustee, receiver or any other entity, whether under any bankruptcy act, foreign or domestic, or otherwise (any such payment is hereinafter referred to as a "Preferential Payment"), then this Guaranty shall continue to be effective or shall be reinstated, as the case may be, and whether or not the Bank is in possession of this Guaranty, and, to the extent of such payment or repayment by the Bank, the Liabilities or part thereof intended to be satisfied by such Preferential Payment shall be revived and continued in full force and effect as if said Preferential Payment had not been made.

Information. The Guarantor assumes all responsibility for being and keeping itself informed of the Borrower's financial condition and assets, and of all other circumstances bearing upon the risk of nonpayment of the Liabilities and the nature, scope and extent of the risks that the Guarantor assumes and incurs under this Guaranty, and agrees that the Bank does not have any duty to advise the Guarantor of information known to it regarding those circumstances or risks.

Severability. The provisions of this Guaranty are severable; if any of the obligations of the Guarantor under this Guaranty is invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining obligations of the Guarantor shall not in any way be affected or impaired, and the invalidity, illegality or unenforceability in one jurisdiction shall not affect the validity, legality or enforceability of the obligations of the Guarantor under this Guaranty in any other jurisdiction. Further, in any action or proceeding involving any state corporate law, or any state, federal or foreign bankruptcy, insolvency, reorganization or other law affecting the rights of creditors generally, if the obligations of the Guarantor under this Guaranty would otherwise be held or determined to be avoidable, invalid or unenforceable on account of the amount of the Guarantor's liability under this Guaranty, then, notwithstanding any other provision of this Guaranty to the contrary, the amount of such liability shall, without any further action by the Guarantor or the Bank, be automatically limited and reduced to the highest amount that is valid and enforceable as determined in such action or proceeding.

Representations by Guarantor. The Guarantor represents that: (a) the execution and delivery of this Guaranty and the performance of the obligations it imposes do not violate any law, do not conflict with, result in a breach of or constitute a default under any agreement or instrument by which it is bound, or require the consent or approval of any governmental authority or any third party and (b) this Guaranty is a valid and binding agreement, enforceable according to its terms. The Guarantor further represents that: (a) it is duly organized, existing and in good standing under the laws where it is organized, and (b) the execution and delivery of this Guaranty and the performance of the obligations it imposes (i) are within its powers and have been duly authorized by all necessary action of its governing body, and (ii) do not contravene the terms of its articles of incorporation or organization, its by-laws, or any agreement governing its affairs.

Notices. All notices, requests and other communications to any party under this Guaranty must be in writing in English (including bank wire, facsimile transmission or similar writing) and must be given to that party, in the case of the Guarantor, at its address or facsimile number set forth on the signature page of this Guaranty, and, in the case of the Bank, at the address or facsimile number stated above, with a copy concurrently sent to:

JPMorgan Chase Bank, N.A.
Attn: Division Manager
Mail Code IL1-1742
120 South La Salle Street
Chicago, IL 60603-3403 United States
Fax No.: 312-661-3566

Either party may change the address or facsimile number to which notice is to be sent for that party by sending a written notice to the other party specifying the change. Each notice, request or other communication is effective (i) if given by facsimile transmission, when transmitted to the facsimile number(s) for the other party and confirmation of receipt is received, (ii) if given by mail, 72 hours after the communication is deposited in the mails with first class postage prepaid, to the address(es) for the other party, or (iii) if given by any other means, when delivered at the address(es) for the other party.

Governing Law and Venue. THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED AND INTERPRETED IN ACCORDANCE WITH, THE LAW OF THE STATE OF NEW YORK. The Guarantor hereby irrevocably and unconditionally: (i) submits for itself and its property in any legal action or proceeding relating to this Agreement, or for recognition and enforcement of any judgment in respect thereof, to the non exclusive general jurisdiction of the courts of the State of New York, the courts of the United States of America for the Southern District of New York, and appellate courts from any thereof, (ii) consents that any such action or proceeding may be brought in such courts and waives any objection that it may now or hereafter have to the venue of any such action or proceeding in any such court or that such action or proceeding was brought in an inconvenient court and agrees not to plead or claim the same, (iii) agrees that service of process in any such action or proceeding may be effected by mailing a copy thereof by registered or certified mail (or any substantially similar form of mail), postage prepaid, to the Guarantor at its address as set forth on the signature page of this Guaranty and (iv) agrees that nothing herein shall affect the right to effect service of process in any other manner permitted by law or shall limit the right to sue in any other jurisdiction.

Miscellaneous. The Guarantor's liability under this Guaranty is independent of its liability under any other guaranty previously or subsequently executed by the Guarantor or any one of them, singularly or together with others, as to all or any part of the Liabilities, and may be enforced for the full amount of this Guaranty regardless of the Guarantor's liability under any other guaranty. This Guaranty binds the Guarantor's heirs, successors and assigns, and benefits the Bank and its successors and assigns. Guarantor may not assign or otherwise transfer any of its rights or obligations under this Guaranty without the written prior consent of the Bank. The Bank may assign this Guaranty in whole or in part without notice, but only together with the Liabilities to which it relates. The use of headings have been inserted in this Guaranty as a matter of

convenience for reference only and it is agreed that such headings are not part of this Guaranty and does not limit the provisions of this Guaranty and shall not be used in the interpretation of any provision of this Guaranty. The Guarantor agrees that the Bank may provide any information or knowledge the Bank may have about the Guarantor or about any matter relating to this Guaranty to JPMorgan Chase & Co. ("JPMC"), or any of its subsidiaries or affiliates or their successors, or to one or more purchasers or potential purchasers of this Guaranty or the Liabilities guaranteed hereby; provided, that prior to any such disclosure, each such purchasers or potential purchasers are advised of and agree to be bound by either the provisions in "Confidentiality" below or other provisions at least as restrictive as contained therein.

Confidentiality. The Bank agrees to keep any information delivered or made available by the Guarantor to it confidential from anyone other than persons employed or retained by the Bank who are or are expected to become engaged in evaluating, approving, structuring or administering the Loan Documents, and who are advised by the Bank of the confidential nature of such information; provided, that nothing herein shall prevent the Bank from disclosing such information (a) to affiliates of JPMC (it being understood that such affiliates of JPMC will be informed of the confidential nature of such information and instructed to keep such information confidential), (b) upon the order of any court or administrative agency, (c) upon the request or demand of any regulatory agency or authority, (d) which has been publicly disclosed other than as a result of a disclosure by the Bank which is not permitted by this Guaranty, (e) in connection with any litigation to which the Bank may be a party to the extent reasonably required, (f) to the extent reasonably required in connection with the exercise of any remedy hereunder, (g) to the Bank's legal counsel and independent auditors, and (h) to any actual or proposed participant or assignee of all or part of its rights hereunder or to any direct or indirect contractual counterparty (or the professional advisors thereto) to any swap or derivative transaction relating to the Borrower and its obligations, in each case, subject to the proviso in the last sentence of in "Miscellaneous" above. If the Bank is in any manner requested or required to disclose any of the information delivered or made available to it by the Guarantor under clauses (b) or (e) of this provision, the Bank will, to the extent permitted by law, provide the Guarantor with prompt notice, to the extent reasonable, so that the Guarantor may seek, at its sole expense, a protective order or other appropriate remedy or may waive compliance with this provision.

WAIVER OF IMMUNITY. TO THE EXTENT THAT THE GUARANTOR HAS OR HEREAFTER MAY BE ENTITLED TO CLAIM OR MAY ACQUIRE, FOR ITSELF OR ANY OF ITS ASSETS, ANY IMMUNITY FROM SUIT, JURISDICTION OF ANY COURT, OR FROM ANY LEGAL PROCESS (WHETHER FROM SERVICE OR NOTICE, ATTACHMENT PRIOR TO JUDGMENT, ATTACHMENT IN AID OF EXECUTION OF A JUDGMENT, EXECUTION OR OTHERWISE) AS TO ITSELF OR ITS PROPERTY, AND TO THE EXTENT PERMITTED BY LAW THE GUARANTOR HEREBY IRREVOCABLY WAIVES SUCH IMMUNITY IN REGARD TO ITS OBLIGATIONS UNDER THIS GUARANTY.

WAIVER OF SPECIAL DAMAGES. THE GUARANTOR WAIVES, TO THE MAXIMUM EXTENT NOT PROHIBITED BY LAW, ANY RIGHT THE UNDERSIGNED MAY HAVE TO CLAIM OR RECOVER FROM THE BANK IN ANY LEGAL ACTION OR PROCEEDING ANY SPECIAL, EXEMPLARY, PUNITIVE OR CONSEQUENTIAL DAMAGES.

JURY WAIVER. THE GUARANTOR HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES TRIAL BY JURY IN ANY LEGAL ACTION OR PROCEEDING RELATING TO THIS AGREEMENT AND FOR ANY COUNTERCLAIM THEREIN.

[SIGNATURE PAGE FOLLOWS]

Guarantor:

Address: One Technology Park Drive
Westford MA 01886 U.S.A.
Attn: Chief Financial Officer, Treasurer
And Chief Legal Officer

KADANT INC.

Fax No.: +1 978-635-1593

By: /s/ Daniel J. Walsh

Its: Treasurer

CERTIFICATION

I, William A. Rainville, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007 of Kadant Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2007

/s/ William A. Rainville

William A. Rainville

Chief Executive Officer

CERTIFICATION

I, Thomas M. O'Brien, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007 of Kadant Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2007

/s/ Thomas M. O'Brien

Thomas M. O'Brien

Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350, the undersigned, William A. Rainville, Chief Executive Officer, and Thomas M. O'Brien, Chief Financial Officer, of Kadant Inc., a Delaware corporation (the "Company"), do hereby certify, to our best knowledge and belief, that:

The Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007 of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in this Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 8, 2007

/s/ William A. Rainville

William A. Rainville

Chief Executive Officer

/s/ Thomas M. O'Brien

Thomas M. O'Brien

Executive Vice President and Chief Financial Officer