

LYDALL INC /DE/
Form 10-Q
August 01, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2012

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: 1-7665

LYDALL, INC.

(Exact name of registrant as specified in its charter)

Delaware 06-0865505
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

One Colonial Road, Manchester, Connecticut 06042
(Address of principal executive offices) (zip code)

(860) 646-1233

(Registrant's telephone number, including area code)

None

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

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

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

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

company” in Rule 12b-2 of the Exchange Act.

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

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

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

Common Stock \$.10 par value per share.

Total Shares outstanding July 19, 2012 17,014,997

LYDALL, INC.**INDEX**

| | Page Number |
|---|------------------------|
| Cautionary Note Concerning Factors That May Affect Future Results | 3 |
| Part I. | |
| Financial Information | |
| Item 1. | |
| Financial Statements | |
| Condensed Consolidated Statements of Operations | 4 |
| Condensed Consolidated Statements of Comprehensive Income | 6 |
| Condensed Consolidated Balance Sheets | 7 |
| Condensed Consolidated Statements of Cash Flows | 8 |
| Notes to Condensed Consolidated Financial Statements | 9 |
| Item 2. | 18 |
| Management's Discussion and Analysis of Financial Condition and Results of Operations | |
| Item 3. | 29 |
| Quantitative and Qualitative Disclosures about Market Risk | |
| Item 4. | 29 |
| Controls and Procedures | |
| Part II. | |
| Other Information | |
| Item 1. | 30 |
| Item 1A. | 30 |
| Item 2. | 30 |
| Unregistered Sales of Equity Securities and Use of Proceeds | |
| Item 5. | 30 |
| Item 6. | 31 |
| Exhibits | |
| Signature | 32 |
| Exhibit Index | 33 |

Cautionary Note Concerning Factors That May Affect Future Results

This report contains “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In general, any statements contained in this report that are not statements of historical fact may be deemed to be forward-looking statements within the meaning of Section 21E. All such forward-looking statements are intended to provide management’s current expectations for the future operating and financial performance of the Company based on current expectations and assumptions relating to the Company’s business, the economy and other future conditions. Forward-looking statements generally can be identified through the use of the words “believes,” “anticipates,” “may,” “plans,” “projects,” “expects,” “estimates,” “forecasts,” “predicts,” “targets,” and other similar expressions in connection with the discussion of future operating or financial performance. Because forward-looking statements relate to the future, they are subject to inherent risks, uncertainties and changes in circumstances that are difficult to predict. Accordingly, the Company’s actual results may differ materially from those contemplated by the forward-looking statements. Therefore, investors are cautioned against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future performance. Forward-looking statements in this Quarterly Report on Form 10-Q includes, among others, statements relating to:

- Overall economic and business conditions and the effects on the Company’s markets;
- Expected automobile production in the North American or European automotive markets;
- Growth opportunities in markets served by the Company’s Performance Materials segment;
 - Product development and new business opportunities;
- Future strategic transactions, included but not limited to: acquisitions, joint ventures, alliances, licensing agreements and divestitures;
 - Pension plan funding requirements;
 - Future cash flow and uses of cash;
 - Future repurchases of the Company’s Common Stock;
 - Future amounts of stock-based compensation expense;
 - Future earnings and other measurements of financial performance;
 - Future levels of indebtedness and capital spending;
 - The Company’s ability to meet cash operating requirements;
 - The Company’s ability to meet financial covenants in its Domestic Credit Facility;
- The expected future impact of recently issued accounting pronouncements upon adoption;
 - Future effective income tax rates and realization of deferred tax assets;
- Estimates of fair values of reporting units and long-lived assets used in assessing goodwill and long-lived assets for possible impairment; and
 - The expected outcomes of contingencies.

All forward-looking statements are inherently subject to a number of risks and uncertainties that could cause the actual results of the Company to differ materially from those reflected in forward-looking statements made in this Quarterly Report on Form 10-Q, in press releases and in other statements made by the Company’s authorized officers. Such risks and uncertainties include, among others, worldwide economic cycles that affect the markets which the businesses serve could affect demand for the Company’s products and impact the Company’s profitability, disruptions in the global credit and financial markets, including diminished liquidity and credit availability, swings in consumer confidence and spending, unstable economic growth, fluctuations in unemployment rates, and increases in fuel prices, which could

cause economic instability and could have a negative impact on the Company's results of operations and financial condition, as well as other risks and uncertainties identified in Part I, Item 1A - Risk Factors of Lydall's Annual Report on Form 10-K for the year ended December 31, 2011 and Part 2, Item 1A - Risk Factors of this Quarterly Report on Form 10-Q.

The forward-looking statements speak only as of the date of this initial filing of this Quarterly Report on Form 10-Q, and Lydall does not undertake to update any forward-looking statement made in this report or that may from time to time be made by or on behalf of the Company.

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****LYDALL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In Thousands Except Per Share Data)**

| | Quarter Ended June 30, | |
|--|---------------------------|-----------------|
| | 2012 | Revised 2011 |
| | (Unaudited) | |
| Net sales | \$97,535 | \$98,831 |
| Cost of sales | 75,542 | 80,774 |
| Gross profit | 21,993 | 18,057 |
| Selling, product development and administrative expenses | 13,655 | 13,477 |
| Gain on sale of product line | (405) | (405) |
| Operating income | 8,743 | 4,985 |
| Interest expense | 87 | 473 |
| Other income, net | (27) | (15) |
| Income from continuing operations before income taxes | 8,683 | 4,527 |
| Income tax expense | 2,091 | 1,911 |
| Income from continuing operations | 6,592 | 2,616 |
| Income from discontinued operations, net of tax of \$2,591 | - | 4,484 |
| Net income | \$6,592 | \$7,100 |
| Basic earnings per share: | | |
| Continuing operations | \$0.39 | \$0.16 |
| Discontinued operations | \$- | \$0.27 |
| Net income | \$0.39 | \$0.42 |
| Diluted earnings per share: | | |
| Continuing operations | \$0.39 | \$0.15 |
| Discontinued operations | \$- | \$0.27 |
| Net income | \$0.39 | \$0.42 |
| Weighted average number of common shares outstanding: | | |
| Basic | 16,770 | 16,741 |
| Diluted | 16,962 | 16,909 |

See accompanying Notes to Condensed Consolidated Financial Statements.

LYDALL, INC.**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In Thousands Except Per Share Data)**

| | Six Months Ended June 30, | |
|--|------------------------------|-----------------|
| | 2012 | Revised 2011 |
| | (Unaudited) | |
| Net sales | \$194,289 | \$200,504 |
| Cost of sales | 153,055 | 164,442 |
| Gross profit | 41,234 | 36,062 |
| Selling, product development and administrative expenses | 27,899 | 27,347 |
| Gain on sale of product line | (810) | (810) |
| Operating income | 14,145 | 9,525 |
| Interest expense | 177 | 683 |
| Other expense, net | 16 | 28 |
| Income from continuing operations before income taxes | 13,952 | 8,814 |
| Income tax expense | 3,448 | 3,566 |
| Income from continuing operations | 10,504 | 5,248 |
| Income from discontinued operations, net of tax of \$2,728 | - | 4,732 |
| Net Income | \$10,504 | \$9,980 |
| Basic earnings per share: | | |
| Continuing operations | \$0.63 | \$0.31 |
| Discontinued operations | \$- | \$0.28 |
| Net income | \$0.63 | \$0.60 |
| Diluted earnings per share: | | |
| Continuing operations | \$0.62 | \$0.31 |
| Discontinued operations | \$- | \$0.28 |
| Net income | \$0.62 | \$0.59 |
| Weighted average number of common shares outstanding: | | |
| Basic | 16,799 | 16,738 |
| Diluted | 16,939 | 16,875 |

See accompanying Notes to Condensed Consolidated Financial Statements.

LYDALL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)

| | Quarter Ended June 30, | | Six Months Ended June 30, | |
|--|---------------------------|-----------------|------------------------------|-----------------|
| | 2012 | Revised 2011 | 2012 | Revised 2011 |
| | (Unaudited) | | (Unaudited) | |
| Net income | \$6,592 | \$ 7,100 | \$10,504 | \$ 9,980 |
| Changes in accumulated other comprehensive loss: | | | | |
| Foreign currency translation adjustments | (3,711) | 1,744 | (1,656) | 5,803 |
| Pension liability adjustment, net of tax | 139 | 86 | 277 | 170 |
| Comprehensive income | \$3,020 | \$ 8,930 | \$9,125 | \$15,953 |

See accompanying Notes to Condensed Consolidated Financial Statements.

LYDALL, INC.**CONDENSED CONSOLIDATED BALANCE SHEETS****(In Thousands)**

| | June 30, 2012 | December 31, 2011 |
|--|------------------|----------------------|
| | (Unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$46,055 | \$ 30,905 |
| Short-term investment | - | 12,015 |
| Accounts receivable, net | 57,046 | 47,258 |
| Inventories | 33,293 | 33,846 |
| Prepaid expenses and other current assets, net | 8,607 | 6,796 |
| Total current assets | 145,001 | 130,820 |
| Property, plant and equipment, at cost | 242,411 | 240,157 |
| Accumulated depreciation | (164,833) | (161,218) |
| Net, property, plant and equipment | 77,578 | 78,939 |
| Goodwill | 18,018 | 18,059 |
| Other intangible assets | 4,058 | 4,537 |
| Other assets, net | 2,375 | 2,830 |
| Total assets | \$247,030 | \$ 235,185 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$843 | \$ 1,035 |
| Accounts payable | 31,887 | 28,163 |
| Accrued payroll and other compensation | 9,828 | 9,031 |
| Accrued taxes | 3,027 | 2,532 |
| Other accrued liabilities | 4,560 | 4,038 |
| Total current liabilities | 50,145 | 44,799 |
| Long-term debt | 1,955 | 2,261 |
| Deferred tax liabilities | 5,291 | 5,240 |
| Benefit plan liabilities | 20,304 | 21,269 |
| Other long-term liabilities | 1,020 | 764 |
| Commitments and Contingencies (Note 13) | | |
| Stockholders' equity: | | |
| Preferred stock | - | - |
| Common stock | 2,373 | 2,365 |
| Capital in excess of par value | 57,256 | 56,214 |
| Retained earnings | 194,795 | 184,291 |
| Accumulated other comprehensive loss | (17,997) | (16,618) |
| Treasury stock, at cost | (68,112) | (65,400) |

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| | | |
|--|-----------|------------|
| Total stockholders' equity | 168,315 | 160,852 |
| Total liabilities and stockholders' equity | \$247,030 | \$ 235,185 |

See accompanying Notes to Condensed Consolidated Financial Statements.

LYDALL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

| | Six Months Ended June 30, | |
|---|------------------------------|-----------------|
| | 2012 | Revised 2011 |
| | (Unaudited) | |
| Cash flows from operating activities: | | |
| Net income | \$ 10,504 | \$ 9,980 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gain on sale of discontinued operations, net of tax | - | (3,857) |
| Gain on sale of product line | (810) | (810) |
| Depreciation and amortization | 6,989 | 7,872 |
| Deferred income taxes | (467) | 957 |
| Stock based compensation | 846 | 808 |
| Loss on disposition of property, plant and equipment | 17 | 2 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (9,428) | (11,091) |
| Inventories | 215 | (334) |
| Accounts payable | 4,041 | 801 |
| Accrued payroll and other compensation | 935 | 604 |
| Accrued taxes | 549 | 2,248 |
| Other, net | (864) | (1,413) |
| Net cash provided by operating activities | 12,527 | 5,767 |
| Cash flows from investing activities: | | |
| Proceeds from divestiture | - | 12,811 |
| Capital expenditures | (5,785) | (3,338) |
| Reimbursement of cash from leasing company | - | 818 |
| Proceeds from maturity of short-term investment | 12,015 | - |
| Increase in restricted cash | - | (3,275) |
| Net cash provided by investing activities | 6,230 | 7,016 |
| Cash flows from financing activities: | | |
| Debt repayments | (573) | (739) |
| Repurchases of common stock | (2,712) | - |
| Common stock issued | 203 | 73 |
| Net cash used for financing activities | (3,082) | (666) |
| Effect of exchange rate changes on cash | (525) | 1,175 |
| Increase in cash and cash equivalents | 15,150 | 13,292 |
| Cash and cash equivalents at beginning of period | 30,905 | 24,988 |
| Cash and cash equivalents at end of period | \$ 46,055 | \$ 38,280 |

See accompanying Notes to Condensed Consolidated Financial Statements.

LYDALL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Financial Statement Presentation

Description of Business

Lydall, Inc. and its subsidiaries (the “Company” or “Lydall”) design and manufacture specialty engineered filtration media, industrial thermal insulating solutions, automotive thermal and acoustical barriers, medical filtration media and devices and biopharmaceutical processing components for thermal/acoustical, filtration/separation, and bio/medical applications.

Basis of Presentation

The accompanying Condensed Consolidated Financial Statements include the accounts of Lydall, Inc. and its subsidiaries. All financial information is unaudited for the interim periods reported. All significant intercompany transactions have been eliminated in the Condensed Consolidated Financial Statements. The Condensed Consolidated Financial Statements have been prepared, in all material respects, in accordance with the same accounting principles followed in the preparation of the Company’s annual financial statements for the year ended December 31, 2011. The year-end Condensed Consolidated Balance Sheet was derived from the December 31, 2011 audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Management believes that all adjustments, which include only normal recurring adjustments necessary for a fair statement of the Company’s consolidated financial position, results of operations and cash flows for the periods reported, have been included. For further information, refer to the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

On June 29, 2011, the Company sold all of the capital stock of its wholly-owned subsidiary, Lydall Industrial Thermal Solutions, Inc. (“Affinity”). The Condensed Consolidated Financial Statements for the quarter and six months ended June 30, 2011 have been retroactively restated to reflect Affinity as a discontinued operation.

During the quarter ended March 31, 2012, the Company revised its reportable segments in order to better align them with its strategic approach and operational decision-making. Refer to Note 12 Segment Information for further information. Prior period segment amounts throughout the Notes to the Condensed Consolidated Financial Statements have been reclassified to reflect the new segment structure. The reclassification of historical business segment information had no impact on the Company's consolidated financial results.

As previously disclosed in the Form 10-K for the year ended December 31, 2011, during the third quarter of 2011 the Company identified and corrected certain prior period errors. As permitted by Staff Accounting Bulletin 108, Lydall revised in the Form 10-Q for the quarterly period ended September 30, 2011 previously reported financial results for the periods affected. Accordingly, the financial results for the three and six months ended June 30, 2011 included herein reflect the previously revised results.

Recently Adopted Accounting Pronouncements

Effective January 1, 2012, the Company adopted the FASB's ASU No. 2011-05, Presentation of Comprehensive Income (Topic 220). The adoption of this accounting guidance did not have an impact on the Company's financial position, results of operations or cash flows. As required by the new standard, the Condensed Consolidated Statements of Comprehensive Income is included in the Condensed Consolidated Financial Statements.

Effective January 1, 2012, the Company adopted the FASB's ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which amends ASC 820, Fair Value Measurement. This ASU requires the categorization by level for items that are required to be disclosed at fair value, information about transfers between Level 1 and Level 2 and additional disclosure for Level 3 measurements. In addition, the ASU provides guidance on measuring the fair value of financial instruments managed within a portfolio and the application of premiums and discounts on fair value measurements. The adoption of this accounting guidance did not have an impact on the Company's consolidated financial statements.

2. Short-Term Investment

The Company's short-term investment at December 31, 2011 consisted of a \$12.0 million certificate of deposit with a banking institution. At December 31, 2011, the short-term investment was classified as held to maturity and carried on the Consolidated Balance Sheet at amortized cost. The certificate of deposit matured on January 23, 2012, and \$12.0 million of proceeds were recorded to cash and cash equivalents. There were no significant holding gains or losses.

3. Inventories

Inventories as of June 30, 2012 and December 31, 2011 were as follows:

| | June 30, | December 31, |
|-------------------------|-----------|--------------|
| In thousands | 2012 | 2011 |
| Raw materials | \$ 14,025 | \$ 15,068 |
| Work in process | 13,101 | 11,569 |
| Finished goods | 10,086 | 9,915 |
| | 37,212 | 36,552 |
| Less: Progress billings | (3,919) | (2,706) |
| Total inventories | \$33,293 | \$ 33,846 |

Included in work in process is gross tooling inventory of \$7.8 million and \$6.4 million at June 30, 2012 and December 31, 2011, respectively. Tooling inventory, net of progress billings, was \$3.9 million and \$3.7 million at June 30, 2012 and December 31, 2011, respectively.

4. Goodwill

The Company tests its goodwill for impairment annually in the fourth quarter, and whenever events or changes in circumstances indicate that the carrying value may exceed its fair value.

The changes in the carrying amount of goodwill by reporting unit for the six months ended June 30, 2012 were as follows:

| In thousands | December 31, 2011 | Currency translation adjustments | Other adjustments | June 30, 2012 |
|-----------------------------|----------------------|--|----------------------|------------------|
| Performance Materials | \$ 13,399 | \$ (104) | \$ 63 | \$ 13,358 |
| Other Products and Services | 4,660 | - | - | 4,660 |
| Total goodwill | \$ 18,059 | \$ (104) | \$ 63 | \$ 18,018 |

Other adjustments relate to contingent consideration owed to the seller of DSM Solutech B.V. (“Solutech”) which was acquired by the Company in December 2008. Consideration equals 4.0% of Solutech’s net revenues (included in the Performance Materials segment), as defined, and increases the amount of goodwill previously recorded, as the acquisition occurred prior to the revised guidance issued by the Financial Accounting Standards Board (ASC 805) for business combinations.

5. Long-term Debt and Financing Arrangements

As of June 30, 2012 and December 31, 2011, the majority of debt outstanding was capital lease obligations. As of June 30, 2012 and December 31, 2011, the Company had no borrowings outstanding under any domestic credit facility, or any credit arrangement entered into by a foreign subsidiary, other than letters of credit.

On June 16, 2011, the Company entered into a \$35.0 million senior secured domestic revolving credit facility (“Domestic Credit Facility”) with a new financial institution, which replaced the Company’s prior \$35.0 million domestic credit facility that was terminated by the Company. The Domestic Credit Facility is secured by substantially all of the assets of the Company. The maturity date for the Domestic Credit Facility is June 15, 2016.

The loan agreement governing the Domestic Credit Facility contains a number of affirmative and negative covenants, including financial covenants. The Company is required to meet a minimum fixed charge coverage ratio. The fixed charge coverage ratio requires that, at the end of each fiscal quarter, the ratio of consolidated EBITDA, as defined in the loan agreement, to fixed charges may not be less than 1 to 1 for the immediately preceding 12 month period. In addition, the Company must maintain a Consolidated Leverage Ratio, as defined, as of the end of each fiscal quarter of no greater than 2.5 to 1.0. The Company must also meet a minimum consolidated EBITDA for the preceding 12 month period of \$15.0 million through September 30, 2014 and \$25.0 million thereafter. The Company was in compliance with all covenants at June 30, 2012.

The Company expects to fund its cash requirements from existing cash balances, cash generated by operations, and through borrowings, if needed, under its Domestic Credit Facility and foreign credit facilities. As of June 30, 2012, the Company had borrowing availability of \$32.2 million under the Domestic Credit Facility net of standby letters of credit outstanding of \$2.8 million. As of June 30, 2012, the Company's foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately \$11.4 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

6. Divestiture

On June 29, 2011, the Company sold its Affinity business for \$15.2 million in cash. Affinity designed and manufactured high precision, specialty engineered temperature-control equipment for semiconductor, pharmaceutical, life sciences and industrial applications. The Company recorded a gain on sale, net of transaction costs and income taxes, of \$3.9 million in the quarter ended June 30, 2011. The Condensed Consolidated Financial Statements have been retroactively restated to reflect Affinity as a discontinued operation for all periods presented.

The following table is a summary of the results of discontinued operations:

| In thousands | Quarter Ended June 30, 2011 | Six Months Ended June 30, 2011 |
|--|--------------------------------|-----------------------------------|
| Net sales | \$ 6,818 | \$ 13,255 |
| Income before income taxes | 989 | 1,374 |
| Income tax expense | 362 | 499 |
| Income from discontinued operations | 627 | 875 |
| Gain on sale of discontinued operations, net of tax of \$2,229 | 3,857 | 3,857 |
| Income from discontinued operations, net of tax | \$ 4,484 | \$ 4,732 |

7. Equity Compensation Plans

As of June 30, 2012 the Company's equity compensation plans consisted of the 2003 Stock Incentive Compensation Plan ("2003 Plan") and the 2012 Stock Incentive Plan ("2012 Plan") collectively, the "Plans," under which incentive and non-qualified stock options and time and performance based restricted shares have been granted to employees and directors from authorized but unissued shares of common stock or treasury shares. The 2003 Plan is not active, but continues to govern all outstanding awards granted under the plan until the awards themselves are exercised or terminate in accordance with their terms. The 2012 Plan, approved by shareholders on April 27, 2012, authorized 1.75 million shares of common stock for awards. The 2012 Plan also authorizes an additional 1.2 million shares to the extent awards granted under prior stock plans that were outstanding as of April 27, 2012 are forfeited. The 2012 Plan provides for the following type of awards: options, restricted stock, restricted stock units and other stock-based awards.

The Company incurred compensation expense of \$0.4 million for the quarters ended June 30, 2012 and June 30, 2011, and \$0.8 million for the six month periods ended June 30, 2012 and June 30, 2011, for the Plans, including restricted stock awards. No compensation costs were capitalized as part of inventory.

Stock Options

The following table is a summary of outstanding and exercisable options as of June 30, 2012:

| In thousands except per share amounts and years | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|---------|---------------------------------|---|---------------------------|
| Outstanding at June 30, 2012 | 888,328 | \$ 8.65 | 6.2 | \$ 4,388 |
| Exercisable at June 30, 2012 | 536,302 | \$ 9.17 | 4.6 | \$ 2,392 |

There were no options granted during the quarter and six months ended June 30, 2012. The amount of cash received from the exercise of stock options during the quarter and six months ended June 30, 2012 was \$0.2 million and the intrinsic value of options exercised was \$0.1 million. There were no options granted during the quarter and six months ended June 30, 2011. There was minimal stock option exercise activity during the quarter and six months ended June 30, 2011. At June 30, 2012, the total unrecognized compensation cost related to nonvested stock option awards was approximately \$1.1 million, with a weighted average expected amortization period of 2.8 years.

Restricted Stock

Restricted stock includes both performance-based and time-based awards. There were 114,500 performance-based restricted shares granted during the quarter and six months ended June 30, 2012, with a 2014 earnings per share target. No restricted shares were vested in the quarter and six months ended June 30, 2012. There were no shares granted in the prior year quarter and 22,120 shares were granted in the six months ended June 30, 2011. No restricted shares were vested in the quarter and six months ended June 30, 2011. At June 30, 2012, there were 369,776 unvested restricted stock awards with total unrecognized compensation cost related to these awards of \$2.1 million with a weighted average expected amortization period of 2.2 years.

8. Stock Repurchase Plan

In April 2012, the Company's Board of Directors approved a stock repurchase program (the "2012 Stock Repurchase Program") which authorized the Company to repurchase up to 1.0 million shares of its common stock.

The Company repurchased 219,476 shares of its common stock at an average price of \$12.35 per share for an aggregate purchase price of \$2.7 million during the three and six months ended June 30, 2012 under the 2012 Stock Repurchase Program. There were 780,524 shares remaining authorized for repurchase under the 2012 Stock Repurchase Program as of June 30, 2012.

9. Employer Sponsored Benefit Plans

As of June 30, 2012, the Company maintains a defined benefit pension plan that covers certain domestic Lydall employees ("domestic pension plan") that is closed to new employees and benefits are no longer accruing. The domestic pension plan is noncontributory and benefits are based on either years of service or eligible compensation paid while a participant is in the plan. The Company's funding policy is to fund not less than the ERISA minimum funding standard and not more than the maximum amount that can be deducted for federal income tax purposes. The Company was minimally required to contribute approximately \$2.7 million in cash to its domestic pension plan in 2012. However, the Company is evaluating the impact of the Moving Ahead for Progress in the 21st Century Act (MAP-21) signed into law in July 2012, which is expected to lower the required minimum contribution to the domestic pension plan in 2012. Contributions of \$0.6 million were made during the second quarter of 2012 and \$1.0 million for the six months ended June 30, 2012. Contributions of \$0.4 million were made during the second quarter of 2011 and \$0.8 million for the six months ended June 30, 2011.

The following is a summary of the components of net periodic benefit cost for the domestic pension plan for the quarters and six months ended June 30, 2012 and 2011:

| In thousands | Quarter Ended | | Six Months Ended | |
|---|------------------|--------|------------------|----------|
| | June 30, 2012 | 2011 | June 30, 2012 | 2011 |
| Components of net periodic benefit cost | | | | |
| Interest cost | \$ 648 | \$ 646 | \$ 1,296 | \$ 1,292 |
| Expected return on assets | (640) | (662) | (1,280) | (1,324) |
| Amortization of actuarial loss | 223 | 140 | 447 | 280 |
| Net periodic benefit cost | \$ 231 | \$ 124 | \$ 463 | \$ 248 |

10. Income Taxes

The Company's effective tax rate for income from continuing operations was 24.1% and 42.2% for the quarters ended June 30, 2012 and 2011 and 24.7% and 40.5% for the six months ended June 30, 2012 and 2011. The difference in the Company's effective tax rate for the quarter and six months ended June 30, 2012 compared to statutory federal income tax rates was due the reversal of valuation allowance against foreign tax credit carryovers in the Company's estimated annual effective tax rate for 2012. The anticipated use of foreign tax credit carryovers to offset 2012 U.S. federal income taxes is based on estimates concerning 2012 income generated from domestic and foreign sources.

The Company maintains valuation allowances against certain deferred tax assets where realization is not reasonably assured. The Company evaluates the likelihood of the realization of deferred tax assets and reduces the carrying amount to the extent it believes a portion will not be realized. The Company's effective tax rates in future periods could be affected by earnings being lower or higher than anticipated in countries where tax rates differ from the United States federal rate, the relative impact of permanent tax adjustments on higher or lower earnings from domestic operations, changes in net deferred tax asset valuation allowances, completion of acquisitions or divestitures, changes in tax rates or tax laws and the completion of tax audits.

The Company and its subsidiaries file a consolidated federal income tax return, as well as returns required by various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities, including such major jurisdictions as the United States, France, Germany and the Netherlands. Within the next four quarters, the Company expects to conclude certain U.S. federal income tax matters through the year ended December 31, 2009, and it is reasonably expected that net unrecognized benefits of \$0.5 million may be recognized. With few exceptions, the Company is no longer subject to U.S. federal examinations for years before 2006, state and local examinations for years before 2002, and non-U.S. income tax examinations for years before 2007.

11. Earnings Per Share

For the quarter and six months ended June 30, 2012 and 2011, basic earnings per share were computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Unexercised stock options and unvested restricted shares are excluded from this calculation but are included in the diluted earnings per share calculation using the treasury stock method as long as their effect is not anti-dilutive.

The following table provides a reconciliation of weighted-average shares used to determine basic and diluted earnings per share.

| In thousands | Quarter Ended | | Six Months Ended | |
|--|---------------|--------|------------------|--------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Basic average common shares outstanding | 16,770 | 16,741 | 16,799 | 16,738 |
| Effect of dilutive options and restricted stock awards | 192 | 168 | 140 | 137 |
| Diluted average common shares outstanding | 16,962 | 16,909 | 16,939 | 16,875 |

For the quarters ended June 30, 2012 and June 30, 2011, stock options for 0.2 million and 0.4 million shares of common stock, respectively, were not considered in computing diluted earnings per common share because they were antidilutive.

For the six months ended June 30, 2012 and June 30, 2011, stock options for 0.4 million and 0.6 million shares of common stock, respectively, were not considered in computing diluted earnings per common share because they were antidilutive.

12. Segment Information

The Company's reportable segments are Performance Materials, Thermal/Acoustical Metals, and Thermal/Acoustical Fibers. The Performance Materials segment reports the results of Industrial Filtration, Industrial Thermal Insulation, and Life Sciences Filtration businesses. The Thermal/Acoustical Metals segment reports the results of the Company's metal-based automotive business. The Thermal/Acoustical Fibers segment reports the results of the Company's fiber-based automotive business. Other Products and Services ("OPS") includes Life Sciences Vital Fluids.

During the quarter ended March 31, 2012, the Thermal/Acoustical business reorganized its management reporting structure. Prior to this reorganization, the Thermal/Acoustical business was comprised of one operating segment for financial reporting purposes. The Company now manages and measures its Thermal/Acoustical business performance in two distinct operating segments: Thermal/Acoustical Metals and Thermal/Acoustical Fibers. The new segments reflect the way the Company's Chief Operating Decision Maker ("CODM") reviews operating results for the purposes of allocating resources and assessing performance.

On June 29, 2011, the Company sold its Affinity business, which had been included within OPS. Affinity designed and manufactured high precision, specialty engineered temperature-control equipment for semiconductor,

pharmaceutical, life sciences and industrial applications. As a result of the sale, the Condensed Consolidated Financial Statements have been retroactively restated to reflect Affinity as a discontinued operation and the following segment information excludes Affinity's net sales and operating income for all periods presented.

Prior period segment amounts throughout the notes to the Condensed Consolidated Financial Statements have been reclassified to give effect to the new segment structure and for discontinued operations. The reclassification of historical business segment information had no impact on the consolidated financial results.

Performance Materials Segment

The Performance Materials segment includes filtration media solutions for air, fluid power, and industrial applications ("Industrial Filtration"), air and liquid life science applications ("Life Sciences Filtration"), and industrial thermal insulation solutions for building products, appliances, and energy and industrial markets ("Industrial Thermal Insulation").

Industrial Filtration products include LydAir® MG (Micro-Glass) Air Filtration Media, LydAir® MB (Melt Blown) Air Filtration Media, LydAir® SC (Synthetic Composite) Air Filtration Media, and Arioso™ Membrane Composite Media. These products constitute the critical media component of clean-air systems for applications in clean-space, commercial, industrial and residential HVAC, power generation, and industrial processes. Lydall has leveraged its extensive technical expertise and applications knowledge into a suite of media products covering the vast liquid filtration landscape across the engine and industrial fields. The LyPore® Liquid Filtration Media and activated carbon containing ActiPure® Filtration Media series address a variety of application needs in fluid power including hydraulic filters, air-water and air-oil coalescing, industrial fluid processes, diesel filtration and fuel filtration.

Life Sciences Filtration products include the LyPore® and ActiPure® Filtration Media developed to meet the requirements of life science applications including biopharmaceutical pre-filtration and clarification, diagnostic and analytical testing, respiratory protection, life protection, medical air filtration, drinking water filtration and high purity process filtration such as that found in food and beverage and medical applications. Lydall also offers Solupor® Membrane specialty microporous membranes that are utilized in various markets and applications including air and liquid filtration and transdermal drug delivery. Solupor® membranes are made from ultra-high molecular weight polyethylene and incorporate a unique combination of mechanical strength, chemical inertness, and high porosity in a unique open structure.

Industrial Thermal Insulation products are high performance nonwoven veils, papers, mats and specialty composites for the building products, appliance, and energy and industrial markets. The Manniglas® Thermal Insulation brand is diverse in its product application ranging from high temperature seals and gaskets in ovens and ranges to specialty veils for HVAC and cavity wall insulation. appLY® Mat Needled Glass Mats have been developed to expand Lydall's high temperature technology portfolio for broad application into the appliance market and supplements the Lytherm® Insulation Media product brand, traditionally utilized in the industrial market for kilns and furnaces used in metal processing. Lydall's Cryotherm® Super-Insulating Media, CRS-Wrap® Super-Insulating Media and Cryo-Lite™ Cryogenic Insulation products are industry standards for state-of-the-art cryogenic insulation designs used by manufacturers of cryogenic equipment for liquid gas storage, piping, and transportation.

Thermal/Acoustical Metals Segment

The Thermal/Acoustical Metals segment offers a full line of innovative engineered products to assist in noise and heat abatement within the transportation sector. Lydall products are found in the interior (dash insulators), underbody (wheel well, fuel tank, exhaust) and under hood (engine compartment) of cars, trucks, SUV's, heavy duty trucks and recreational vehicles.

Thermal/Acoustical Metals segment products are stamped metal combinations which provide thermal and acoustical shielding solutions for the global automotive and truck markets. Thermal/Acoustical Metals products include AMS® which is an all metal shield designed to be used in various vehicle applications, and Direct Exhaust Mount Heat

shields which are mounted to high temperature surfaces like exhaust down-pipes or engine manifolds.

Thermal/Acoustical Fibers Segment

The Thermal/Acoustical Fibers segment offers a full line of innovative engineered products to assist in noise and heat abatement within the transportation sector. Lydall products are found in the interior (dash insulators), underbody (wheel well, fuel tank, exhaust) and under hood (engine compartment) of cars, trucks, SUV's, heavy duty trucks and recreational vehicles.

Thermal/Acoustical Fibers segment products offer thermal and acoustical insulating solutions comprised of organic and inorganic fiber composites for the automotive and truck markets primarily in North America. Lydall's dBCore® is a lightweight acoustical composite that emphasizes absorption principles over heavy-mass type systems. Lydall's dBlyte® is a high-performance acoustical barrier with sound absorption and blocking properties and can be used throughout a vehicle's interior to minimize intrusive noise from an engine compartment and road. Lydall's ZeroClearance® is an innovative thermal solution that utilizes an adhesive backing for attachment and is ideal for protecting floor sheet metal from excessive exhaust heat. Lydall's specially engineered wheel wells provide a solution with weight reduction and superior noise suppression capabilities over conventional designs.

Thermal/Acoustical Metals segment and Thermal/Acoustical Fibers segment operating results include allocations of certain costs shared between the segments.

Other Products and Services

The Life Sciences Vital Fluids business offers specialty products for blood filtration devices, blood transfusion single-use containers and bioprocessing single-use containers and products for containment of media, buffers and bulk intermediates used in biotech, pharmaceutical and diagnostic reagent manufacturing processes.

The tables below present net sales and operating income by segment for the quarters and six months ended June 30, 2012 and 2011, and also a reconciliation of total segment net sales and operating income to total consolidated net sales and operating income.

Net sales by segment:

| In thousands | Quarter Ended | | Six Months Ended | |
|---|------------------|----------|------------------|----------|
| | June 30, 2012 | 2011 | June 30, 2012 | 2011 |
| Performance Materials Segment: | | | | |
| Industrial Filtration | \$18,109 | \$18,449 | \$36,285 | \$38,920 |
| Industrial Thermal Insulation | 11,119 | 13,624 | 19,850 | 25,576 |
| Life Sciences Filtration | 3,295 | 3,819 | 5,476 | 7,865 |
| Performance Materials Segment net sales | 32,523 | 35,892 | 61,611 | 72,361 |
| Thermal/Acoustical Metals Segment: | | | | |
| Metal parts | 35,738 | 37,455 | 73,546 | 72,969 |
| Tooling | 1,947 | 2,406 | 6,252 | 8,344 |
| Thermal/Acoustical Metals Segment net sales | 37,685 | 39,861 | 79,798 | 81,313 |
| Thermal/Acoustical Fibers Segment: | | | | |
| Fiber parts | 24,191 | 20,283 | 46,337 | 39,712 |
| Tooling | 719 | 48 | 745 | 1,303 |
| Thermal/Acoustical Fibers Segment net sales | 24,910 | 20,331 | 47,082 | 41,015 |
| Other Products and Services: | | | | |
| Life Sciences Vital Fluids | 3,749 | 3,403 | 7,980 | 7,171 |
| Other Products and Services net sales | 3,749 | 3,403 | 7,980 | 7,171 |
| Eliminations and Other | (1,332) | (656) | (2,182) | (1,356) |

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Consolidated Net Sales \$97,535 \$98,831 \$194,289 \$200,504

Operating income (loss) by segment:

| In thousands | Quarter Ended | | Six Months Ended | |
|-------------------------------|---------------|----------|------------------|----------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2012 | 2011 | 2012 | 2011 |
| Performance Materials | \$4,982 | \$6,093 | \$7,102 | \$12,390 |
| Thermal/Acoustical Metals | 4,050 | 4,137 | 9,117 | 7,861 |
| Thermal/Acoustical Fibers | 3,382 | (1,549) | 5,611 | (3,087) |
| Other Products and Services: | | | | |
| Life Sciences Vital Fluids | 211 | (294) | 520 | (579) |
| Corporate Office Expenses | (3,882) | (3,402) | (8,205) | (7,060) |
| Consolidated Operating Income | \$8,743 | \$4,985 | \$14,145 | \$9,525 |

13. Commitments and Contingencies

From time-to-time the Company is subject to legal proceedings, claims, investigations and inquiries that arise in the ordinary course of business such as, but not limited to, patent, employment, personal injury, commercial and environmental matters. Although there can be no assurance, the Company is not aware of any matters pending that are expected to be material with respect to the Company's business, financial position, results of operations or cash flows.

14. Recently Issued Accounting Standards

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities, which amends ASC 210, Balance Sheet. This ASU requires entities to disclose gross and net information about both instruments and transactions eligible for offset in the statement of financial position and those subject to an agreement similar to a master netting arrangement. This would include derivatives and other financial securities arrangements. The effective date is January 1, 2013 and must be applied retrospectively. The adoption of this ASU will have no effect on the Company's consolidated financial statements.

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

Overview and Outlook

Business

Lydall, Inc. and its subsidiaries (collectively, the "Company" or "Lydall") design and manufacture specialty engineered filtration media, industrial thermal insulating solutions, automotive thermal and acoustical barriers, medical filtration media and devices and biopharmaceutical processing components for filtration/separation, thermal/acoustical, and bio/medical applications. Lydall principally conducts its business through three reportable segments: Performance Materials, Thermal/Acoustical Metals and Thermal/Acoustical Fibers, with sales globally.

The Performance Materials segment includes filtration media solutions for air, fluid power, and industrial applications ("Industrial Filtration"), air and liquid life science applications ("Life Sciences Filtration"), and industrial thermal insulation solutions for building products, appliances, and energy and industrial markets ("Industrial Thermal Insulation").

During the quarter ended March 31, 2012, the Thermal/Acoustical business reorganized its management reporting structure. Prior to this reorganization, the Thermal/Acoustical business was comprised of one operating segment for financial reporting purposes. The Company now manages and measures its Thermal/Acoustical business performance in two distinct operating segments: Thermal/Acoustical Metals and Thermal/Acoustical Fibers. The new segments reflect the way the Company's Chief Operating Decision Maker ("CODM") reviews operating results for the purposes of allocating resources and assessing performance.

The Thermal/Acoustical Metals segment and Thermal/Acoustical Fibers segment ("Fibers Business") offer a full line of innovative engineered products to assist in noise and heat abatement within the transportation sector. Lydall products are found in the interior (dash insulators), underbody (wheel well, fuel tank, exhaust) and under hood (engine compartment) of cars, trucks, SUV's, heavy duty trucks and recreational vehicles. Lydall's patented products include organic and inorganic fiber composites (fiber parts) as well as metal combinations (metal parts).

Included in Other Products and Services ("OPS") is the Life Sciences Vital Fluids business. Life Sciences Vital Fluids offers specialty products for blood filtration devices, blood transfusion single-use containers and bioprocessing single-use containers and products for containment of media, buffers and bulk intermediates used in biotech, pharmaceutical and diagnostic reagent manufacturing processes.

Second Quarter 2012 Highlights

Below are financial highlights comparing Lydall's quarter ended June 30, 2012 ("Q2 2012") results to its quarter ended June 30, 2011 results:

- Consolidated net sales were \$97.5 million, a decrease of \$1.3 million, or 1.3%; foreign currency translation negatively impacted Q2 2012 net sales by \$3.9 million;
- Gross margin increased to 22.5% compared to 18.3%, principally caused by improvement in the Thermal/Acoustical Fibers segment;
- Consolidated operating income was \$8.7 million, or 9.0% of net sales, compared to operating income of \$5.0 million, or 5.0% of net sales;
- Effective tax rate of 24.1%, as a result of reversal of valuation allowance against foreign tax credit carryovers in the estimated annual effective tax rate for 2012 of \$1.3 million, or \$0.08 per share, compared to 42.2%;
- Income from continuing operations was \$6.6 million, \$0.39 per share, compared to \$2.6 million, or \$0.15 per share;
- Net income was \$6.6 million, or \$0.39 per share, compared to \$7.1 million, or \$0.42 per share, which included income from discontinued operations (including gain on sale of \$3.9 million) of \$4.5 million, or \$0.27 per share in the second quarter of 2011; and
- Cash provided by operations was \$11.9 million compared to \$7.9 million.

Operational and Financial Overview

Performance Materials Segment

The Performance Materials segment reported net sales of \$32.5 million in the second quarter of 2012, a decrease of \$3.4 million, or 9.4%, compared to net sales of \$35.9 million in the second quarter of 2011. Foreign currency translation negatively impacted net sales by \$1.2 million, or 3.4% in the current quarter compared to the second quarter of 2011. A reduction in Industrial Thermal Insulation net sales of \$2.5 million primarily contributed to the remaining reduction in net sales. Negatively impacting the Industrial Thermal Insulation business was \$1.3 million lower net sales of electrical paper products manufactured under a contract manufacturing agreement with a customer. The Company sold this product line to the customer in 2010, and the Company will continue to manufacture product until the customer commences manufacturing electrical paper products later in 2012. Also, net sales of insulation products used in commercial buildings were lower in the second quarter of 2012 compared to the same quarter of 2011 due to customers adjusting inventory levels on certain products. Net sales of Industrial Filtration products of \$18.1 million in the second quarter of 2012, compared to \$18.4 million in the second quarter of 2011, was at its highest amount since the third quarter of 2011, as the Company experienced increased demand for its products.

Net sales in the second quarter of 2011 were near record levels and subsequently declined the remainder of 2011. Net sales in the second quarter of 2012 improved 11.8% compared to the first quarter of 2012.

The segment reported operating income of \$5.0 million, or 15.3% of net sales, in the second quarter of 2012 compared to operating income of \$6.1 million, or 17.0% of net sales in the second quarter of 2011. Contributing to this reduction was the decrease in net sales of \$3.4 million discussed above, lower absorption of fixed overhead costs and unfavorable mix among product sales, compared to the same period in the prior year.

Thermal/Acoustical Metals Segment

The Thermal/Acoustical Metals segment reported net sales of \$37.7 million in the second quarter of 2012, a reduction of \$2.2 million, or 5.5%, from the second quarter of 2011. Foreign currency translation negatively impacted net sales by \$2.7 million, or 6.8%, in the current quarter compared to the second quarter of 2011. Higher net sales of domestic automotive metal parts were offset by lower net sales from the Company's European operations and negative foreign currency translation. Higher consumer demand for automobiles on Lydall's existing domestic platforms, as well as from sales of parts on new domestic platforms awarded to the Company contributed to higher domestic part net sales. Economic conditions in Europe contributed to lower demand for certain automotive parts in Europe during the second quarter of 2012 compared to the second quarter of 2011.

The segment reported operating income in the second quarter of 2012 of \$4.1 million, or 10.7% of net sales, which was essentially flat compared to the second quarter of 2011.

Thermal/Acoustical Fibers Segment

The Thermal/Acoustical Fibers segment reported net sales of \$24.9 million in the second quarter of 2012, an increase of \$4.6 million, or 22.5%, from the second quarter of 2011. This increase was driven by higher consumer demand for automobiles on Lydall's existing platforms, as well as from sales of parts on new platforms awarded to the Company.

The segment reported operating income in the second quarter of 2012 of \$3.4 million, or 13.6% of net sales, compared to an operating loss of \$1.5 million in the second quarter of 2011. This improvement was due to higher net sales and improved gross margin realized from manufacturing efficiency improvements. These manufacturing improvements began in the second half of 2011 and continued through the second quarter of 2012. Significant reductions in scrap, material usage, and labor costs primarily contributed to lower per-unit manufacturing costs in the current quarter compared to the second quarter of 2011, resulting in improved gross margin.

Liquidity

At June 30, 2012, the majority of debt outstanding was capital lease obligations. The Company had a cash balance of \$46.1 million and no borrowings under any credit facility other than letters of credit. The Company expects to fund its cash requirements from existing cash balances, cash generated by operations and from available borrowings, as needed, under its Domestic Credit Facility and foreign credit facilities. At June 30, 2012, the Company had borrowing availability of \$32.2 million under the Domestic Credit Facility, net of standby letters of credit outstanding of \$2.8 million. The Company's foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately \$11.4 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

Outlook

Demand for Performance Materials and Thermal/Acoustical Fibers products in the third quarter of 2012 is expected to be at levels consistent with the second quarter of 2012, however, Thermal/Acoustical Metals is expected to be impacted by lower demand, primarily in Europe. Also, the Company receives a material portion of its revenue from foreign operations and translation of those operations' results into U.S. dollars may be affected by negative Euro exchange rate fluctuations.

The Company remains committed to assessing and adjusting its portfolio of businesses to provide shareholder value, and, as previously announced, is exploring strategic alternatives with respect to its Thermal/Acoustical Fibers business.

Results of Operations

Note: All of the following tabular comparisons, unless otherwise indicated, are for the quarters ended June 30, 2012 (Q2-12) and June 30, 2011 (Q2-11) and for the six months ended June 30, 2012 (YTD-12) and June 30, 2011 (YTD-11).

Net Sales

Quarter Ended

Six Months Ended

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| In thousands | Q2-12 | Q2-11 | Percent Change | YTD-12 | YTD-11 | Percent Change |
|--------------|----------|----------|-------------------|-----------|-----------|-------------------|
| Net sales | \$97,535 | \$98,831 | (1.3)% | \$194,289 | \$200,504 | (3.1)% |

Net sales for the current quarter decreased by \$1.3 million, or 1.3%, compared to the second quarter of 2011. Foreign currency translation decreased net sales by \$3.9 million, or 4.0%, for the current quarter, compared with the second quarter of 2011, impacting the Thermal/Acoustical Metals segment by \$2.7 million, or 6.8%, and the Performance Materials segment by \$1.2 million, or 3.4%. The unfavorable foreign currency translation and lower sales volumes resulted in lower net sales for the Performance Materials and Thermal/Acoustical Metals segments of \$3.4 million and \$2.2 million, respectively, compared to the same quarter a year ago. This was partially offset by an increase in net sales volumes from the Thermal/Acoustical Fibers segment of \$4.6 million, or 22.5%, compared to the same quarter a year ago. Net sales of OPS, in the second quarter of 2012, increased by \$0.3 million, or 10.2%, compared to the same quarter a year ago, primarily due to sales volumes and price increases.

Net sales for the six months ended June 30, 2012 decreased by \$6.2 million, or 3.1%, compared to the first six months of 2011. Foreign currency translation decreased net sales by \$5.4 million, or 2.7%, for the current six months ended, compared with the first six months of 2011, impacting the Thermal/Acoustical Metals segment by \$3.8 million, or 4.7%, and the Performance Materials segment by \$1.6 million, or 2.2%. The unfavorable foreign currency translation and lower sales volumes resulted in lower net sales from the Performance Materials and Thermal/Acoustical Metals segments of \$10.8 million and \$1.5 million, respectively, compared to the same period of 2011. This was partially offset by an increase in net sales volumes from the Thermal/Acoustical Fibers segment of \$6.1 million, or 14.8%, compared to the same period of 2011. Net sales of OPS, for the six months ended June 30, 2012, increased by \$0.8 million, or 11.3%, compared to the same period a year ago, primarily due to sales volumes and price increases.

Gross Profit

| In thousands | Quarter Ended | | | Six Months Ended | | |
|---------------------|---------------|----------|----------------|------------------|----------|----------------|
| | Q2-12 | Q2-11 | Percent Change | YTD-12 | YTD-11 | Percent Change |
| Gross profit | \$21,993 | \$18,057 | 21.8 % | \$41,234 | \$36,062 | 14.3 % |
| Percentage of sales | 22.5 % | 18.3 % | | 21.2 % | 18.0 % | |

Gross margin for the second quarter of 2012 was 22.5% compared to 18.3% in the second quarter of 2011. The primary contributor to the improved gross margin was the Thermal/Acoustical Fibers segment which reported higher net sales and improved gross margin realized from manufacturing efficiency improvements. Additionally, to a lesser extent, OPS reported gross margin improvement in the second quarter of 2012, compared to the same quarter of 2011, primarily as a result of higher net sales and improved absorption of fixed costs.

Gross margin for the six months ended June 30, 2012 was 21.2% compared to 18.0% in the comparable period of 2011. The primary contributor to the improved gross margin was the Thermal/Acoustical Fibers segment which reported higher net sales and improved gross margin realized from manufacturing efficiency improvements. Additionally, to a lesser extent, the Thermal/Acoustical Metals segment and OPS reported gross margin improvement in the first six months of 2012, compared to the same period of 2011. Thermal/Acoustical Metals segment improvement was attributed to increased volumes of metal part sales partially offset by foreign currency translation and lower raw material costs, specifically aluminum and aluminum conversion costs. OPS improvement was attributed to higher net sales and improved absorption of fixed costs. These improvements in gross margin were partially offset by lower gross margin in the Performance Materials segment due to a decrease in net sales, lower absorption of fixed overhead costs as well as unfavorable mix among product sales.

Selling, Product Development and Administrative Expenses

| In thousands | Quarter Ended | | | Six Months Ended | | |
|--|---------------|----------|----------------|------------------|----------|----------------|
| | Q2-12 | Q2-11 | Percent Change | YTD-12 | YTD-11 | Percent Change |
| Selling, product development and administrative expenses | \$13,655 | \$13,477 | 1.3 % | \$27,899 | \$27,347 | 2.0 % |
| Percentage of sales | 14.0 % | 13.6 % | | 14.4 % | 13.6 % | |

The increase in selling, product development and administrative expenses for the quarter and the six months ended June 30, 2012 compared to the same periods of 2011 was primarily due to higher professional services expense incurred by the corporate office, mostly associated with strategic initiatives with respect to the Fibers business, and to a lesser extent, higher accrued incentive compensation expense. Partially offsetting the increase was foreign currency

translation of \$0.4 million and \$0.6 million for the quarter and six months ended June 30, 2012, compared with the comparable periods of 2011.

Gain On Sale of Product Line

| In thousands | Quarter Ended | | | Six Months Ended | | |
|------------------------------|---------------|-------|----------------|------------------|--------|----------------|
| | Q2-12 | Q2-11 | Percent Change | YTD-12 | YTD-11 | Percent Change |
| Gain on sale of product line | \$405 | \$405 | - | \$810 | \$810 | - |

On June 30, 2010, the Company divested its electrical papers product line business for total consideration of \$5.8 million, of which \$4.8 million was paid on June 30, 2010, with the remaining \$1.0 million paid in accordance with a License Agreement on July 2, 2012. This transaction contained multiple deliverables, some of which were delivered on June 30, 2010, while others were delivered in subsequent periods through June 30, 2012. The Company recognized \$0.4 million of gain in both second quarters of 2012 and 2011 and \$0.8 million of gain in both six months ended June 30, 2012 and June 30, 2011 as the Company completed its services to be provided under the License Agreement.

Interest Expense

| In thousands | Quarter Ended | | | Six Months Ended | | |
|--------------------------------|---------------|-------|----------------|------------------|--------|----------------|
| | Q2-12 | Q2-11 | Percent Change | YTD-12 | YTD-11 | Percent Change |
| Interest expense | \$87 | \$473 | (81.6)% | \$177 | \$683 | (74.1)% |
| Weighted average interest rate | 5.5% | 5.3% | | 5.5% | 5.4% | |

The decrease in interest expense for the quarter and six months ended June 30, 2012 compared to the same periods of 2011 was due to lower average principal balances on capital lease obligations as well as lower amortization of debt financing costs resulting from the Company's new domestic revolving credit facility that was entered into during the second quarter of 2011.

Other Income/Expense

Other income and expense for the quarters and six months ended June 30, 2012 and 2011 consisted of insignificant activity related to foreign exchange transaction gains and losses and interest income.

Income Taxes

The Company's effective tax rate for income from continuing operations was 24.1% and 42.2% for the quarters ended June 30, 2012 and 2011 and 24.7% and 40.5% for the six months ended June 30, 2012 and 2011. The difference in the Company's effective tax rate for the quarter and six months ended June 30, 2012 compared to statutory federal income tax rates was due the reversal of valuation allowance against foreign tax credit carryovers in the Company's estimated annual effective tax rate for 2012. The anticipated use of foreign tax credit carryovers to offset 2012 U.S. federal income taxes is based on estimates concerning 2012 income generated from domestic and foreign sources. The difference in the Company's effective tax rate for the quarter and six months ended June 30, 2011 compared to statutory federal income tax rates was primarily due to dividends from a foreign subsidiary and an increase in valuation allowance against foreign tax credits.

The Company maintains valuation allowances against certain deferred tax assets where realization is not reasonably assured. The Company evaluates the likelihood of the realization of deferred tax assets and reduces the carrying amount to the extent it believes a portion will not be realized. The Company's effective tax rates in future periods could be affected by earnings being lower or higher than anticipated in countries where tax rates differ from the

United States federal rate, the relative impact of permanent tax adjustments on higher or lower earnings from domestic operations, changes in net deferred tax asset valuation allowances, completion of acquisitions or divestitures, changes in tax rates or tax laws and the completion of tax audits.

The Company and its subsidiaries file a consolidated federal income tax return, as well as returns required by various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities, including such major jurisdictions as the United States, France, Germany and the Netherlands. Within the next four quarters, the Company expects to conclude certain U.S. federal income tax matters through the year ended December 31, 2009 and it is reasonably expected that net unrecognized benefits of \$0.5 million may be recognized. With few exceptions, the Company is no longer subject to U.S. federal examinations for years before 2006, state and local examinations for years before 2002, and non-U.S. income tax examinations for years before 2007.

Discontinued Operation, net of tax

On June 29, 2011, the Company sold its Affinity business for \$15.2 million in cash. Affinity designed and manufactured high precision, specialty engineered temperature-control equipment for semiconductor, pharmaceutical, life sciences and industrial applications.

| In thousands | Quarter Ended June 30, 2011 | Six Months Ended June 30, 2011 |
|--|--------------------------------|-----------------------------------|
| Net sales | \$ 6,818 | \$ 13,255 |
| Income before income taxes | 989 | 1,374 |
| Income tax expense | 362 | 499 |
| Income from discontinued operations | 627 | 875 |
| Gain on sale of discontinued operations, net of tax of \$2,229 | 3,857 | 3,857 |
| Income from discontinued operations, net of tax | \$ 4,484 | \$ 4,732 |

Segment Results

The following tables presents sales and operating income information for the key product and service groups included within each operating segment and other products and services for the quarter and six months ended June 30, 2012 compared with the quarter and six months ended June 30, 2011:

Net sales by segment:

| In thousands | Quarter Ended | | Dollar Change |
|---|---------------|----------|---------------|
| | Q2-12 | Q2-11 | |
| Performance Materials Segment: | | | |
| Industrial Filtration | \$18,109 | \$18,449 | \$ (340) |
| Industrial Thermal Insulation | 11,119 | 13,624 | (2,505) |
| Life Sciences Filtration | 3,295 | 3,819 | (524) |
| Performance Materials Segment net sales | 32,523 | 35,892 | (3,369) |
| Thermal/Acoustical Metals Segment: | | | |
| Metal parts | 35,738 | 37,455 | (1,717) |
| Tooling | 1,947 | 2,406 | (459) |
| Thermal/Acoustical Metals Segment net sales | 37,685 | 39,861 | (2,176) |
| Thermal/Acoustical Fibers Segment: | | | |

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| | | | |
|---|----------|----------|-------------|
| Fiber parts | 24,191 | 20,283 | 3,908 |
| Tooling | 719 | 48 | 671 |
| Thermal/Acoustical Fibers Segment net sales | 24,910 | 20,331 | 4,579 |
| Other Products and Services: | | | |
| Life Sciences Vital Fluids | 3,749 | 3,403 | 346 |
| Other Products and Services net sales | 3,749 | 3,403 | 346 |
| Eliminations and Other | (1,332) | (656) | (676) |
| Consolidated Net Sales | \$97,535 | \$98,831 | \$ (1,296) |

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| In thousands | Six Months Ended | | Dollar Change |
|---|------------------|-----------|---------------|
| | YTD-12 | YTD-11 | |
| Performance Materials Segment: | | | |
| Industrial Filtration | \$36,285 | \$38,920 | \$ (2,635) |
| Industrial Thermal Insulation | 19,850 | 25,576 | (5,726) |
| Life Sciences Filtration | 5,476 | 7,865 | (2,389) |
| Performance Materials Segment net sales | 61,611 | 72,361 | (10,750) |
| Thermal/Acoustical Metals Segment: | | | |
| Metal parts | 73,546 | 72,969 | 577 |
| Tooling | 6,252 | 8,344 | (2,092) |
| Thermal/Acoustical Metals Segment net sales | 79,798 | 81,313 | (1,515) |
| Thermal/Acoustical Fibers Segment: | | | |
| Fiber parts | 46,337 | 39,712 | 6,625 |
| Tooling | 745 | 1,303 | (558) |
| Thermal/Acoustical Fibers Segment net sales | 47,082 | 41,015 | 6,067 |
| Other Products and Services: | | | |
| Life Sciences Vital Fluids | 7,980 | 7,171 | 809 |
| Other Products and Services net sales | 7,980 | 7,171 | 809 |
| Eliminations and Other | (2,182) | (1,356) | (826) |
| Consolidated Net Sales | \$194,289 | \$200,504 | \$ (6,215) |

Operating income (loss) by segment:

| In thousands | Quarter Ended | | Dollars | Dollars | Dollars |
|-------------------------------|---------------|--------|---------|---------|------------|
| | Q2-12 | Q2-11 | | | |
| Performance Materials | \$4,982 | 15.3 % | \$6,093 | 17.0 % | \$(1,111) |
| Thermal/Acoustical Metals | 4,050 | 10.7 % | 4,137 | 10.4 % | (87) |
| Thermal/Acoustical Fibers | 3,382 | 13.6 % | (1,549) | (7.6)% | 4,931 |
| Other Products and Services: | | | | | |
| Life Sciences Vital Fluids | 211 | 5.6 % | (294) | (8.6)% | 505 |
| Corporate Office Expenses | (3,882) | | (3,402) | | (480) |
| Consolidated Operating Income | \$8,743 | 9.0 % | \$4,985 | 5.0 % | \$3,758 |

| In thousands | Six Months Ended | | Dollars | Dollars | Dollars |
|------------------------------|------------------|--------|----------|---------|------------|
| | YTD-12 | YTD-11 | | | |
| Performance Materials | \$7,102 | 11.5 % | \$12,390 | 17.1 % | \$(5,288) |
| Thermal/Acoustical Metals | 9,117 | 11.4 % | 7,861 | 9.7 % | 1,256 |
| Thermal/Acoustical Fibers | 5,611 | 11.9 % | (3,087) | (7.5)% | 8,698 |
| Other Products and Services: | | | | | |
| Life Sciences Vital Fluids | 520 | 6.5 % | (579) | (8.1)% | 1,099 |

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| | | | | | |
|-------------------------------|----------|-----|-----------|-----|-----------|
| Corporate Office Expenses | (8,205) | | (7,060) | | (1,145) |
| Consolidated Operating Income | \$14,145 | 7.3 | % \$9,525 | 4.8 | % \$4,620 |

Performance Materials

Segment net sales decreased \$3.4 million, or 9.4%, in the second quarter of 2012 compared to the near record levels in the second quarter of 2011, due to decreased volumes and the negative impact of foreign currency translation. A reduction in Industrial Thermal Insulation net sales of \$2.5 million, or 18.4%, primarily contributed to the reduction in net sales. Negatively impacting the Industrial Thermal Insulation business was \$1.3 million lower net sales of electrical paper products manufactured under a contract manufacturing agreement with a customer. The Company sold this product line to the customer in 2010, and the Company will continue to manufacture product until the customer commences manufacturing electrical paper products later in 2012. Also impacting Industrial Thermal Insulation net sales was a decrease in sales of products used in commercial buildings due to customers adjusting inventory levels on certain products. Net sales of Industrial Filtration products decreased by \$0.3 million, or 1.8%, in the second quarter of 2012 compared to the second quarter of 2011, due to foreign currency translation decreasing net sales \$1.2 million, or 3.4%. The Company experienced greater demand for its products primarily in North America. Net sales of Life Sciences Filtration products decreased by \$0.5 million, or 13.7%, in the second quarter of 2012 compared to the second quarter of 2011, primarily due to decreased demand for products used in life protection application products.

The segment reported operating income of \$5.0 million, in the second quarter of 2012, or 15.3% of net sales, compared to operating income of \$6.1 million, or 17.0% of net sales, in the second quarter of 2011. Operating income in the second quarters of 2012 and 2011 included a \$0.4 million gain from services provided to the buyer of the electrical papers product line in accordance with the terms of a license agreement, which expired June 30, 2012. The decrease in operating income was primarily a result of lower net sales of \$3.4 million, lower absorption of fixed overhead costs as well as unfavorable mix among product sales. Segment selling, product development and administrative expenses decreased \$0.3 million in the current quarter compared to the second quarter of 2011, primarily due to foreign currency translation.

Segment net sales decreased \$10.8 million, or 14.9%, in the first six months of 2012 compared to the record levels in the first six months of 2011, due to decreased volumes and the negative impact of foreign currency translation. A reduction in Industrial Thermal Insulation net sales of \$5.7 million, or 22.4%, primarily contributed to the reduction in net sales. Negatively impacting the Industrial Thermal Insulation business was \$3.1 million lower net sales of electrical paper products manufactured under a contract manufacturing agreement with a customer. The Company sold this product line to the customer in 2010, and the Company will continue to manufacture product until the customer commences manufacturing electrical paper products later in 2012. Also impacting Industrial Thermal Insulation net sales was a decrease in products used in commercial buildings due to a temporary customer shut-down in the first quarter of 2012 and customers adjusting inventory levels on certain products. Net sales of Industrial Filtration products decreased by \$2.6 million, or 6.8%, in the first six months of 2012 compared to the first six months of 2011, due to a reduction in demand for its products in Europe and Asia markets as well as foreign currency translation decreasing net sales \$1.6 million. Net sales of Life Sciences Filtration products decreased by \$2.4 million, or 30.4%, in the first six months of 2012 compared to the first six months of 2011, primarily due to decreased demand for products used in water and life protection application products.

The segment reported operating income of \$7.1 million, in the first six months of 2012, or 11.5% of net sales, compared to operating income of \$12.4 million, or 17.1% of net sales, in the first six months of 2011. Operating income in the first six months of 2012 and 2011 included a \$0.8 million gain from services provided to the buyer of the electrical papers product line in accordance with the terms of a license agreement, which expired June 30, 2012. The decrease in operating income was primarily a result of lower net sales of \$10.8 million, lower absorption of fixed overhead costs as well as unfavorable mix among product sales. Segment selling, product development and administrative expenses decreased \$0.3 million in the first half of 2012 compared to the first six months of 2011, primarily due to foreign currency translation.

Thermal/Acoustical Metals

In the second quarter of 2012, segment net sales decreased by \$2.2 million, or 5.5%, compared to the second quarter of 2011. Foreign currency translation decreased net sales by \$2.7 million, or 6.8%, for the current quarter, compared with the second quarter of 2011. Automotive parts net sales decreased by \$1.7 million, or 4.6%, compared to the second quarter of 2011 due to foreign currency translation of \$2.6 million, partially offset by increased demand for automobiles in North America on existing platforms, as well as from sales of parts on new platforms awarded to the Company, partially offset by lower demand in Europe. Tooling net sales in the second quarter of 2012 were lower by \$0.5 million compared to the second quarter of 2011 due to foreign currency translation and the timing of new product launches.

For the second quarter of 2012, operating income for the segment was \$4.1 million, or 10.7% of net sales, which was essentially flat compared to the second quarter of 2011.

In the first six months of 2012, segment net sales decreased by \$1.5 million, or 1.9%, compared to the first six months of 2011. Foreign currency translation decreased net sales by \$3.8 million, or 4.7%, in the first six months of 2012 compared with the first six months of 2011. Automotive parts net sales increased by \$0.6 million, compared to the first six months of 2011. Higher volumes of net sales were due to strong consumer demand for automobiles in North America on existing platforms, as well as from sales of parts on new platforms awarded to the Company, partially offset by lower demand in Europe. Tooling net sales in the first six months of 2012 were lower by \$2.1 million compared to the first six months of 2011 due to timing of new product launches and foreign currency translation.

For the first six months of 2012, operating income for the segment was \$9.1 million, or 11.4% of net sales, compared to \$7.9 million, or 9.7% of net sales, in the first six months of 2011. Contributing to this increase was increased volumes of metal parts sales, partially offset by foreign currency translation and lower raw material costs, specifically aluminum and aluminum conversion costs, compared to the first six months of 2011. Segment selling, product development and administrative expenses were essentially flat in the first half of 2012 compared to the first half of 2011.

Thermal/Acoustical Fibers

Segment net sales increased by \$4.6 million, or 22.5%, compared to the second quarter of 2011. Automotive parts net sales increased by \$3.9 million, or 19.3%, compared to the second quarter of 2011. Higher volumes of net sales were due to strong consumer demand for automobiles on existing platforms, as well as from sales of new parts on existing and new platforms awarded to the Company. Tooling net sales in the second quarter of 2012 were higher by \$0.7 million compared to the second quarter of 2011, due to timing of new product launches.

Operating income for the segment was \$3.4 million, or 13.6% of net sales, compared to an operating loss of \$1.5 million in the second quarter of 2011. This improvement was due to higher net sales and improved gross margin realized from manufacturing efficiency improvements. These manufacturing improvements began in the second half of 2011 and continued through the second quarter of 2012. Significant reductions in scrap, material usage, and labor costs primarily contributed to lower per-unit manufacturing costs in the second quarter of 2012 compared to the second quarter of 2011, resulting in improved gross margin. Segment selling, product development and administrative expenses were essentially flat in the current quarter compared to the second quarter of 2011.

Segment net sales increased by \$6.1 million, or 14.8%, compared to the first half of 2011. Automotive parts net sales increased by \$6.6 million, or 16.7%, compared to the first half of 2011. Higher volumes of net sales were due to strong consumer demand for automobiles on existing platforms, as well as from sales of new parts on existing and new platforms awarded to the Company. Tooling net sales in the first half of 2012 were lower by \$0.6 million compared to the first half of 2011, due to timing of new product launches.

Operating income for the segment was \$5.6 million, or 11.9% of net sales, compared to an operating loss of \$3.1 million in the first half of 2011. This improvement was due to higher net sales and improved gross margin realized from manufacturing efficiency improvements. These manufacturing improvements began in the second half of 2011 and continued through the first half of 2012. Significant reductions in scrap, material usage, and labor costs primarily contributed to lower per-unit manufacturing costs in the first half of 2012 compared to the first half of 2011, resulting in improved gross margin. Segment selling, product development and administrative expenses increased \$0.2 million in the first half of 2012 compared to the first half of 2011. This increase was primarily related to increases in selling expenses as a result of higher net sales.

Other Products and Services

OPS net sales for the quarter ended June 30, 2012 increased \$0.3 million, or 10.2%, compared to the same quarter a year ago, due to increased sales from the Life Sciences Vital Fluids business which was primarily attributed to higher volumes of blood transfusion net sales.

OPS reported operating income of \$0.2 million, or 5.6% of net sales, for the quarter ended June 30, 2012, compared to an operating loss of \$0.3 million for the second quarter of 2011. This improvement was due to higher net sales as well as reductions in the business's cost structure in order to better align it with the long development cycles in the bioprocessing industry.

OPS net sales for the six months ended June 30, 2012 increased \$0.8 million, or 11.3%, compared to the same period a year ago, due to increased sales from the Life Sciences Vital Fluids business which was primarily attributed to higher volumes of blood transfusion and bioprocessing product net sales.

OPS reported operating income of \$0.5 million, or 6.5% of net sales, for the six months ended June 30, 2012, compared to an operating loss of \$0.6 million for the same period a year ago. This improvement was due to higher net sales as well as reductions in 2012 to the business's cost structure in order to better align it with the long development cycles in the bioprocessing industry.

Corporate Office Expenses

Corporate office expenses were \$3.9 million and \$3.4 million in the second quarters of 2012 and 2011, respectively. The increase was principally due to higher accrued incentive compensation.

Corporate office expenses were \$8.2 million and \$7.1 million in the first six months of 2012 and 2011, respectively. The increase was principally due to higher professional fees primarily related to exploring strategic initiatives with respect to the Fibers business and higher accrued incentive compensation.

Liquidity and Capital Resources

The Company assesses its liquidity in terms of its ability to generate cash to fund operating, investing and financing activities. The principal source of liquidity is operating cash flows. In addition to operating cash flows, other significant factors that affect the overall management of liquidity include capital expenditures, investments in businesses, strategic transactions, income tax payments, outcomes of contingencies, pension plan funding and availability of lines of credit and long-term financing. The Company manages worldwide cash requirements by considering available funds among domestic and foreign subsidiaries. The Company expects to finance its 2012 operating cash and capital spending requirements from existing cash balances, cash provided by operating activities and through borrowings under its existing credit agreements, as needed.

Financing Arrangements

As of June 30, 2012 and December 31, 2011, the majority of debt outstanding was capital lease obligations. As of June 30, 2012 and December 31, 2011, the Company had no borrowings outstanding under any domestic credit facility, or any credit arrangement entered into by a foreign subsidiary, other than letters of credit.

On June 16, 2011, the Company entered into a \$35.0 million senior secured domestic revolving credit facility (“Domestic Credit Facility”) with a new financial institution, which replaced the Company’s prior \$35.0 million domestic credit facility that was terminated by the Company. The Domestic Credit Facility is secured by substantially all of the assets of the Company. The maturity date for the Domestic Credit Facility is June 15, 2016.

The loan agreement governing the Domestic Credit Facility contains a number of affirmative and negative covenants, including financial covenants. The Company is required to meet a minimum fixed charge coverage ratio. The fixed charge coverage ratio requires that, at the end of each fiscal quarter, the ratio of consolidated EBITDA, as defined in the loan agreement, to fixed charges may not be less than 1 to 1 for the immediately preceding 12 month period. In addition, the Company must maintain a Consolidated Leverage Ratio, as defined, as of the end of each fiscal quarter of no greater than 2.5 to 1.0. The Company must also meet a minimum consolidated EBITDA of \$15.0 million through September 30, 2014 and \$25.0 million thereafter. The Company was in compliance with all covenants at June 30, 2012.

As of June 30, 2012, the Company had borrowing availability of \$32.2 million under the Domestic Credit Facility, net of standby letters of credit outstanding of \$2.8 million. The Company’s foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately \$11.4 million) all of which was available for borrowings, primarily restricted to borrowings by the respective foreign subsidiary.

Operating Cash Flows

Net cash provided by operating activities in the first six months of 2012 was \$12.5 million compared with net cash provided by operating activities of \$5.8 million in the first six months of 2011. In the first six months of 2012 compared to the same period for 2011, net income, excluding the gain on sale of discontinued operations from all periods, improved by \$4.4 million. Since December 31, 2011, operating assets and liabilities increased by \$4.6 million, primarily due to increases in accounts receivable of \$9.4 million in the first half of 2012, partially offset by higher accounts payable of \$4.0 million due to timing of inventory purchases. The increase in accounts receivable was due to higher net sales in the last half of the second quarter of 2012 compared to the last half of the fourth quarter of 2011, with accounts receivable days outstanding at June 30, 2012 being consistent with December 31, 2011.

Investing Cash Flows

In the first six months of 2012, net cash provided by investing activities was \$6.2 million compared to cash provided by investing of \$7.0 million in the first six months of 2011. The Company received \$12.0 million in cash in the first six months of 2012 as a result of its short-term investment maturing, compared to receiving \$12.8 million in cash in the second quarter of 2011 as part of the sale of Affinity. Capital expenditures were \$5.8 million during the first six months of 2012, compared with \$3.3 million for the same period of 2011. Capital spending for 2012 is expected to be approximately \$12.0 million to \$14.0 million. Additionally, in the second quarter of 2011, the company placed \$3.3 million into escrow as collateral for letters of credit.

Financing Cash Flows

In the first six months of 2012, net cash used for financing activities was \$3.1 million compared to net cash used of \$0.7 million in the first six months of 2011. In the first six months of 2012, the Company repurchased \$2.7 million in company stock, compared to none for the comparable period. Capital lease payments made were \$0.6 million and \$0.7 million for the first six months of 2012 and 2011, respectively.

Critical Accounting Estimates

The preparation of the Company's consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Footnote 1

of the “Notes to Consolidated Financial Statements” and Critical Accounting Estimates in Item 7 of the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, and the “Notes to Condensed Consolidated Financial Statements” of this report describe the significant accounting policies and critical accounting estimates used in the preparation of the consolidated financial statements. The Company’s management is required to make judgments and estimates about the effect of matters that are inherently uncertain. Actual results could differ from management’s estimates. There have been no significant changes in the Company’s critical accounting estimates during the quarter ended June 30, 2012.

During the fourth quarter of 2011, the Company performed its annual impairment analysis of \$4.7 million of goodwill in the Life Sciences Vital Fluids reporting unit (“VF reporting unit”), included in OPS. The Company’s goodwill impairment testing analysis included estimating the fair value of the VF reporting unit, using both: (i) the income approach - discounted cash flows, and (ii) the market approach - comparable company analysis. The income approach involved determining the present value of future cash flows from the reporting unit’s projected financial results in 2012 – 2014 (and the projected cash flows beyond that three year period computed as the terminal value) and discounting those amounts based on appropriate market risks and other market factors. Based on those projections and the market approach using valuation multiples derived from select guideline companies, the Company concluded that the fair value of this reporting unit exceeded its carrying value of net assets. As a result, there was no impairment of goodwill.

The estimates of fair value of reporting units are based on the best information available as of the date of the assessment, which incorporate management assumptions about expected future cash flows, as well as other factors such as market capitalization and other market information. Future cash flows can be affected by numerous factors including changes in economic, industry or market conditions, changes in the underlying business or products of the reporting unit, changes in competition and changes in technology. Any changes in key assumptions about the business and its prospects, changes in any of the factors discussed above or other factors could affect the fair value of one or more of the reporting units resulting in an impairment charge. If future operating performance in the VF reporting unit does not reasonably meet expectations or other key assumptions change or are not met, then a non-cash impairment charge to income from operations could occur.

Recently Issued Accounting Standards

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities, which amends ASC 210, Balance Sheet. This ASU requires entities to disclose gross and net information about both instruments and transactions eligible for offset in the statement of financial position and those subject to an agreement similar to a master netting arrangement. This would include derivatives and other financial securities arrangements. The effective date is January 1, 2013 and must be applied retrospectively. The adoption of this ASU will have no effect on the Company's consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in market risks from those disclosed in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's management, including the Company's President and Chief Executive Officer (the "CEO") and Vice President and Chief Financial Officer (the "CFO"), conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e)). Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures were effective as of June 30, 2012. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to management of the Company, with the participation of its CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Change in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting during the quarter ended June 30, 2012 that materially affected, or are reasonably likely to materially affect, the Company's internal controls

over financial reporting.

29

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to legal proceedings, claims, investigations and inquiries that arise in the ordinary course of business such as, but not limited to, patent, employment, personal injury, commercial, and environmental matters. Although there can be no assurance, the Company is not aware of any matters pending that are expected to be material with respect to the Company's business, financial position, results of operations or cash flows.

Item 1A. Risk Factors

See the Company's most recent annual report filed on Form 10-K (Part I, Item 1A). There has been no material change in this information. The risks described in the annual report on Form 10-K, and the "Safe Harbor Statement" in this report, are not the only risks faced by the Company. Additional risks and uncertainties not currently known or that are currently judged to be immaterial may also materially affect the Company's business, financial position, results of operations or cash flows.

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

In August 2003, the Company's Board of Directors approved a stock repurchase to mitigate the potentially dilutive effects of stock options and shares of restricted and unrestricted stock granted by the Company. Under the 2003 repurchase program, shares may be purchased by the Company up to the quantity of shares underlying options and other equity-based awards granted under shareholder approved plans.

On April 27, 2012 the Company's Board of Directors approved a new stock repurchase program under which the Company may purchase up to 1.0 million shares. The new program replaces the 2003 repurchase program. During the three months ended June 30, 2012, the Company repurchased 219,476 shares at a total cost of \$2.7 million.

The following table provides information with respect to all purchases made by the Company during the three months ended June 30, 2012. All purchases listed below were made in the open market at prevailing market prices.

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| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of a Publicly announced plan | Maximum Number of Shares That May Yet Be Purchased Under the Plan |
|--------------------------------|---|------------------------------------|--|--|
| April 1, 2012 - April 30, 2012 | - | \$ - | - | 1,000,000 |
| May 1, 2012 - May 31, 2012 | 130,167 | \$ 12.28 | 130,167 | 869,833 |
| June 1, 2012 - June 30, 2012 | 89,309 | \$ 12.45 | 89,309 | 780,524 |
| | 219,476 | \$ 12.35 | 219,476 | 780,524 |

Item 5. Other Information

On July 27, 2012, James V. Laughlan, Chief Accounting Officer and Controller (Principal Accounting Officer) was appointed the additional position of Treasurer, reporting to Erika H. Steiner, Vice President and Chief Financial Officer (Principal Financial Officer). The Treasurer position was previously held by Ms. Steiner.

Item 6. Exhibits

| Exhibit Number | Description |
|----------------|---|
| 3.1 | Certificate of Incorporation of the Registrant, as amended, filed as Exhibit 3.1 to the Registrant's Annual Report on Form 10-K dated March 12, 2004 and incorporated herein by this reference. |
| 3.2 | Bylaws of the Registrant, as amended and restated as of December 11, 2003, filed as Exhibit 3.2 to the Registrant's Annual Report on 10-K dated March 12, 2004 and incorporated herein by this reference. |
| 10.1 | Lydall 2012 Stock Incentive Compensation Plan, filed with the Registrant's 2012 Proxy Statement dated March 16, 2012 and incorporated herein by this reference. |
| 10.2 | Offer of Employment Letter to David H. Williams dated June 12, 2012, filed herewith. |
| 10.3 | Employment Agreement with David H. Williams dated June 27, 2012, filed herewith. |
| 10.4 | Form (for U.S. Employees) of Lydall, Inc. [Nonqualified] [Incentive] Stock Option Agreement, dated April 26, 2012, filed herewith. |
| 10.5 | Form (For U.S. Employees) of Lydall, Inc. Performance Share Award Agreement (Three-Year Period), dated April 26, 2012, filed herewith. |
| 10.6 | Form (For French Employees) of Lydall, Inc. Performance Share Award Agreement (Three-Year Period), dated June 21, 2012, filed herewith. |
| 10.7 | Form (For German Employees) of Lydall, Inc. Performance Share Award Agreement (Three-Year Period), dated June 21, 2012, filed herewith. |
| 10.8 | Form (For U.S. Employees) of Lydall, Inc. Restricted Share Award Agreement, dated June 21, 2012, filed herewith. |
| 10.9 | Form (For Non-Employee Directors) of Lydall, Inc. Restricted Share Award Agreement, dated July 26, 2012, filed herewith. |
| 10.10 | Form (For Netherlands Employees) of Lydall, Inc. Nonqualified Stock Option Agreement, dated July 26, 2012, filed herewith. |
| 10.11 | Form (For French Employees) of Lydall, Inc. Nonqualified Stock Option Agreement, dated July 26, 2012, filed herewith. |
| 10.12 | Form (For German Employees) of Lydall, Inc. Nonqualified Stock Option Agreement, dated July 26, 2012, filed herewith. |

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- 31.1 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, filed herewith.
- 31.2 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, filed herewith.
- 32.1 Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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.

LYDALL, INC.

August 1, 2012 By: /s/ Erika H. Steiner

Erika H. Steiner
Vice President and Chief Financial Officer

**(On behalf of the Registrant and as
Principal Financial Officer)**

LYDALL, INC.

Index to Exhibits

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Form (For German Employees) of Lydall, Inc. Nonqualified Stock Option Agreement, dated July 26, 2012, filed herewith.

31.1 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, filed herewith.

31.2 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, filed herewith.

32.1 Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document