

LYDALL INC /DE/  
Form 10-Q  
May 01, 2013

**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 March 31, 2013**

**OR**

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

**For the transition period from            to**

**Commission File Number: 1-7665**

**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.

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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 April 19, 2013 17,036,907**

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## Cautionary Note Concerning Factors That May Affect Future Results

Lydall, Inc. and its subsidiaries are hereafter collectively referred to as “Lydall,” the “Company” or the “Registrant.”

This report contains “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). 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 of the Exchange Act. 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,” “signs” 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. Investors, therefore, 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 include, among others, statements relating to:

- Overall economic and business conditions and the effects on the Company’s markets;
- Expected vehicle production in the North American or European 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 \$35.0 million senior secured domestic revolving 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 long-lived assets used in assessing 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

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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 Company's 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, raw material pricing and supply issues, fluctuations in unemployment rates, and increases in fuel prices, as well as other risks and uncertainties identified in Part II, Item 1A – Risk Factors of this Quarterly Report on Form 10-Q and Part I, Item 1A Risk Factors of Lydall's Annual Report on Form 10-K for the year ended December 31, 2012.

The forward-looking statements speak only as of the date of the initial filing of this Quarterly Report on Form 10-Q. 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 |          |
|----------------------------------------------------------|---------------|----------|
|                                                          | March 31,     |          |
|                                                          | 2013          | 2012     |
|                                                          | (Unaudited)   |          |
| Net sales                                                | \$99,029      | \$96,754 |
| Cost of sales                                            | 77,664        | 77,513   |
| Gross profit                                             | 21,365        | 19,241   |
| Selling, product development and administrative expenses | 14,848        | 14,244   |
| Gain on sale of product line                             | -             | (405 )   |
| Operating income                                         | 6,517         | 5,402    |
| Interest expense                                         | 78            | 90       |
| Other expense, net                                       | 42            | 43       |
| Income before income taxes                               | 6,397         | 5,269    |
| Income tax expense                                       | 1,905         | 1,357    |
| Net income                                               | \$4,492       | \$3,912  |
| Earnings per share:                                      |               |          |
| Basic                                                    | \$0.27        | \$0.23   |
| Diluted                                                  | \$0.26        | \$0.23   |
| Weighted average number of common shares outstanding:    |               |          |
| Basic                                                    | 16,752        | 16,828   |
| Diluted                                                  | 17,036        | 16,981   |

See accompanying Notes to Condensed Consolidated Financial Statements.



**LYDALL, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In Thousands)**

|                                          | Quarter Ended |         |
|------------------------------------------|---------------|---------|
|                                          | March 31,     |         |
|                                          | 2013          | 2012    |
|                                          | (Unaudited)   |         |
| Net income                               | \$4,492       | \$3,912 |
| Other comprehensive income:              |               |         |
| Foreign currency translation adjustments | (2,034)       | 2,055   |
| Pension liability adjustment, net of tax | 165           | 138     |
| Comprehensive income                     | \$2,623       | \$6,105 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

|                                                                   | March 31,<br>2013 | December 31,<br>2012 |
|-------------------------------------------------------------------|-------------------|----------------------|
|                                                                   | (Unaudited)       |                      |
| <b>ASSETS</b>                                                     |                   |                      |
| Current assets:                                                   |                   |                      |
| Cash and cash equivalents                                         | \$57,467          | \$ 63,623            |
| Accounts receivable, less allowances (2013 - \$459; 2012 - \$469) | 56,661            | 47,486               |
| Inventories                                                       | 37,575            | 31,292               |
| Prepaid expenses and other current assets                         | 9,438             | 9,400                |
| Total current assets                                              | 161,141           | 151,801              |
| Property, plant and equipment, at cost                            | 248,917           | 249,206              |
| Accumulated depreciation                                          | (174,220)         | (172,952)            |
| Net, property, plant and equipment                                | 74,697            | 76,254               |
| Goodwill                                                          | 18,191            | 18,282               |
| Other intangible assets                                           | 3,564             | 3,825                |
| Other assets, net                                                 | 1,276             | 1,754                |
| Total assets                                                      | \$258,869         | \$ 251,916           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                       |                   |                      |
| Current liabilities:                                              |                   |                      |
| Current portion of long-term debt                                 | \$683             | \$ 765               |
| Accounts payable                                                  | 33,241            | 29,441               |
| Accrued payroll and other compensation                            | 8,481             | 10,273               |
| Accrued taxes                                                     | 2,292             | 1,728                |
| Other accrued liabilities                                         | 4,954             | 4,143                |
| Total current liabilities                                         | 49,651            | 46,350               |
| Long-term debt                                                    | 1,449             | 1,646                |
| Deferred tax liabilities                                          | 4,202             | 3,902                |
| Benefit plan liabilities                                          | 24,937            | 25,080               |
| Other long-term liabilities                                       | 666               | 442                  |
| Commitments and Contingencies (Note 11)                           |                   |                      |
| Stockholders' equity:                                             |                   |                      |
| Preferred stock                                                   | -                 | -                    |
| Common stock                                                      | 2,386             | 2,379                |
| Capital in excess of par value                                    | 59,964            | 58,784               |
| Retained earnings                                                 | 205,589           | 201,097              |
| Accumulated other comprehensive loss                              | (20,235)          | (18,366)             |
| Treasury stock, at cost                                           | (69,740)          | (69,398)             |

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|                                            |           |            |
|--------------------------------------------|-----------|------------|
| Total stockholders' equity                 | 177,964   | 174,496    |
| Total liabilities and stockholders' equity | \$258,869 | \$ 251,916 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**LYDALL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In Thousands)**

|                                                                                              | Three Months Ended<br>March 31,<br>2013      2012<br>(Unaudited) |           |
|----------------------------------------------------------------------------------------------|------------------------------------------------------------------|-----------|
| Cash flows from operating activities:                                                        |                                                                  |           |
| Net income                                                                                   | \$ 4,492                                                         | \$ 3,912  |
| Adjustments to reconcile net income to net cash (used for) provided by operating activities: |                                                                  |           |
| Gain on sale of product line                                                                 | -                                                                | (405 )    |
| Depreciation and amortization                                                                | 3,345                                                            | 3,564     |
| Deferred income taxes                                                                        | 293                                                              | 16        |
| Stock based compensation                                                                     | 494                                                              | 366       |
| Changes in operating assets and liabilities:                                                 |                                                                  |           |
| Accounts receivable                                                                          | (9,791 )                                                         | (10,363 ) |
| Inventories                                                                                  | (6,681 )                                                         | (2,348 )  |
| Accounts payable                                                                             | 4,135                                                            | 4,478     |
| Accrued payroll and other compensation                                                       | (1,625 )                                                         | (831 )    |
| Accrued taxes                                                                                | 611                                                              | 1,350     |
| Other, net                                                                                   | 1,510                                                            | 874       |
| Net cash (used for) provided by operating activities                                         | (3,217 )                                                         | 613       |
| Cash flows from investing activities:                                                        |                                                                  |           |
| Proceeds from maturity of short-term investment                                              | -                                                                | 12,015    |
| Capital expenditures                                                                         | (2,463 )                                                         | (2,962 )  |
| Net cash (used for) provided by investing activities                                         | (2,463 )                                                         | 9,053     |
| Cash flows from financing activities:                                                        |                                                                  |           |
| Debt repayments                                                                              | (218 )                                                           | (360 )    |
| Common stock issued                                                                          | 653                                                              | 2         |
| Common stock repurchased                                                                     | (342 )                                                           | -         |
| Excess tax benefit on stock awards                                                           | 103                                                              | -         |
| Net cash provided by (used for) financing activities                                         | 196                                                              | (358 )    |
| Effect of exchange rate changes on cash                                                      | (672 )                                                           | 553       |
| (Decrease) increase in cash and cash equivalents                                             | (6,156 )                                                         | 9,861     |
| Cash and cash equivalents at beginning of period                                             | 63,623                                                           | 30,905    |
| Cash and cash equivalents at end of period                                                   | \$ 57,467                                                        | \$ 40,766 |

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 (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 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, 2012. The year-end Condensed Consolidated Balance Sheet was derived from the December 31, 2012 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, 2012.

*Recently Adopted Accounting Pronouncements*

In December 2011, the Financial Accounting Standards Board (“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 was January 1, 2013. The adoption of this ASU had no effect on the Company's consolidated financial statements.

In February 2013, the FASB issued an accounting standards update requiring new disclosures about reclassifications from accumulated other comprehensive loss to net income. These disclosures may be presented on the face of the statements or in the notes to the consolidated financial statements. The standards update was effective for fiscal years beginning after December 15, 2012. The Company adopted this standards update and revised its disclosure, as required, beginning with the first quarter of 2013. See Note 12 Changes in Accumulated Other Comprehensive Income (Loss).

## 2. Inventories

Inventories as of March 31, 2013 and December 31, 2012 were as follows:

| In thousands            | March 31,<br>2013 | December 31,<br>2012 |
|-------------------------|-------------------|----------------------|
| Raw materials           | \$ 14,579         | \$ 12,501            |
| Work in process         | 14,756            | 12,800               |
| Finished goods          | 10,423            | 10,549               |
|                         | 39,758            | 35,850               |
| Less: Progress billings | (2,183 )          | (4,558 )             |
| Total inventories       | \$ 37,575         | \$ 31,292            |

Included in work in process is gross tooling inventory of \$9.6 million and \$8.0 million at March 31, 2013 and December 31, 2012, respectively. Tooling inventory, net of progress billings, was \$7.4 million and \$3.5 million at March 31, 2013 and December 31, 2012, respectively.

## 3. 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 segment as of and for the three months ended March 31, 2013 were as follows:

| In thousands                | December 31,<br>2012 | Currency<br>translation<br>adjustments | Other<br>adjustments | March 31,<br>2013 |
|-----------------------------|----------------------|----------------------------------------|----------------------|-------------------|
| Performance Materials       | \$ 13,622            | \$ (133 )                              | \$ 42                | \$ 13,531         |
| Other Products and Services | 4,660                | -                                      | -                    | 4,660             |
| Total goodwill              | \$ 18,282            | \$ (133 )                              | \$ 42                | \$ 18,191         |

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. The Company is obligated to pay, for a period of five years beginning

December 1, 2008, consideration equal to 4.0% of Solutech's net revenues (included in the Performance Materials segment). These payments increase the amount of goodwill previously recorded, as the acquisition occurred prior to the revised guidance issued by the FASB (ASC 805) for business combinations.

#### **4. Long-term Debt and Financing Arrangements**

As of March 31, 2013 and December 31, 2012, the majority of debt outstanding was capital lease obligations. As of March 31, 2013 and December 31, 2012, 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 March 31, 2013.



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 March 31, 2013, the Company had borrowing availability of \$32.5 million under the Domestic Credit Facility net of standby letters of credit outstanding of \$2.5 million. As of March 31, 2013, the Company's foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately \$11.5 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

## 5. Equity Compensation Plans

As of March 31, 2013, the Company's equity compensation plans consisted of the 2003 Stock Incentive Compensation Plan (the "2003 Plan") and the 2012 Stock Incentive Plan (the "2012 Plan" and together with the 2003 Plan, 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 of common stock 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 \$0.5 million and \$0.4 million for the quarters ended March 31, 2013 and March 31, 2012, respectively, 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 March 31, 2013:

| In thousands except per share amounts and years | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|-------------------------------------------------|--------|---------------------------------|-----------------------------------------------------|---------------------------|
| Outstanding at March 31, 2013                   | 772    | \$ 9.63                         | 6.1                                                 | \$ 4,454                  |
| Exercisable at March 31, 2013                   | 463    | \$ 9.11                         | 4.4                                                 | \$ 2,925                  |
| Expected to Vest at March 31, 2013              | 295    | \$ 10.39                        | 8.8                                                 | \$ 1,464                  |

There were no stock options granted and 70,649 stock options exercised during the quarter ended March 31, 2013. The amount of cash received from the exercise of stock options was \$0.7 million during the quarter ended March 31, 2013. The intrinsic value of stock options exercised was \$0.4 million with a tax benefit of \$0.1 million during the quarter ended March 31, 2013. There were no stock options granted and 1,250 stock options exercised during the quarter ended March 31, 2012. The amount of cash received from the exercise of stock options during the quarter ended March 31, 2012 and the intrinsic value of the stock options exercised was minimal. At March 31, 2013, the total unrecognized compensation cost related to nonvested stock option awards was approximately \$1.4 million, with a weighted average expected amortization period of 3.0 years.

### ***Restricted Stock***

Restricted stock includes both performance-based and time-based awards. There were 5,000 time-based restricted shares granted during the quarter ended March 31, 2013. There were 77,290 performance-based restricted shares granted during the quarter ended March 31, 2013, which have a 2015 earnings per share target. During the quarter ended March 31, 2013, there were 61,800 performance-based shares that vested in accordance with Plan provisions. There were no shares granted or vested in the first quarter ended March 31, 2012. At March 31, 2013, there were 319,440 unvested restricted stock awards with total unrecognized compensation cost related to these awards of \$2.6 million with a weighted average expected amortization period of 2.3 years.

## 6. 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 did not repurchase any stock during the quarter ended March 31, 2013 under the 2012 Stock Repurchase Program. As of March 31, 2013, there were 690,333 shares remaining and authorized for repurchase under the 2012 Stock Repurchase Program.

During the first quarter ended March 31, 2013, the Company purchased 21,224 shares of common stock valued at \$0.3 million, through withholding, pursuant to provisions in agreements with recipients of restricted stock granted under the Company's equity compensation plans, which allow the Company to withhold the number of shares having fair value equal to each recipient's tax withholding due.

## 7. Employer Sponsored Benefit Plans

As of March 31, 2013, 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 expects to contribute approximately \$1.2 million in cash to its domestic pension plan in 2013. Contributions of \$0.1 million and \$0.5 million were made during the first quarters of 2013 and 2012, respectively.

The following is a summary of the components of net periodic benefit cost, which is recorded primarily within selling, product development and administrative expenses, for the domestic pension plan for the quarters ended March 31, 2013 and 2012:

| In thousands                            | Quarter Ended |        |
|-----------------------------------------|---------------|--------|
|                                         | 2013          | 2012   |
| Components of net periodic benefit cost |               |        |
| Interest cost                           | \$ 613        | \$ 648 |
| Expected return on assets               | (673)         | (640)  |
| Amortization of actuarial loss          | 267           | 224    |
| Net periodic benefit cost               | \$ 207        | \$ 232 |

## 8. Income Taxes

The Company's effective tax rate for the first quarter of 2013 was 29.8% compared to an effective tax rate of 25.8% in the first quarter of 2012. During the first quarter of 2013, the Company concluded certain U.S. federal income tax matters through the year ended December 31, 2009 and recognized a discrete tax benefit of \$0.5 million. The difference in the Company's effective tax rate for the quarter ended March 31, 2012 compared to statutory federal income tax rates was primarily due a \$0.8 million reversal of valuation allowance against foreign tax credit carryovers.

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. With few exceptions, the Company is no longer subject to U.S. federal examinations for years before 2010, state and local examinations for years before 2002, and non-U.S. income tax examinations for years before 2003.

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.

## 9. Earnings Per Share

For the quarters ended March 31, 2013 and March 31, 2012, 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<br>March 31, |        |
|--------------------------------------------------------|----------------------------|--------|
|                                                        | 2013                       | 2012   |
| Basic average common shares outstanding                | 16,752                     | 16,828 |
| Effect of dilutive options and restricted stock awards | 284                        | 153    |
| Diluted average common shares outstanding              | 17,036                     | 16,981 |

For the quarters ended March 31, 2013 and March 31, 2012, 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.

## 10. 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 the Industrial Filtration, Industrial Thermal Insulation, and Life Sciences Filtration businesses. The Thermal/Acoustical Metals segment reports the results of Lydall's automotive business which includes metal parts and related tooling. The Thermal/Acoustical Fibers segment reports the results of Lydall's automotive business, which includes fiber parts and related tooling. Other Products and Services ("OPS") includes Life Sciences Vital Fluids.

*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 range of innovative engineered products to assist in noise and heat abatement within the transportation sector. Lydall products are found in the underbody (tunnel, fuel tank, exhaust, rear muffler, and spare tire) and under hood (engine compartment, turbo charger, and manifolds) 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 using aluminized and stainless steel with high performance heat absorbing metals. A recently developed and patented CLD (constraint layer damped) material is a lightweight material with characteristics to reduce vibration and parasitic noise on powertrain mounted heat shields.

#### *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 ended March 31, 2013 and 2012, and also a reconciliation of total segment net sales and operating income to total consolidated net sales and operating income.

Consolidated net sales by segment:

| In thousands                                | Quarter Ended |          |
|---------------------------------------------|---------------|----------|
|                                             | 2013          | 2012     |
| Performance Materials Segment:              |               |          |
| Industrial Filtration                       | \$16,650      | \$18,176 |
| Industrial Thermal Insulation               | 8,156         | 8,731    |
| Life Sciences Filtration                    | 2,677         | 2,181    |
| Performance Materials Segment net sales     | 27,483        | 29,088   |
| Thermal/Acoustical Metals Segment:          |               |          |
| Metal parts                                 | 33,109        | 37,808   |
| Tooling                                     | 7,093         | 4,305    |
| Thermal/Acoustical Metals Segment net sales | 40,202        | 42,113   |
| Thermal/Acoustical Fibers Segment:          |               |          |
| Fiber parts                                 | 27,784        | 22,146   |
| Tooling                                     | 143           | 26       |
| Thermal/Acoustical Fibers Segment net sales | 27,927        | 22,172   |
| Other Products and Services:                |               |          |
| Life Sciences Vital Fluids                  | 4,307         | 4,231    |
| Other Products and Services net sales       | 4,307         | 4,231    |
| Eliminations and Other                      | (890 )        | (850 )   |
| Consolidated Net Sales                      | \$99,029      | \$96,754 |

Operating income by segment:

| In thousands                 | Quarter Ended |         |
|------------------------------|---------------|---------|
|                              | 2013          | 2012    |
| Performance Materials        | \$1,277       | \$2,120 |
| Thermal/Acoustical Metals    | 3,018         | 5,067   |
| Thermal/Acoustical Fibers    | 6,154         | 2,229   |
| Other Products and Services: |               |         |
| Life Sciences Vital Fluids   | 356           | 309     |

|                               |         |         |
|-------------------------------|---------|---------|
| Corporate Office Expenses     | (4,288) | (4,323) |
| Consolidated Operating Income | \$6,517 | \$5,402 |

## 11. 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 financial position, results of operations or cash flows.

**12. Changes in Accumulated Other Comprehensive Income (Loss)**

The following table discloses the changes by classification within accumulated other comprehensive income (loss) for the period ended March 31, 2013:

| In thousands                                                         | Foreign Currency<br>Translation<br>Adjustment | Defined Benefit<br>Pension<br>Adjustment | Total<br>Accumulated<br>Other<br>Comprehensive<br>(Loss) Income |
|----------------------------------------------------------------------|-----------------------------------------------|------------------------------------------|-----------------------------------------------------------------|
| Balance at December 31, 2012                                         | \$ 3,178                                      | \$ (21,544                               | ) \$ (18,366 )                                                  |
| Other comprehensive loss                                             | (2,034                                        | )                                        | - (2,034 )                                                      |
| Amounts reclassified from accumulated other comprehensive income (a) | -                                             | 165                                      | 165                                                             |
| Balance at March 31, 2013                                            | \$ 1,144                                      | \$ (21,379                               | ) \$ (20,235 )                                                  |

(a) Amount represents amortization of actuarial losses, a component of net periodic benefit cost, net of \$0.1 million tax benefit. See Note 7, Employer Sponsored Benefit Plans.

## **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”).

The Thermal/Acoustical Metals (“T/A Metals”) segment and Thermal/Acoustical Fibers (“T/A Fibers”) segment 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.

#### **First Quarter 2013 Highlights**

Below are financial highlights comparing Lydall’s quarter ended March 31, 2013 (“Q1 2013”) results to its quarter ended March 31, 2012 (“Q1 2012”) results:

· Net sales were \$99.0 million, an increase of \$2.3 million, or 2.4%, compared to Q1 2012;  
· Gross margin increased to 21.6%, compared to 19.9%, principally caused by improvement in the Thermal/Acoustical Fibers segment;  
· Selling, product development and administrative expenses were \$14.8 million, or 15.0% of net sales, compared to \$14.2 million, or 14.7%, primarily due to increases in new product development;  
· Operating income was \$6.5 million, or 6.6% of net sales, compared to operating income of \$5.4 million, or 5.6% of net sales;  
· Operating income in the first quarter 2013 included \$1.8 million, or 1.8% of net sales, related to a completed pricing negotiation and a non-recurring customer project.  
· Operating income in the first quarter of 2012 included a gain of \$0.4 million from services provided under a license agreement.  
· Effective tax rate of 29.8%, compared to an effective tax rate of 25.8% in Q1 2012;  
· Q1 2013 included a discrete tax benefit of \$0.5 million, or \$0.03 per share, related to the conclusion of certain U.S. federal income tax matters through the year ended December 31, 2009.  
· Q1 2012 included a tax benefit of \$0.8 million, or \$0.05 per share, for the reversal of valuation allowance against foreign tax credit carryovers.  
· Net income was \$4.5 million, or \$0.26 per share, compared to \$3.9 million, or \$0.23 per share.

### *Operational and Financial Overview*

Net sales for the first quarter of 2013 increased by \$2.3 million, or 2.4%, compared to the first quarter of 2012, primarily from higher sales volumes, and to a lesser extent, a completed pricing negotiation. Net sales from a first quarter 2013 non-recurring customer project were essentially offset by lower net sales of electrical paper products in the first quarter of 2013 due to the sale of a product line in a prior year.

In the T/A Fibers segment, higher net sales of \$5.8 million, or 26.0%, compared to the same quarter a year ago, were the result of increased consumer demand for vehicles in North America on Lydall's platforms, a completed pricing negotiation and a non-recurring customer project. This increase was offset by decreases in net sales volumes from the T/A Metals segment of \$1.9 million, or 4.5%, and the Performance Materials segment by \$1.6 million, or 5.5%, compared to the first quarter of 2012. Lower net sales for both segments were primarily due to economic conditions in Europe negatively impacting demand for Industrial Filtration products in the Performance Materials segment and automotive parts in the T/A Metals segment.

Operating income increased by \$1.1 million in the first quarter of 2013, compared to the first quarter of 2012, primarily driven by the T/A Fibers segment which reported an increase of \$3.9 million, partially offset by reductions in T/A Metals and Performance Materials segments operating income of \$2.0 million and \$0.8 million, respectively.

The T/A Fibers segment realized increased gross profit and gross margin from higher net sales, a change in the mix of sales, and reductions in scrap, material usage and labor costs. Additionally, gross profit and operating income in the first quarter of 2013 included a completed pricing negotiation and a non-recurring customer project which contributed to an increase in operating income of \$1.8 million compared to the first quarter 2012. Lower operating income in the T/A Metals segment was due to lower net sales and the unfavorable mix in sales between automotive parts and tooling, as higher margin automotive parts net sales decreased by \$4.7 million in the first quarter of 2013 compared to the first quarter of 2012. Also, operating income for the T/A Metals segment was negatively impacted by unfavorable absorption of fixed overhead costs and increases in selling expenses and administrative salaries and benefits expenses. The decrease of \$0.8 million in Performance Materials segment operating income was caused by lower net sales in the first quarter of 2013 and a gain of \$0.4 million from services provided under a license agreement in the first quarter of 2012.

### *Liquidity*

At March 31, 2013, the majority of debt outstanding was capital lease obligations. The Company had a cash balance of \$57.5 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 \$35.0 million senior secured domestic revolving credit facility (“Domestic Credit Facility”) and foreign credit facilities. As of March 31, 2013, the Company had borrowing availability of \$32.5 million under the Domestic Credit Facility net of standby letters of credit outstanding of \$2.5 million. As of March 31, 2013, the Company’s foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately \$11.5 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

*Outlook*

Unstable economic conditions in Europe resulted in lower demand for Industrial Filtration products in the Performance Materials segment and automotive parts in the T/A Metals segment during the first quarter of 2013. Despite the continued uncertainty in the macro-economic environment, the Company remains cautiously optimistic going into the second quarter of 2013. The Company is seeing signs of improved demand in Europe for Industrial Filtration products and expects to continue to benefit from strong demand in North America for automotive parts.

**Results of Operations**

Note: All of the following tabular comparisons, unless otherwise indicated, are for the quarters ended March, 31 2013 (Q1-13) and March 31, 2012 (Q1-12).

*Net Sales*

|              | Quarter Ended |          |                |
|--------------|---------------|----------|----------------|
| In thousands | Q1-13         | Q1-12    | Percent Change |
| Net sales    | \$99,029      | \$96,754 | 2.4%           |

Net sales for the current quarter increased \$2.3 million, or 2.4%, compared to the first quarter of 2012. In the T/A Fibers segment, higher sales volumes resulted in improved net sales of \$5.8 million, or 26.0%, compared to the same quarter a year ago. This was offset by decreases in net sales volumes from the Performance Materials segment of \$1.6 million, or 5.5%, and the T/A Metals segment of \$1.9 million, or 4.5%, compared to the first quarter of 2012. Net sales from the Life Sciences Vital Fluids business of \$4.3 million, in the first quarter of 2013, were essentially flat with the first quarter of 2012.

*Gross Profit*

|              | Quarter Ended |       |
|--------------|---------------|-------|
| In thousands | Q1-13         | Q1-12 |



|              |          |          | Percent<br>Change |
|--------------|----------|----------|-------------------|
| Gross profit | \$21,365 | \$19,241 | 11.0%             |
| Gross margin | 21.6 %   | 19.9 %   |                   |

Gross margin for the first quarter of 2013 was 21.6% compared to 19.9% in the first quarter of 2012. This increase was from higher T/A Fibers segment gross margin due higher net sales, change in mix of product sales, reductions in scrap, material usage and labor costs as well as from \$1.8 million of gross profit from a T/A Fibers segment completed pricing negotiation and a non-recurring customer project in the first quarter of 2013. Partially offsetting the increase in gross margin was lower gross margin from the T/A Metals segment due to lower net sales resulting in lower absorption of fixed overhead costs, changes in mix of product sales, and higher raw material costs. There was no significant change in the gross margin related to the Performance Materials segment in first quarter of 2013 compared to the first quarter of 2012.

### *Selling, Product Development and Administrative Expenses*

| In thousands                                             | Quarter Ended |           | Percent<br>Change |
|----------------------------------------------------------|---------------|-----------|-------------------|
|                                                          | Q1-13         | Q1-12     |                   |
| Selling, product development and administrative expenses | \$ 14,848     | \$ 14,244 | 4.2%              |
| Percentage of sales                                      | 15.0 %        | 14.7 %    |                   |

The increase in selling, product development and administrative expenses for the quarter ended March 31, 2013 compared to the same period of 2012 was due to increases in new product development costs of \$0.4 million, salaries and wages of \$0.4 million, and accrued incentive compensation of \$0.2 million, partially offset by lower professional services expenses of \$0.5 million.

### ***Gain On Sale of Product Line***

| In thousands                 | Quarter Ended |        | Percent Change |
|------------------------------|---------------|--------|----------------|
|                              | Q1-13         | Q1-12  |                |
| Gain on sale of product line | \$-           | \$ 405 | (100.0 )%      |

On June 30, 2010, the Company divested its electrical papers product line business. 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 the first quarter of 2012 for services provided under a license agreement associated with the electrical papers product line divestiture.

### ***Interest Expense***

| In thousands                   | Quarter Ended |       | Percent Change |
|--------------------------------|---------------|-------|----------------|
|                                | Q1-13         | Q1-12 |                |
| Interest expense               | \$78          | \$ 90 | (13.3 )%       |
| Weighted average interest rate | 5.5 %         | 5.4 % |                |

The decrease in interest expense for the first quarter of 2013 compared to the same period of 2012 was due to lower average principal balances on capital lease obligations.

### ***Other Income/Expense***

Other income and expense for the quarters ended March 31, 2013 and 2012 consisted of insignificant activity related to foreign exchange transaction gains and losses and interest income.

*Income Taxes*

The Company's effective tax rate for the first quarter of 2013 was 29.8% compared to an effective tax rate of 25.8% in the first quarter of 2012. During the first quarter of 2013, the Company concluded certain U.S. federal income tax matters through the year ended December 31, 2009 and recognized a discrete tax benefit of \$0.5 million. The difference in the Company's effective tax rate for the quarter ended March 31, 2012 compared to statutory federal income tax rates was primarily due to a \$0.8 million reversal of valuation allowance against foreign tax credit carryovers.

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. With few exceptions, the Company is no longer subject to U.S. federal examinations for years before 2010, state and local examinations for years before 2002, and non-U.S. income tax examinations for years before 2003.

The Company's effective tax rate for the year ended December 31, 2013 is expected to be between 35% and 37%. 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.

**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 ended March 31, 2013 compared with the quarter ended March 31, 2012:

Net sales by segment:

| In thousands                                | Quarter Ended |          | Dollar Change |
|---------------------------------------------|---------------|----------|---------------|
|                                             | Q1-13         | Q1-12    |               |
| Performance Materials Segment:              |               |          |               |
| Industrial Filtration                       | \$16,650      | \$18,176 | \$ (1,526 )   |
| Industrial Thermal Insulation               | 8,156         | 8,731    | (575 )        |
| Life Sciences Filtration                    | 2,677         | 2,181    | 496           |
| Performance Materials Segment net sales     | 27,483        | 29,088   | (1,605 )      |
| Thermal/Acoustical Metals Segment:          |               |          |               |
| Metal parts                                 | 33,109        | 37,808   | (4,699 )      |
| Tooling                                     | 7,093         | 4,305    | 2,788         |
| Thermal/Acoustical Metals Segment net sales | 40,202        | 42,113   | (1,911 )      |
| Thermal/Acoustical Fibers Segment:          |               |          |               |
| Fiber parts                                 | 27,784        | 22,146   | 5,638         |
| Tooling                                     | 143           | 26       | 117           |
| Thermal/Acoustical Fibers Segment net sales | 27,927        | 22,172   | 5,755         |
| Other Products and Services:                |               |          |               |
| Life Sciences Vital Fluids                  | 4,307         | 4,231    | 76            |
| Other Products and Services net sales       | 4,307         | 4,231    | 76            |
| Eliminations and Other                      | (890 )        | (850 )   | (40 )         |
| Consolidated Net Sales                      | \$99,029      | \$96,754 | \$ 2,275      |

Operating income by segment:

| In thousands                 | Quarter Ended    |                    | Dollar Change    |                    |          |
|------------------------------|------------------|--------------------|------------------|--------------------|----------|
|                              | Q1-13            | Q1-12              |                  |                    |          |
|                              | Operating Income | Operating Margin % | Operating Income | Operating Margin % |          |
| Performance Materials        | \$1,277          | 4.6%               | \$2,120          | 7.3%               | \$(843 ) |
| Thermal/Acoustical Metals    | 3,018            | 7.5%               | 5,067            | 12.0%              | (2,049 ) |
| Thermal/Acoustical Fibers    | 6,154            | 22.0%              | 2,229            | 10.1%              | 3,925    |
| Other Products and Services: |                  |                    |                  |                    |          |

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|                               |         |      |         |      |         |
|-------------------------------|---------|------|---------|------|---------|
| Life Sciences Vital Fluids    | 356     | 8.3% | 309     | 7.3% | 47      |
| Corporate Office Expenses     | (4,288) |      | (4,323) |      | 35      |
| Consolidated Operating Income | \$6,517 | 6.6% | \$5,402 | 5.6% | \$1,115 |

### *Performance Materials*

Segment net sales were \$27.5 million in the first quarter of 2013, a decrease of \$1.6 million, or 5.5%, compared to net sales of \$29.1 million in the first quarter of 2012. Lower demand for Industrial filtration products of \$1.5 million, primarily as a result of volatile economic conditions in Europe, contributed to the decrease in segment net sales. Industrial Thermal Insulation net sales decreased by \$0.6 million in the first quarter of 2013, compared to the same quarter of 2012. This reduction was a result of the Company selling the electrical papers product line to a customer in a prior year resulting in lower first quarter 2013 net sales, partially offset by increased net sales of cryogenic products. Life Sciences Filtration products net sales increased by \$0.5 million, in the current quarter compared to the first quarter of 2012, primarily from greater demand for water application products.

The segment reported operating income of \$1.3 million, in the first quarter of 2013, or 4.6% of net sales, compared to operating income of \$2.1 million, or 7.3% of net sales, in the first quarter of 2012. Operating income in the first quarter of 2012 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. The remaining decrease in operating income was the result of lower net sales of \$1.6 million in the first quarter of 2013 compared to the first quarter of 2012.

### *Thermal/Acoustical Metals*

In the first quarter of 2013, segment net sales of \$40.2 million were \$1.9 million lower than the first quarter of 2012. Automotive parts net sales decreased by \$4.7 million, or 12.4%, compared to the first quarter of 2012 primarily due to decreased demand from customers served by the Company's European automotive operations. Continued economic uncertainty in Europe has resulted in lower demand for automobiles by consumers. Tooling net sales in the first quarter of 2013 increased \$2.8 million, or 64.8%, compared to the first quarter of 2012 due to timing of new product launches.

For the first quarter of 2013, operating income for the segment was \$3.0 million, or 7.5% of net sales, compared to \$5.1 million, or 12.0% of net sales, in the first quarter of 2012. Contributing to the decrease in operating income was unfavorable mix in sales between automotive parts and tooling. Net sales of higher margin automotive parts decreased by \$4.7 million in the first quarter of 2013 compared to the first quarter of 2012. Lower net sales also contributed to unfavorable absorption of fixed overhead costs. Selling, product development and administrative costs increased by \$0.4 million in the first quarter of 2013 compared to the first quarter of 2012 primarily due to increases in selling expenses and administrative salaries and benefits expenses.

### *Thermal/Acoustical Fibers*

Segment net sales increased by \$5.8 million, or 26.0%, compared to the first quarter of 2012. Automotive parts net sales increased by \$5.7 million, or 25.5%, compared to the first quarter of 2012. This increase was driven by higher consumer demand for vehicles in North America on Lydall's existing platforms and new platform awards as well as net sales from a completed pricing negotiation and a non-recurring customer project. Tooling net sales in the first quarter of 2013 increased \$0.1 million compared to the first quarter of 2012 due to timing of new product launches.

The segment reported operating income in the first quarter of 2013 of \$6.2 million, or 22.0% of net sales, compared to operating income of \$2.2 million, or 10.1% of net sales, in the first quarter of 2012. This increase was due to higher net sales and improved gross margin realized from the mix of sales and reductions in scrap, material usage and labor costs and to a lesser extent \$1.8 million related to a completed pricing negotiation and a non-recurring customer project.

### ***Other Products and Services***

Life Sciences Vital Fluids net sales for the quarter ended March 31, 2013 increased \$0.1 million, or 1.8%, compared to the same quarter a year ago, primarily due to price increases.

Life Sciences Vital Fluids operating income was \$0.4 million, or 8.3% of net sales, for the quarter ended March 31, 2013, compared to operating income of \$0.3 million, or 7.3% of net sales, for the first quarter of 2012. This improvement was primarily due to higher net sales.

### *Corporate Office Expenses*

Corporate office expenses were \$4.3 million in the first quarter of 2013, essentially flat with the first quarter of 2012. Increases in salaries expense and accrued incentive compensation aggregating to \$0.4 million were offset by lower professional services expenses.

### **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 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 2013 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 March 31, 2013 and December 31, 2012, the majority of debt outstanding was capital lease obligations. As of March 31, 2013 and December 31, 2012, 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 March 31, 2013.

As of March 31, 2013, the Company had borrowing availability of \$32.5 million under the Domestic Credit Facility net of standby letters of credit outstanding of \$2.5 million. As of March 31, 2013, the Company's foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately \$11.5 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

#### *Operating Cash Flows*

Net cash used by operating activities in the first quarter of 2013 was \$3.2 million compared with net cash provided by operating activities of \$0.6 million in the first quarter of 2012. In the first quarter of 2013 compared to the same period for 2012, net income improved by \$0.6 million primarily due to improved operating income from the Thermal/Acoustical Fibers segment. Since December 31, 2012, net operating assets and liabilities increased by \$11.8 million, primarily due to increases in accounts receivable of \$9.8 million and inventory of \$6.7 million, partially offset by higher accounts payable of \$4.1 million due to timing of inventory purchases. The increase in accounts receivable was due to higher net sales in the last half of the first quarter of 2013 compared to the last half of the fourth quarter of 2012. The increase in inventory of \$6.7 million in 2013 was largely due to an increase in tooling inventory of \$3.9 million in preparation of new part launches and increased production activity in the first quarter of 2013.

### *Investing Cash Flows*

In the first quarter of 2013, net cash used for investing activities was \$2.5 million compared to net cash provided by investing activities of \$9.1 million in the first quarter of 2012. Capital expenditures were \$2.5 million during the first quarter of 2013, compared with \$3.0 million for the same period of 2012. Capital spending for full-year 2013 is expected to be approximately \$14.0 million to \$15.0 million. In the first quarter of 2012, the Company redeemed its \$12.0 million dollar short term investment, which was purchased in 2011.

### *Financing Cash Flows*

In the first quarter of 2013, net cash provided by financing activities was \$0.2 million compared to net cash used of \$0.4 million in the first quarter of 2012. Debt repayments were \$0.2 million and \$0.4 million for the first quarters of 2013 and 2012, respectively. The Company received \$0.7 million from the exercise of stock options in 2013, compared to minimal activity in the first quarter of 2012. The Company acquired \$0.3 million in company stock through withholding, pursuant to provisions in agreements with recipients of restricted stock granted under the company's equity compensation plan, which allows the Company to withhold the number of shares having fair value equal to each recipient's tax withholding due. There were no shares acquired in the first quarter of 2012.

### **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, 2012, 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 March 31, 2013.

During the fourth quarter of 2012, the Company performed an impairment analysis for long-lived assets at the Company's DSM Solutech B.V. ("Solutech") operation, included in the Performance Materials segment. Negative cash flows in 2012 combined with historical operating losses contributed to testing the Solutech asset group for recoverability. Negative cash flows were a result of a delay in commercialization of Solutech products to the market

place by Solutech's customers. The Company determined that the Solutech asset group had undiscounted cash flow in excess of its carrying value, and as a result, the asset group was not impaired at December 31, 2012. The estimate of undiscounted cash flows of the Solutech long-lived asset group was based on the best information available as of the date of the assessment, which incorporated management assumptions about expected future cash flows, as well as other market information. Based on developments with Solutech customers and the expectation of sales growth with other OEMs, the Company expects to meet the cash flow forecasts included in the impairment analysis. Future cash flows are dependent on the success of commercialization efforts of Solutech products by OEMs, the quality of Solutech products and technology advancements. Small changes in future operating results, compared to projections in the cash flow analysis, could result in a future non-cash impairment charge to income from operations.

### **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, 2012.

### **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 Executive 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 March 31, 2013. 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, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, 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 March 31, 2013 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

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 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**

On April 27, 2012, the Company's Board of Directors approved a stock repurchase program under which the Company may purchase up to 1.0 million shares. During the three months ended March 31, 2013, no shares were repurchased under the stock repurchase program. As reflected in the following table, during the three months ended March 31, 2013, the Company acquired 21,224 shares, with an average price paid per share of \$16.07, through withholding, pursuant to provisions in agreements with recipients of restricted stock granted under the Company's equity compensation, plans which allow the Company to withhold the number of shares having fair value equal to each recipient's tax withholding due:

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| Period                               | Total Number of Shares Purchased(1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Number of Shares That May Yet Be Purchased Under the Program |
|--------------------------------------|-------------------------------------|------------------------------|------------------------------------------------------------------------|----------------------------------------------------------------------|
| January 1, 2013 - January 31, 2013   | -                                   | -                            | -                                                                      | 690,333                                                              |
| February 1, 2013 - February 28, 2013 | 21,224                              | \$ 16.07                     | -                                                                      | 690,333                                                              |
| March 1, 2013 - March 31, 2013       | -                                   | -                            | -                                                                      | 690,333                                                              |
|                                      | 21,224                              | \$ 16.07                     | -                                                                      | 690,333                                                              |

Represents shares acquired and retained by the Company to satisfy tax withholding liability associated with awards (1) under the Company's equity compensation plans. These shares were not repurchased pursuant to the Company's stock repurchase program.

**Item 5. Other Information**

**Submission of Matters to a Vote of Security Holders**

The Company's Annual Meeting of Stockholders was held on April 26, 2013. Stockholders voted on three proposals presented to them for consideration:

**1.) Election of Nominees to the Board of Directors**

Stockholders elected eight Directors to serve until the next Annual Meeting to be held in 2014 and until their successors are duly elected and qualified. The results of the voting were as follows:

|                         | For        | Withheld | Broker Non-Votes |
|-------------------------|------------|----------|------------------|
| Dale G. Barnhart        | 14,103,838 | 163,821  | 1,256,366        |
| Kathleen Burdett        | 14,108,378 | 159,281  | 1,256,366        |
| W. Leslie Duffy         | 14,070,317 | 197,342  | 1,256,366        |
| Matthew T. Farrell      | 14,111,644 | 156,015  | 1,256,366        |
| Marc T. Giles           | 14,117,889 | 149,770  | 1,256,366        |
| William D. Gurley       | 14,111,805 | 155,854  | 1,256,366        |
| Suzanne Hammett         | 14,083,287 | 184,372  | 1,256,366        |
| S. Carl Soderstrom, Jr. | 14,110,758 | 156,901  | 1,256,366        |

**2.) Advisory Vote on Executive Compensation**

Stockholders voted to approve the executive compensation of the Company's named executive officers. The results of the voting were as follows:

|                   |            |
|-------------------|------------|
| For:              | 13,810,175 |
| Against:          | 67,424     |
| Abstain:          | 390,060    |
| Broker Non-Votes: | 1,256,366  |

**3.) Ratification of Appointment of Independent Auditors**

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Stockholders ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent auditors for fiscal year 2013. The results of the voting were as follows:

For: 15,426,598

Against: 97,248

Abstain: 179

**Item 6. Exhibits**

| <b>Exhibit Number</b> | <b>Description</b>                                                                                                                                                                                        |
|-----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 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. |
| 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.

May 1, 2013 By: /s/ Robert K. Julian

**Robert K. Julian**

**Executive 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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