NCI BUILDING SYSTEMS INC
Form 11-K
June 26, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 11-K

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

For the fiscal year ended December 31, 2013

OR

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

For the transition period from _____ to _____.

Commission file number: 1–143156-

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

NCI 401(k) Profit Sharing Plan

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

NCI Building Systems, Inc.

10943 North Sam Houston Parkway West
Houston, Texas 77064

NCI 401(K) PROFIT SHARING PLAN

December 31, 2013 and 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Audit Committee and 401(k) Benefits

Administration Committee

NCI 401(k) Profit Sharing Plan

We have audited the accompanying Statements of Net Assets Available for Benefits of NCI 401(k) Profit Sharing Plan (the “Plan”) as of December 31, 2013 and 2012, and the related Statements of Changes in Net Assets Available for Benefits for the years then ended. These financial statements are the responsibility of the Plan’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan’s control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2013 and 2012, and the changes in net assets available for benefits for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule, Schedule of Assets (Held at End of Year), as of December 31, 2013 is presented for the purpose of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by the Department of Labor’s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplemental schedule is the responsibility of the Plan’s management. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Houston, Texas

June 26, 2014

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NCI 401(k) Profit Sharing Plan

Statements of Net Assets Available for Benefits

December 31, 2013 and 2012

	2013	2012
Assets		
Cash, non-interest bearing	$9,659	$-
Investments, at fair value (See Notes 3 and 4):		
Money market fund	222,780	90,902
Registered investment companies (mutual funds)	113,971,262	92,346,149
Common collective trusts	76,368,953	69,670,273
NCI Building Systems, Inc. common stock	9,208,606	8,842,082
Total investments	199,771,601	170,949,406
Receivables:		
Participants' contributions	278,882	252,199
Employer contributions	1,018,877	994,237
Participant notes receivable	8,463,683	7,803,920
Total receivables	9,761,442	9,050,356
Net Assets Available for Benefits at Fair Value	209,542,702	179,999,762
Adjustment from Fair Value to Contract Value for Fully Benefit-responsive Investment Contracts	(365,896)	(1,318,901)
Net Assets Available for Benefits	$209,176,806	$178,680,861

The accompanying notes are an integral part of these financial statements

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NCI 401(k) Profit Sharing Plan

Statements of Changes in Net Assets Available for Benefits

For the Years Ended December 31, 2013 and 2012

	2013	2012
Additions to net assets attributed to:		
Investment income:		
Interest and dividends	$1,669,455	$1,808,234
Net appreciation in fair value of investments (See Note 3)	28,007,291	15,679,741
Total investment income	29,676,746	17,487,975
Interest from participant notes receivable	343,903	336,375
Contributions:		
Participants	9,988,050	9,194,775
Employer	3,728,598	3,448,851
Rollovers	689,455	4,593,295
Total contributions	14,406,103	17,236,921
Total additions	44,426,752	35,061,271
Deductions from net assets attributable to:		
Benefits paid directly to participants	13,665,095	13,454,433
Administrative expenses	265,712	234,033
Total deductions	13,930,807	13,688,466
Net Increase in Net Assets Available for Benefits	30,495,945	21,372,805
Net Assets Available for Benefits, Beginning of Year	178,680,861	157,308,056
Net Assets Available for Benefits, End of Year	$209,176,806	$178,680,861

The accompanying notes are an integral part of these financial statements

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NCI 401(k) Profit Sharing Plan

Notes to Financial Statements

December 31, 2013 and 2012

Note 1: Description of the Plan

The following description of NCI 401(k) Profit Sharing Plan (the “Plan”) provides only general information. Participants should refer to the *Summary Plan Description* for a more complete description of the Plan’s provisions, which is available from the Plan administrator.

General

The Plan, established January 15, 1992, is a defined contribution plan covering all eligible employees of NCI Building Systems, Inc. and its affiliates (the “Company”) who have completed three months of service, as defined by the Plan, are employed on the first day of the calendar quarter, and are age 18 or older.

The Plan has been amended from time to time. Effective June 21, 2012, the Plan was amended as a result of the acquisition of Metl-Span LLC ("Metl-Span"). The provisions of the amendment include (i) permitting the rollover of outstanding participant plan loans made to employees of Metl-Span; (ii) recognizing, for purposes of the Plan, the service with Metl-Span performed by Metl-Span employees as a result of the acquisition and to add a special enrollment date of June 21, 2012 for such employees; (iii) allowing employees and former employees of Metl-Span, who subsequently become participants in the Plan as a result of the acquisition, to be fully vested in their matching contribution sub-accounts; and (iv) adding provisions to expand the Plan's eligibility provisions in connection with acquisitions. On June 21, 2012, the Plan received rollovers totaling $3,493,749 as a result of the acquisition of Metl-Span.

Effective January 1, 2013, the Plan was amended and restated in the form of a nonstandardized prototype plan sponsored by Wells Fargo Bank, N.A. to incorporate all previous amendments, as well as to adopt provisions to provide for Roth deferred contributions.

The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”).

Contributions

Participants may contribute a minimum of 1% up to a maximum of 50% of their annual compensation, limited to the maximum limit determined annually by the Internal Revenue Service. Highly compensated employees may defer a maximum of 7% of their annual compensation.

The Company may make a discretionary contribution in an amount determined by the Plan sponsor. During the years ended December 31, 2013 and 2012, the Company made discretionary contributions totaling $3,728,598 and $3,448,851, respectively, of which $1,018,877 and $994,237, respectively, are included in employer contributions receivable.

Participants direct the investment of their contributions, as well as the Company’s contribution, into various investment options offered by the Plan. The Plan currently offers a variety of mutual funds, common collective trust funds, separately managed funds, and the NCI Common Stock Fund as investment options for participants.

NCI 401(k) Profit Sharing Plan

Notes to Financial Statements

December 31, 2013 and 2012

Participant Accounts

Each participant's account is credited with the participant's contribution, the Company's contribution and Plan earnings, and is charged with an allocation of administrative expenses. Allocations of expenses are based on participant earnings or account balances, as defined in the Plan document. The benefit to which a participant is entitled is the benefit that can be provided from the participant's vested account balance.

Vesting and Forfeitures

Participants are immediately vested in their voluntary contributions plus earnings thereon. Vesting in the Company's contribution portion of their accounts plus earnings thereon is based on years of continuous service. A participant is fully vested after 6 years of continuous service, except as otherwise provided in the Plan with respect to the accounts of certain participants who were employees of companies acquired by the Company.

A participant becomes fully vested upon death, becoming disabled (as defined in the Plan) or attaining age 65; otherwise, the non-vested balance is forfeited upon termination of service. Forfeitures may be used to pay for Plan administrative expenses and to reduce employer matching contributions. At December 31, 2013 and 2012, forfeited non-vested accounts totaled approximately $17,515 and $40,484, respectively. For the years ended December 31, 2013 and 2012, plan fees totaling approximately $28,342 and $21,724, respectively, were paid from forfeited non-vested accounts. For the years ended December 31, 2013 and 2012, employer contributions were reduced by $10,000 and $17,000, respectively, from forfeited non-vested accounts. During the years ended December 31, 2013 and 2012, employer contributions were reinstated for participants in the amount of $24,437 and $0, respectively, from forfeited non-vested accounts.

Payment of Benefits

Upon termination of service, a participant may elect to receive a lump-sum amount equal to the vested value of his account, NCI Common Stock at the value of the NCI Common Stock Fund, or subject to minimum distribution rules described in the Plan, continue in the trust in such a manner as though the employee had not terminated his eligibility (if the participant's account balance is greater than $5,000, excluding rollover contributions).

Participant Notes Receivable

Participants may borrow from their fund accounts a minimum of $1,000 up to a maximum of $50,000 or 50 percent of their vested account balance, whichever is less. The loans are secured by the balance in the participants' account and bear interest at rates that are commensurate with local prevailing rates as determined by the Plan administrator. Interest rates on outstanding participant notes receivable ranged from 4.25% to 10.25% at December 31, 2013 and 2012.

Plan Termination

Although it has not expressed an intention to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan, subject to the provisions of ERISA. In the event of Plan termination, participants will become 100% vested in their accounts.

NCI 401(k) Profit Sharing Plan

Notes to Financial Statements

December 31, 2013 and 2012

Note 2: Summary of Significant Accounting Policies

Basis of Accounting

The financial statements of the Plan are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

As described in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 962, *Defined Benefit Pension Plans,* investment contracts held by a defined-contribution plan are required to be reported at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined-contribution plan attributable to fully benefit-responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the Plan. At December 31, 2013 and 2012, investments in the accompanying Statements of Net Assets Available for Benefits include a common collective trust, i.e., the Wells Fargo Stable Return Fund N25, which is a fully benefit-responsive investment contract. The Statements of Net Assets Available for Benefits present the fair value of the investment contract, as well as the adjustment of the fully benefit-responsive investment contract from fair value to contract value. The Statements of Changes in Net Assets Available for Benefits are prepared on a contract value basis.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Risks and Uncertainties

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the Statements of Net Assets Available for Benefits.

Valuation of Investments and Income Recognition

The Plan investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 4 for discussion of fair value measurements.

Net appreciation in fair value of investments includes realized gains and losses on investments sold during the year and unrealized appreciation (depreciation) of investments held at the end of the year. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

NCI 401(k) Profit Sharing Plan

Notes to Financial Statements

December 31, 2013 and 2012

Participant Notes Receivable

Participant notes receivable are measured at their unpaid principal balance plus any accrued but unpaid interest. Delinquent participant loans are reclassified as distributions based upon the terms of the Plan document. No allowance for credit losses has been recorded as of December 31, 2013 and 2012.

Benefit Payments

Benefit payments to participants are recorded upon distribution.

Administrative Expenses

Certain expenses of maintaining the Plan are paid directly by the Company and are excluded from these financial statements. Fees related to the administration of notes receivable from participants are charged directly to the participant’s account and are included in administrative expenses. Investment related expenses are included in net appreciation of fair value of investments.

Expense Offset Arrangements

Fees incurred by the Plan for the investment management services or recordkeeping are included in net appreciation in fair value of investments, as they are paid through revenue sharing, rather than a direct payment.

Note 3: Investments

The following table presents the Plan's investments at fair value. Investments that represent 5% or more of the Plan's net assets at December 31, 2013 and 2012 are separately identified.

	2013	2012
Wells Fargo Stable Return Fund N25	$46,103,005	$46,798,233
Wells Fargo/Blackrock S&P 500 Index Fund N	30,265,948	22,872,040
Vanguard Target Retirement 2020 Fund	13,671,178	10,651,294
Investments less than 5% of the Plan's net assets	109,731,470	90,627,839
Total investments	$199,771,601	$170,949,406

During the years ended December 31, 2013 and 2012, the Plan's investments (including gains and losses on investments bought, sold and held during the year) appreciated in value by $28,007,291 and $15,679,741, respectively.

	2013	2012
Mutual funds	$17,988,193	$9,605,256
NCI Building Systems, Inc. Common Stock Fund	2,039,392	2,167,217
Common collective trusts	7,979,706	3,907,268
Net appreciation in fair value	$28,007,291	$15,679,741

NCI 401(k) Profit Sharing Plan

Notes to Financial Statements

December 31, 2013 and 2012

Interest and dividends realized on the Plan's investments for the years ended 2013 and 2012 were $1,669,455 and $1,808,234, respectively.

Note 4: Fair Value Measurements

ASC 820, *Fair Value Measurements and Disclosures*, defines fair value and establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2 Inputs to the valuation methodology include: 1) quoted prices for similar assets or liabilities in active markets; 2) quoted prices for identical or similar assets or liabilities in inactive markets; 3) inputs other than quoted prices that are observable for the asset or liability; and 4) inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the *Level 2* input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

In determining the fair value, the Plan uses two different approaches (the market approach and the income approach), depending on the nature of the assets and liabilities. The market approach uses prices and other relevant data based on market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts such as cash flows or earnings to a single present amount, with the measurement based on the value indicated by current market expectations about those future amounts.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2013 and 2012.

Common stock: Valued at the closing price reported on the active market on which the individual securities are traded (Market approach).

Mutual funds: Valued at the daily closing price as reported by the fund. Mutual funds held by the Plan are open-ended mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value ("NAV") and to transact at that price. The mutual funds held by the Plan are deemed to be actively traded. (Market approach)

NCI 401(k) Profit Sharing Plan

Notes to Financial Statements

December 31, 2013 and 2012

Common collective trusts: Valued at the NAV of units of a collective trust. The NAV, as provided by the trustee, is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. (Income approach).

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables set forth by level, within the fair value hierarchy, the Plan's assets at fair value as of December 31, 2013 and 2012:

	Investments at Fair Value as of December 31, 2013			
	Level 1	Level 2	Level 3	Total
Mutual Funds:				
Index Funds	$ 56,228,358	$ -	$ -	$ 56,228,358
Total Mutual Funds	56,228,358	-	-	56,228,358
Separately Managed Funds:				
Mutual Funds:				
Equity Funds	-	30,612,988	-	30,612,988
Growth & Income Funds	-	20,323,068	-	20,323,068
Index Funds	-	6,806,848	-	6,806,848
Total Mutual Funds	-	57,742,904	-	57,742,904
Common Collective Trusts	-	30,265,948	-	30,265,948
Total Separately Managed Funds	-	88,008,852	-	88,008,852
NCI Common Stock Fund				
NCI Common Stock	9,208,606	-	-	9,208,606
Money Market Fund	222,780	-	-	222,780
Total NCI Common Stock Fund	9,431,386	-	-	9,431,386
Common Collective Trusts	-	46,103,005	-	46,103,005

Total Investments at Fair Value	**$ 65,659,744**	**$ 134,111,857**	**$ -**	**$ 199,771,601**

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NCI 401(k) Profit Sharing Plan

Notes to Financial Statements

December 31, 2013 and 2012

	Investments at Fair Value as of December 31, 2012					
	Level 1	Level 2	Level 3	Total		
Mutual Funds:						
Index Funds	$43,899,971	$ -	$ -	$43,899,971		
Total Mutual Funds	43,899,971	-	-	43,899,971		
Separately Managed Funds:						
Mutual Funds:						
Equity Funds	-	18,138,907	-	18,138,907		
Growth & Income Funds	-	25,195,389	-	25,195,389		
Index Funds	-	5,111,882	-	5,111,882		
Total Mutual Funds	-	48,446,178	-	48,446,178		
Common Collective Trusts	-	22,872,040	-	22,872,040		
Total Separately Managed Funds	-	71,318,218	-	71,318,218		
NCI Common Stock Fund						
NCI Common Stock	8,842,082	-	-	8,842,082		
Money Market Fund	90,902	-	-	90,902		
Total NCI Common Stock Fund	8,932,984	-	-	8,932,984	44	(3)
Income before income taxes	23,149	19,075				
Income tax expense	8,127	4,696				
Net income	$15,022	$14,379				
Earnings per share:						
Basic	$0.90	$0.86				
Diluted	$0.89	$0.85				
Weighted average number of common shares outstanding:						
Basic	16,599	16,742				
Diluted	16,888	16,978				

See accompanying Notes to Condensed Consolidated Financial Statements.

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LYDALL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	Quarter Ended September 30, 2013 (Unaudited)	2012	Nine Months Ended September 30, 2013 (Unaudited)	2012
Net income	$ 4,575	$ 3,875	$ 15,022	$ 14,379
Other comprehensive income:				
Foreign currency translation adjustments	2,772	1,039	1,774	(617)
Pension liability adjustment, net of tax	166	138	497	415
Comprehensive income	$ 7,513	$ 5,052	$ 17,293	$ 14,177

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	2013 (Unaudited)	2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 59,996	$ 63,623
Accounts receivable, less allowances (2013 - $441; 2012 - $469)	63,708	47,486
Inventories	38,576	31,292
Prepaid expenses and other current assets	10,260	9,400
Total current assets	172,540	151,801
Property, plant and equipment, at cost	260,616	249,206
Accumulated depreciation	(183,464)	(172,952)
Net, property, plant and equipment	77,152	76,254
Goodwill	18,491	18,282
Other intangible assets	3,553	3,825
Other assets, net	1,049	1,754
Total assets	$ 272,785	$ 251,916
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 718	$ 765
Accounts payable	34,317	29,441
Accrued payroll and other compensation	9,158	10,273
Accrued taxes	469	1,728
Other accrued liabilities	5,869	4,143
Total current liabilities	50,531	46,350
Long-term debt	1,201	1,646
Deferred tax liabilities	6,989	3,902
Benefit plan liabilities	24,087	25,080
Other long-term liabilities	2,073	442
Commitments and Contingencies (Note 11)		
Stockholders' equity:		
Preferred stock	-	-
Common stock	2,404	2,379
Capital in excess of par value	61,285	58,784
Retained earnings	216,119	201,097
Accumulated other comprehensive loss	(16,095)	(18,366)
Treasury stock, at cost	(75,809)	(69,398)
Total stockholders' equity	187,904	174,496
Total liabilities and stockholders' equity	$ 272,785	$ 251,916

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	September 30, 2013 (Unaudited)	2012
Cash flows from operating activities:		
Net income	$ 15,022	$ 14,379
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of product line	-	(810)
Depreciation and amortization	9,586	10,346
Deferred income taxes	2,722	(687)
Stock based compensation	1,187	1,040
Loss on disposition of property, plant and equipment	234	101
Changes in operating assets and liabilities:		
Accounts receivable	(15,768)	(11,136)
Inventories	(6,950)	810
Accounts payable	4,635	5,678
Accrued payroll and other compensation	(1,253)	(16)
Accrued taxes	(1,247)	401
Other, net	2,740	(895)
Net cash provided by operating activities	10,908	19,211
Cash flows from investing activities:		
Proceeds from maturity of short-term investment	-	12,015
Capital expenditures	(9,502)	(7,945)
Proceeds from sale of product line	-	1,000
Acquisition earn out payments	(158)	-
Net cash (used for) provided by investing activities	(9,660)	5,070
Cash flows from financing activities:		
Debt repayments	(536)	(778)
Common stock issued	1,204	303
Common stock repurchased	(6,411)	(3,076)
Excess tax benefit on stock awards	197	-
Net cash used for financing activities	(5,546)	(3,551)
Effect of exchange rate changes on cash	671	(124)
(Decrease) increase in cash and cash equivalents	(3,627)	20,606
Cash and cash equivalents at beginning of period	63,623	30,905
Cash and cash equivalents at end of period	$ 59,996	$ 51,511

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 condensed 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 Accounting Standard Update ("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 the ASU had no effect on the Company's condensed consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (Topic 220), which requires 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 ASU was effective for fiscal years beginning after December 15, 2012. The Company adopted this ASU and revised its disclosure, as required, beginning with the first quarter of 2013. See Note 12, Changes in Accumulated Other Comprehensive Income (Loss).

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (Topic 740). This ASU requires entities to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in their financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The objective of this update is to eliminate the diversity in practice in the presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The ASU is effective for fiscal years beginning after December 15, 2013. The Company is currently evaluating this new guidance and believes its adoption will not have a significant impact on our condensed consolidated financial statements.

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2. Inventories

Inventories as of September 30, 2013 and December 31, 2012 were as follows:

In thousands	September 30, 2013	December 31, 2012
Raw materials	$ 13,940	$ 12,501
Work in process	17,832	12,800
Finished goods	9,621	10,549
	41,393	35,850
Less: Progress billings	(2,817)	(4,558)
Total inventories	$ 38,576	$ 31,292

Included in work in process is gross tooling inventory of $11.8 million and $8.0 million at September 30, 2013 and December 31, 2012, respectively. Tooling inventory, net of progress billings, was $9.0 million and $3.5 million at September 30, 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 nine months ended September 30, 2013 were as follows:

In thousands	December 31, 2012	Currency translation adjustments	Other adjustments	September 30, 2013
Performance Materials	$ 13,622	$ 119	$ 90	$ 13,831
Other Products and Services	4,660	-	-	4,660
Total goodwill	$ 18,282	$ 119	$ 90	$ 18,491

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 net revenues of 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 September 30, 2013, the only debt outstanding was capital lease obligations and as of December 31, 2012, the majority of debt outstanding was capital lease obligations. As of September 30, 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 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.

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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 1.0 to 1.0 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 September 30, 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 September 30, 2013, the Company had borrowing availability of $32.4 million under the Domestic Credit Facility net of standby letters of credit outstanding of $2.6 million. As of September 30, 2013, the Company's foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately $12.2 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

5. Equity Compensation Plans

As of September 30, 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, authorizes 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 types of awards: options, restricted stock, restricted stock units and other stock-based awards.

The Company incurred compensation expense of $0.5 million and $0.2 million for the quarters ended September 30, 2013 and September 30, 2012, respectively, and $1.2 million and $1.0 million for the nine months ended September 30, 2013 and September 30, 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 September 30, 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 September 30, 2013	726	$ 9.71	6.1	$ 5,422
Exercisable at September 30, 2013	422	$ 9.01	4.4	$ 3,456
Expected to Vest at September 30, 2013	290	$ 10.70	8.4	$ 1,878

There were no stock options granted and 30,074 stock options exercised during the quarter ended September 30, 2013 and 12,500 stock options granted and 128,060 stock options exercised during the nine months ended September 30,

2013. The amount of cash received from the exercise of stock options was $0.3 million during the quarter ended September 30, 2013 and $1.2 million during the nine months ended September 30, 2013. The intrinsic value of stock options exercised was $0.2 million with a minimal tax benefit during the quarter ended September 30, 2013 and the intrinsic value of stock options exercised was $0.7 million with a tax benefit of $0.2 million for the nine months ended September 30, 2013. There were 20,000 stock options granted during the quarter and nine months ended September 30, 2012. The amount of cash received from the exercises of stock options was $0.1 million and $0.3 million during the quarter and nine months ended September 30, 2012, respectively. The intrinsic value of options exercised was $0.1 million and $0.2 million during the quarter and nine months ended September 30, 2012, respectively, with minimal tax benefit. At September 30, 2013, the total unrecognized compensation cost related to non-vested stock option awards was approximately $1.2 million, with a weighted average expected amortization period of 2.7 years.

Restricted Stock

Restricted stock includes both performance-based and time-based awards. There were 5,000 time-based restricted shares granted during the nine months ended September 30, 2013 and no shares granted in the third quarter of 2013. There were 84,790 performance-based restricted shares granted during the nine months ended September 30, 2013, which have a 2015 earnings per share target, and there were no shares granted in the third quarter of 2013. During the nine months ended September 30, 2013, there were 61,800 performance-based shares that vested in accordance with Plan provisions. There were 3,750 time-based shares that vested in the third quarter and nine months ended September 30, 2013. At September 30, 2013, there were 313,985 unvested restricted stock awards with total unrecognized compensation cost related to these awards of $1.5 million with a weighted average expected amortization period of 2.2 years. Compensation expense for performance based awards is recorded based on management's assessment of the probability of achieving the performance goals and service period.

6. Stock Repurchases

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 approximately 423,000 shares of its common stock at an average price of $14.30 per share for an aggregate purchase price of $6.1 million during the nine months ended September 30, 2013 under the 2012 Stock Repurchase Program. As of September 30, 2013, there were 267,089 shares remaining and authorized for repurchase under the 2012 Stock Repurchase Program.

During the nine months ended September 30 2013, the Company purchased 22,236 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 September 30, 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 $0.3 million were made during the third quarter of 2013 and $0.9 million were made for the nine months ended September 30, 2013. Contributions of $1.1 million were made during the third quarter of 2012 and $2.1 million were made for the nine months ended September 30, 2012.

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 and nine months ended September 30, 2013 and 2012:

	Quarter Ended September 30,		Nine Months Ended September 30,	
In thousands	2013	2012	2013	2012
Components of net periodic benefit cost				
Interest cost	$ 614	$ 648	$ 1,841	$ 1,944
Expected return on assets	(673)	(640)	(2,019)	(1,920)
Amortization of actuarial loss	267	224	801	671

Net periodic benefit cost	$ 208	$ 232	$ 623	$ 695

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8. Income Taxes

The Company's effective tax rate was 37.5% and 24.4% for the quarters ended September 30, 2013 and 2012, respectively, and 35.1% and 24.6% for the nine months ended September 30, 2013 and 2012, respectively. The difference in the Company's effective tax rate for the nine months ended September 30, 2013 compared to statutory federal income tax rates was primarily due to a discrete tax benefit of $0.5 million, recorded in the first quarter of 2013, as the Company concluded certain U.S. federal income tax matters through the year ended December 31, 2009. The difference in the Company's effective tax rate for the quarter and nine months ended September 30, 2012 compared to the statutory federal income tax rates was primarily due to reversal of valuation allowance against foreign tax credit carryovers in the amounts of $0.5 million and $2.6 million, respectively.

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 2009, 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 and nine months ended September 30, 2013 and 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 antidilutive.

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
In thousands	2013	2012	2013	2012
Basic average common shares outstanding	16,437	16,630	16,599	16,742
Effect of dilutive options and restricted stock awards	298	313	289	236
Diluted average common shares outstanding	16,735	16,943	16,888	16,978

For the quarters and nine months ended September 30, 2013 and 2012, stock options for 0.2 million shares of common stock, for each period, 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.

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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 components 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 fields. The Manniglas® Thermal Insulation brand is diverse in its product application, ranging from high temperature seals and gaskets in ovens to specialty veils for HVAC and cavity wall insulation. The appLY® 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 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, vans, trucks, SUVs, 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® shield 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. The recently developed and patented CLD (constraint layer damped) material used in our heat shields 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 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, and exhaust) and under hood (engine compartment) of cars, vans, trucks, SUVs, heavy duty trucks and recreational vehicles.

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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® composite is a lightweight acoustical composite that emphasizes absorption principles over heavy-mass type systems. Lydall's dBLyte® barrier 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® barrier 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 nine months ended September 30, 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 September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
Performance Materials Segment:				
Industrial Filtration	$ 15,536	$ 17,035	$ 50,089	$ 53,320
Industrial Thermal Insulation	9,877	10,647	26,612	30,497
Life Sciences Filtration	2,447	3,128	7,610	8,604
Performance Materials Segment net sales	27,860	30,810	84,311	92,421
Thermal/Acoustical Metals Segment:				
Metal parts	32,910	31,347	101,976	104,893
Tooling	2,939	5,249	14,995	11,501
Thermal/Acoustical Metals Segment net sales	35,849	36,596	116,971	116,394
Thermal/Acoustical Fibers Segment:				
Fiber parts	26,642	23,484	80,884	69,821
Tooling	4,533	146	6,177	891
Thermal/Acoustical Fibers Segment net sales	31,175	23,630	87,061	70,712
Other Products and Services:				
Life Sciences Vital Fluids	4,114	4,326	12,684	12,306
Other Products and Services net sales	4,114	4,326	12,684	12,306
Eliminations and Other	(1,003)	(1,195)	(2,952)	(3,377)
Consolidated Net Sales	$ 97,995	$ 94,167	$ 298,075	$ 288,456

Operating income by segment:

In thousands	Quarter Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
Performance Materials	$ 2,419	$ 3,325	$ 6,967	$ 10,427
Thermal/Acoustical Metals	3,742	2,612	11,191	11,729
Thermal/Acoustical Fibers	5,206	3,445	16,792	9,056
Other Products and Services	112	354	593	874
Corporate Office Expenses	(4,093)	(4,536)	(12,119)	(12,741)
Consolidated Operating Income	$ 7,386	$ 5,200	$ 23,424	$ 19,345

11. Commitments and Contingencies

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, actions with respect to commercial, intellectual property, employment, personal injury and environmental matters. While the outcome of any matter is inherently uncertain and the Company cannot be sure that it will prevail in any of the cases, 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 September 30, 2013:

In thousands	Foreign Currency Translation Adjustment	Defined Benefit Pension Adjustment	Total Accumulated Other Comprehensive (Loss) Income
Balance at December 31, 2012	$ 3,178	$ (21,544)	$ (18,366)
Other Comprehensive income	1,774	-	1,774
Amounts reclassified from accumulated other comprehensive income (a)	-	497	497
Balance at September 30, 2013	$ 4,952	$ (21,047)	$ (16,095)

(a) Amount represents amortization of actuarial losses, a component of net periodic benefit cost. This amount was $0.2 million, net of a $0.1 million tax benefit, for the quarter ended September 30, 2013, and $0.5 million, net of a $0.3 million tax benefit, for the nine months ended September 30, 2013. 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 innovative engineered products to assist in noise and heat abatement within the transportation sector. These products are found in the interior (dash insulators), underbody (wheel well, fuel tank, and exhaust) and under hood (engine compartment) of cars, vans, trucks, SUVs, 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.

Third Quarter 2013 Highlights

Below are financial highlights comparing Lydall's quarter ended September 30, 2013 ("Q3 2013") results to its quarter ended September 30, 2012 ("Q3 2012") results:

- Net sales were $98.0 million, an increase of $3.8 million, or 4.1%, compared to Q3 2012;
  - Foreign currency translation positively impacted net sales by $1.6 million, or 1.6%.
- Gross margin increased to 20.9%, compared to 20.5% in Q3 2012, principally caused by improvement in the Thermal/Acoustical Metals segment;
- Selling, product development and administrative expenses were $13.1 million, or 13.4% of net sales, compared to $14.1 million, or 14.9% of net sales in Q3 2012;
- Operating income was $7.4 million, or 7.5% of net sales, compared to operating income of $5.2 million, or 5.5% of net sales, in Q3 2012;
- Net income was $4.6 million, or $0.27 per diluted share, compared to $3.9 million, or $0.23 per diluted share, in Q3 2012;
  - Effective tax rate of 37.5% in Q3 2013 compared to 24.4% in Q3 2012, which included the reversal of valuation allowance of $0.5 million, or a benefit of $0.03 per diluted share.
- Cash balance of $60.0 million as of September 30, 2013, compared to $63.6 million at December 31, 2012; and

- During the first nine months of 2013, cash of $6.1 million was used to purchase approximately 423,000 shares of the Company's common stock under a share repurchase program.

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Operational and Financial Overview

Net sales for the third quarter of 2013 were $98.0 million, an increase of $3.8 million, or 4.1%, compared to the third quarter of 2012, from higher net sales of $7.5 million in the Thermal/Acoustical Fibers segment. The Thermal/Acoustical Fibers segment continued to benefit from increased production of vehicles on Lydall's platforms in North America resulting in greater parts net sales of $3.1 million, as well as increased tooling revenues of $4.4 million to support the launch of new vehicle platforms. Lower net sales were reported in the third quarter of 2013, compared to the third quarter of 2012, by the Performance Materials segment of $3.0 million, Thermal/Acoustical Metals segment of $0.7 million, and the Life Sciences Vital Fluids business of $0.2 million. Lower net sales for the Performance Materials segment were primarily due to lower global demand for Industrial Filtration products of $1.5 million, primarily air filtration products. Also, net sales of Industrial Thermal Insulation products in the Performance Materials segment decreased by $0.8 million, due to the divestiture of a product line in a prior year. Foreign currency translation had a favorable impact of $1.6 million, or 1.6% of net sales, in the third quarter of 2013 compared to the third quarter of 2012.

Consolidated operating income was $7.4 million in the third quarter of 2013 compared to $5.2 million in the third quarter of 2012. The increase in operating income was attributable to the Company's Thermal/Acoustical Fibers and Thermal/Acoustical Metals segments, with increases in operating income of $1.8 million and $1.1 million, respectively. The Thermal/Acoustical Metals segment's third quarter 2012 operating income included an unfavorable $0.5 million customer pricing adjustment. These increases were offset to some extent by a decrease in operating income in the Performance Materials segment of $0.9 million and the Life Sciences Vital Fluids business of $0.2 million, each in the third quarter of 2013 compared to the third quarter of 2012. Operating income for the Company in the third quarter of 2013 was favorably impacted by lower selling, product development and administrative expenses of $1.0 million, due to lower severance and recruiting charges of $0.9 million and professional services of $0.8 million, primarily at the corporate office, partially offset by company-wide higher salaries and benefits expense. Foreign currency translation had a minimal impact on operating income in the third quarter of 2013 compared to the third quarter of 2012.

Consolidated operating margin in the third quarter of 2013 was 7.5% compared to 5.5% in the third quarter of 2012. This increase was primarily due to an improvement in the Thermal/Acoustical Metals segment as a result of lower raw material costs, favorable absorption of fixed overhead costs, and a favorable mix between parts and tooling net sales as higher margin part sales increased by $1.6 million while lower margin tooling sales decreased by $2.3 million in the third quarter of 2013 compared to the third quarter of 2012. Higher net sales and lower selling costs from the Thermal/Acoustical Fibers segment also contributed to improved operating margin. These increases in operating margin were partially offset by a decrease in the third quarter of 2013 operating margin in the Performance Materials segment primarily due to lower net sales, lower absorption of fixed overhead costs, and an unfavorable mix among product net sales.

Liquidity

At September 30, 2013, the only debt outstanding was capital lease obligations. The Company had a cash balance of $60.0 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 September 30, 2013, the Company had borrowing availability of $32.4 million under the Domestic Credit Facility net of standby letters of credit outstanding of $2.6 million. As of September 30, 2013, the Company's foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately $12.2 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

Outlook

Overall, Lydall's operating results for the third quarter of 2013 in comparison to the third quarter of 2012 were positively impacted by increased automotive parts sales for the Thermal/Acoustical Fibers and Thermal/Acoustical Metals segments in North America on existing platforms and new platform launches. This strong demand for automotive parts helped to offset lower demand for certain product lines within the Company's Performance Materials segment. Also impacting the improved operating results in the third quarter of 2013 compared to the third quarter of 2012 was lower administrative costs primarily at the corporate office, due to lower professional services, recruiting and severance costs.

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Entering the final quarter of 2013, the Company expects global demand for products to remain stable with the most recent quarter. The Company expects operating results in the fourth quarter of 2013 to be impacted by an unfavorable shift in product mix and by seasonality, which effects production activity and absorption of fixed costs. The Company anticipates that tooling sales related to the Thermal/Acoustical Metals and Fibers segments will be robust as Lydall continues to win new vehicle platforms. In addition, the Company is in the process of establishing a new Thermal/Acoustical Metals manufacturing facility outside of Shanghai, China. The business remains on schedule to be fully operational in the first half of 2014.

Results of Operations

Note: All of the following tabular comparisons, unless otherwise indicated, are for the quarters ended September 30, 2013 (Q3-13) and September 30, 2012 (Q3-12) and for the nine months ended September 30, 2013 (YTD-13) and September 30, 2012 (YTD-12).

Net Sales

	Quarter Ended			Nine Months Ended		
In thousands	Q3-13	Q3-12	Percent Change	YTD-13	YTD-12	Percent Change
Net sales	$ 97,995	$ 94,167	4.1 %	$ 298,075	$ 288,456	3.3 %

Net sales for the third quarter ended September 30, 2013 increased by $3.8 million, or 4.1%, compared to the third quarter ended September 30, 2012. This increase was due to higher sales volumes for the Thermal/Acoustical Fibers segment resulting in higher net sales of $7.5 million, or 31.9%, primarily related to tooling net sales, compared to the same quarter a year ago. This increase was partially offset by decreases in net sales from the Performance Materials segment of $3.0 million, or 9.6%, the Thermal/Acoustical Metals segment of $0.7 million, or 2.0%, and OPS of $0.2 million, or 4.9%, compared to the same quarter a year ago. Foreign currency translation increased net sales by $1.6 million, or 1.6%, for the current quarter, compared with the third quarter of 2012, positively impacting the Thermal/Acoustical Metals segment by $1.1 million, or 2.9%, and the Performance Materials segment by $0.5 million, or 1.6%.

Net sales for the nine months ended September 30, 2013 increased by $9.6 million, or 3.3%, compared to the nine months ended September 30, 2012. The increase was primarily due to higher sales volumes for the Thermal/Acoustical Fibers segment resulting in higher net sales of $16.3 million, or 23.1%, as parts net sales increased by $11.1 million, or 15.8%. Thermal/Acoustical Metals net sales increased by $0.6 million, or 0.5%, due to foreign currency translation, compared to the same period of 2012. Net sales of OPS, for the nine months ended September 30, 2013, increased by $0.4 million, or 3.1%, compared to the same period of 2012. These increases were partially offset by lower sales volumes for the Performance Materials segment of $8.1 million, or 8.8%, compared to the same period of 2012. Foreign currency translation increased net sales by $2.3 million, or 0.8%, for the nine months ended September 30, 2013, compared with the first nine months of 2012, positively impacting the Thermal/Acoustical Metals segment by $1.5 million, or 1.3%, and the Performance Materials segment by $0.7 million, or 0.8%.

Gross Profit

	Quarter Ended			Nine Months Ended		
In thousands	Q3-13	Q3-12	Percent Change	YTD-13	YTD-12	Percent Change
Gross profit	$ 20,494	$ 19,269	6.4 %	$ 64,896	$ 60,503	7.3 %

Gross margin	20.9	%	20.5	%	21.8	%	21.0	%

Gross margin for the third quarter of 2013 was 20.9% compared to 20.5% in the third quarter of 2012. The primary contributor to the improved gross margin was the Thermal/Acoustical Metals segment, which reported improved gross margin as a result of lower raw material costs, improved absorption of fixed overhead costs, and a favorable mix between higher margin parts and lower margin tooling net sales in the third quarter of 2013 compared to the third quarter of 2012. Partially offsetting this improved gross margin was lower gross margin associated with the Performance Materials segment primarily as a result of lower sales volume, unfavorable absorption of fixed overhead costs, and an unfavorable mix among product sales. Changes in Thermal/Acoustical Fibers gross margin had minimal impact on the Company’s overall gross margin in the third quarter of 2013 compared to the third quarter of 2012.

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Gross margin for the nine months ended September 30, 2013 was 21.8% compared to 21.0% in the first nine months of 2012. The primary contributor to the improved gross margin was the Thermal/Acoustical Fibers segment which reported lower raw material costs, improved absorption of fixed overhead costs, labor efficiencies and other costs savings. This improvement was offset to some extent by lower gross margin associated with the Performance Materials segment primarily as a result of lower sales volume, unfavorable absorption of fixed overhead costs as well as an unfavorable mix among product sales.

Selling, Product Development and Administrative Expenses

	Quarter Ended			Nine Months Ended		
In thousands	Q3-13	Q3-12	Percent Change	YTD-13	YTD-12	Percent Change
Selling, product development and administrative expenses	$ 13,108	$ 14,069	(6.8) %	$ 41,472	$ 41,968	(1.2) %
Percentage of sales	13.4 %	14.9 %		13.9 %	14.5 %	

Selling, product development and administrative expenses for the quarter ended September 30, 2013 decreased by $1.0 million compared to the quarter ended September 30, 2012. This decrease is due to lower severance and recruiting costs of $0.9 million, primarily at the corporate office, and lower professional service expenses of $0.8 million, principally associated with exploring strategic initiatives in the third quarter of 2012. These decreased expenses were partially offset by an increase of $0.8 million in salaries and benefits expenses, primarily due to increased headcount and annual salary increases.

Selling, product development and administrative expenses for the nine months ended September 30, 2013 decreased by $0.5 million compared to the same period of 2012, primarily due to lower professional services of $1.3 million, principally associated with exploring strategic initiatives in the prior year, lower severance and recruiting costs of $0.8 million, primarily at the corporate office, and lower sales commission expenses of $0.6 million. These decreased expenses were partially offset by an increase of $2.2 million associated with higher salaries, benefits and accrued incentive compensation, due to increased headcount, annual salary increases and accruing higher expected payouts on the Company's incentive bonus program.

Gain on Sale of Product Line

	Quarter Ended			Nine Months Ended		
In thousands	Q3-13	Q3-12	Percent Change	YTD-13	YTD-12	Percent Change
Gain on sale of product line, net	$ -	$ -	-	$ -	$ 810	(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 $0.8 million of gain in the nine months ended September 30, 2012 as the Company completed its services to be provided under a license agreement associated with the divestiture of the electrical papers product line business.

Interest Expense

In thousands	Quarter Ended Q3-13	Q3-12	Percent Change	Nine Months Ended YTD-13	YTD-12	Percent Change
Interest expense	$ 77	$ 96	(19.8) %	$ 231	$ 273	(15.4) %
Weighted average interest rate	5.4 %	5.5 %		5.4 %	5.4 %	

The decrease in interest expense for the quarter and nine months ended September 30, 2013 compared to the same periods of 2012 was due to lower average principal balances on capital lease obligations.

Other Income/Expense

Other income and expense for the quarters and nine months ended September 30, 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 was 37.5% and 24.4% for the quarters ended September 30, 2013 and 2012, respectively, and 35.1% and 24.6% for the nine months ended September 30, 2013 and 2012, respectively. The difference in the Company's effective tax rate for the nine months ended September 30, 2013 compared to statutory federal income tax rates was primarily due to a discrete tax benefit of $0.5 million, recorded in the first quarter of 2013, as the Company concluded certain U.S. federal income tax matters through the year ended December 31, 2009. The difference in the Company's effective tax rate for the quarter and nine months ended September 30, 2012 compared to the statutory federal income tax rates was primarily due to reversal of valuation allowance against foreign tax credit carryovers in the amounts of $0.5 million and $2.6 million, respectively.

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 2009, 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 present sales information for the key product and service groups included within each operating segment as well as other products and services and operating income by segment, for the quarter and nine months ended September 30, 2013 compared with the quarter and nine months ended September 30, 2012:

Net sales by segment:

In thousands	Quarter Ended Q3-13	Q3-12	Dollar Change
Performance Materials Segment:			
Industrial Filtration	$ 15,536	$ 17,035	$ (1,499)
Industrial Thermal Insulation	9,877	10,647	(770)
Life Sciences Filtration	2,447	3,128	(681)
Performance Materials Segment net sales	27,860	30,810	(2,950)
Thermal/Acoustical Metals Segment:			
Metal parts	32,910	31,347	1,563
Tooling	2,939	5,249	(2,310)
Thermal/Acoustical Metals Segment net sales	35,849	36,596	(747)
Thermal/Acoustical Fibers Segment:			
Fiber parts	26,642	23,484	3,158
Tooling	4,533	146	4,387
Thermal/Acoustical Fibers Segment net sales	31,175	23,630	7,545
Other Products and Services:			
Life Sciences Vital Fluids	4,114	4,326	(212)
Other Products and Services net sales	4,114	4,326	(212)
Eliminations and Other	(1,003)	(1,195)	192
Consolidated Net Sales	$ 97,995	$ 94,167	$ 3,828

In thousands	Nine Months Ended YTD-13	YTD-12	Dollar Change
Performance Materials Segment:			
Industrial Filtration	$ 50,089	$ 53,320	$ (3,231)
Industrial Thermal Insulation	26,612	30,497	(3,885)
Life Sciences Filtration	7,610	8,604	(994)
Performance Materials Segment net sales	84,311	92,421	(8,110)
Thermal/Acoustical Metals Segment:			
Metal parts	101,976	104,893	(2,917)
Tooling	14,995	11,501	3,494
Thermal/Acoustical Metals Segment net sales	116,971	116,394	577
Thermal/Acoustical Fibers Segment:			
Fiber parts	80,884	69,821	11,063
Tooling	6,177	891	5,286
Thermal/Acoustical Fibers Segment net sales	87,061	70,712	16,349
Other Products and Services:			
Life Sciences Vital Fluids	12,684	12,306	378
Other Products and Services net sales	12,684	12,306	378
Eliminations and Other	(2,952)	(3,377)	425
Consolidated Net Sales	$ 298,075	$ 288,456	$ 9,619

Operating income by segment:

In thousands	Quarter Ended Q3-13 Operating Income	Operating Margin %		Q3-12 Operating Income	Operating Margin %		Dollar Change
Performance Materials	$ 2,419	8.7	%	$ 3,325	10.8	%	$ (906)
Thermal/Acoustical Metals	3,742	10.4	%	2,612	7.1	%	1,130
Thermal/Acoustical Fibers	5,206	16.7	%	3,445	14.6	%	1,761
Other Products and Services	112	2.7	%	354	8.2	%	(242)
Corporate Office Expenses	(4,093)			(4,536)			443
Consolidated Operating Income	$ 7,386	7.5	%	$ 5,200	5.5	%	$ 2,186

In thousands	Nine Months Ended YTD-13 Operating Income	Operating Margin %		YTD-12 Operating Income	Operating Margin %		Dollar Change
Performance Materials	$ 6,967	8.3	%	$ 10,427	11.3	%	$ (3,460)
Thermal/Acoustical Metals	11,191	9.6	%	11,729	10.1	%	(538)
Thermal/Acoustical Fibers	16,792	19.3	%	9,056	12.8	%	7,736
Other Products and Services	593	4.7	%	874	7.1	%	(281)
Corporate Office Expenses	(12,119)			(12,741)			622
Consolidated Operating Income	$ 23,424	7.9	%	$ 19,345	6.7	%	$ 4,079

Performance Materials

Segment net sales decreased $3.0 million, or 9.6%, in the third quarter of 2013 compared to the third quarter of 2012. Net sales of Industrial Filtration products decreased by $1.5 million, or 8.8%, in the third quarter of 2013 compared to the third quarter of 2012, primarily from lower global demand in air filtration products. Industrial Thermal Insulation product net sales decreased by $0.8 million, or 7.2%, as net sales of electrical paper products were lower by $1.1 million, as a result of the Company selling the electrical papers product line to a customer in a prior year, partially offset by higher sales of products used in cryogenic applications, compared to the third quarter of 2012. Net sales of Life Sciences Filtration products decreased by $0.7 million, or 21.8%, in the third quarter of 2013 compared to the third quarter of 2012, primarily due to decreased demand for products used in respiration applications. Foreign currency translation increased net sales by $0.5 million, or 1.6%, in the third quarter of 2013 compared to the third quarter of 2012.

The segment reported operating income of $2.4 million, or 8.7% of net sales, in the third quarter of 2013, compared to operating income of $3.3 million, or 10.8% of net sales, in the third quarter of 2012. The decrease in operating income was primarily a result of lower net sales of $3.0 million, lower absorption of fixed overhead costs as well as unfavorable mix among product sales. Segment selling, product development and administrative expenses decreased $0.9 million in the current quarter compared to the third quarter of 2012, primarily due to reductions in salaries, benefits and accrued incentive compensation of $0.5 million, lower product development trial costs of $0.3 million, and lower general administrative expenses of $0.1 million.

Segment net sales decreased $8.1 million, or 8.8%, in the first nine months of 2013 compared to the first nine months of 2012. A reduction in Industrial Thermal Insulation net sales of $3.9 million, or 12.7%, primarily contributed to the reduction in net sales. Negatively impacting the Industrial Thermal Insulation business was approximately $4.3 million lower net sales of electrical papers product as a result of the Company selling the electrical papers product line to a customer in a prior year. Net sales of Industrial Filtration products decreased by $3.2 million, or 6.1%, in the first nine months of 2013 compared to the first nine months of 2012, primarily due to a reduction in demand for products in Europe as a result of macroeconomic conditions. Net sales of Life Sciences Filtration products decreased by $1.0 million, or 11.6%, in the first nine months of 2013 compared to the first nine months of 2012, primarily due to decreased demand for products used in water and respiration application products. Foreign currency translation had a minimal impact on net sales in the nine months ended September 30, 2013 compared to nine months ended September 30, 2012.

The segment reported operating income of $7.0 million, or 8.3% of net sales, in the first nine months of 2013, compared to operating income of $10.4 million, or 11.3% of net sales, in the first nine months of 2012. The decrease in operating income was primarily a result of lower net sales of $8.1 million, lower absorption of fixed overhead costs as well as unfavorable mix among product sales. Operating income in the first nine months of 2012 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. Segment selling, product development and administrative expenses decreased $1.3 million in the first nine months of 2013 compared to the first nine months of 2012, due to reductions in research and development expenses of $0.3 million and lower salaries, benefits and accrued incentive compensation of $0.3 million. Also, lower general administrative expenses of $0.5 million, primarily related to professional services and travel, and a decrease in selling commission expenses of $0.1 million, contributed to the reduction in selling, product development and administrative expenses in the first nine months of 2013 compared to the same period a year ago.

Thermal/Acoustical Metals

In the third quarter of 2013, segment net sales decreased by $0.7 million, or 2.0%, compared to the third quarter of 2012. Tooling net sales in the third quarter of 2013 were lower by $2.3 million, or 44.0%, compared to the third quarter of 2012 due to timing of new product launches. Automotive parts net sales increased by $1.6 million, or 5.0%, compared to the third quarter of 2012, primarily due to higher North America parts net sales and a modest improvement in European part net sales due to foreign currency translation. Foreign currency translation increased net sales by $1.1 million, or 2.9%, for the current quarter, compared to the third quarter of 2012.

The segment reported operating income of $3.7 million, or 10.4% of net sales, in the third quarter of 2013 compared to operating income of $2.6 million, or 7.1% of net sales, in the third quarter of 2012. The increase in operating income was primarily due to reduced raw material costs from lower aluminum pricing, improved absorption of fixed overhead costs due to higher inventory levels in anticipation of new platform launches, and by a favorable mix between higher margin automotive parts and lower margin tooling. The Thermal/Acoustical Metals segment’s third quarter 2012 operating income included an unfavorable $0.5 million customer pricing adjustment. Selling, product development and administrative costs increased by $0.6 million in the third quarter of 2013 compared to the third quarter of 2012, primarily due to increases in salaries, benefits and accrued incentive compensation of $0.3 million and higher expenses of $0.2 million for the start-up of the segment’s China operations.

In the first nine months of 2013, segment net sales increased by $0.6 million, or 0.5%, compared to the first nine months of 2012. Tooling net sales in the first nine months of 2013 were higher by $3.5 million, or 30.4%, compared to the first nine months of 2012 due to timing of new product launches, particularly in Europe. Automotive parts net sales decreased by $2.9 million, or 2.8%, compared to the first nine months of 2012, due to decreased demand from customers served by the Company’s European automotive operations due to macroeconomic conditions, partially offset by higher parts sales in North America due to strong market demand. Foreign currency translation increased net sales by $1.5 million, or 1.3%, in the first nine months of 2013 compared with the first nine months of 2012.

The segment reported operating income of $11.2 million, or 9.6% of net sales, in the first nine months of 2013 compared to $11.7 million, or 10.1% of net sales, in the first nine months of 2012. The decrease in operating income was primarily due to an unfavorable mix between automotive parts and tooling net sales. Net sales of higher margin automotive parts decreased by $2.9 million in the first nine months of 2013 compared to the first nine months of 2012. Selling, product development and administrative costs increased by $1.5 million in the first nine months of 2013 primarily due to higher salaries, benefits and accrued incentive compensation of $0.9 million, as well as increased sales commissions of $0.2 million, higher research and development design services of $0.2 million and higher expenses of $0.2 million for the start-up of the segment's China operations.

Thermal/Acoustical Fibers

In the third quarter of 2013, segment net sales increased by $7.5 million, or 31.9%, compared to the third quarter of 2012. Automotive parts net sales increased by $3.1 million, or 13.4%, compared to the third quarter of 2012. This increase was driven by higher consumer demand for vehicles in North America on Lydall's existing platforms and new platform launches. Tooling net sales in the third quarter of 2013 were higher by $4.4 million compared to the third quarter of 2012, due to timing of new product launches.

The segment reported operating income of $5.2 million, or 16.7% of net sales, in the third quarter of 2013, compared to operating income of $3.4 million, or 14.6% of net sales, in the third quarter of 2012. This improvement was due to higher net sales, improved absorption of fixed overhead costs, favorable raw material pricing and other cost savings from manufacturing efficiency improvements. These manufacturing efficiency improvements included reductions in material usage and reduced labor costs per unit in the third quarter of 2013 compared to the third quarter of 2012. Segment selling, product development and administrative expenses were lower by $0.3 million in the third quarter of 2013 compared to the third quarter of 2012, primarily due to lower sales commissions as a result of lower commission rates in the third quarter of 2013 compared to the third quarter of 2012.

In the first nine months of 2013, segment net sales increased by $16.3 million, or 23.1%, compared to the first nine months of 2012. Automotive parts net sales increased by $11.1 million, or 15.8%, compared to the first nine months of 2012. Higher volumes of net sales were primarily due to improved consumer demand for vehicles in North America on Lydall's existing platforms and new platform launches, and to a lesser extent, from a completed pricing negotiation and a non-recurring customer project. Tooling net sales in the first nine months of 2013 were higher by $5.3 million compared to the same period of 2012, due to timing of new product launches.

The segment reported operating income of $16.8 million, or 19.3% of net sales, in the first nine months of 2013 compared to operating income of $9.1 million, or 12.8%, in the first nine months of 2012. This increase was due to higher net sales and improved gross margin realized from favorable absorption of fixed overhead costs, lower raw material and labor costs, and to a lesser extent, $1.8 million related to a completed pricing negotiation and a non-recurring customer project. Segment selling, product development and administrative expenses were lower by $0.3 million in the first nine months of 2013 compared to the same period of 2012, primarily due to lower sales commissions of $0.6 million, as a result of lower commission rates in the first nine months of 2013 compared to the same period of 2012, partially offset by higher salaries and wages expenses.

Other Products and Services

Life Sciences Vital Fluids net sales for the third quarter of 2013 decreased $0.2 million, or 4.9%, compared to the same quarter a year ago, due to lower volumes of bioprocessing net sales.

Life Sciences Vital Fluids reported operating income of $0.1 million, or 2.7% of net sales, for the third quarter of 2013, compared to $0.4 million, or 8.2% of net sales, for the third quarter of 2012. This decrease in operating income was due to higher selling costs of $0.2 million as the Company expanded its product offerings in the biotech and cellular therapy markets and to a lesser extent unfavorable absorption of fixed overhead costs.

Life Sciences Vital Fluids net sales for the first nine months of 2013 increased $0.4 million, or 3.1%, compared to the same period a year ago, due to higher volumes of blood filtration net sales, and to a lesser extent, price increases.

Life Sciences Vital Fluids reported operating income of $0.6 million, or 4.7% of net sales, for the first nine months of 2013, compared to $0.9 million, or 7.1% of net sales, for the same period a year ago. This decrease in operating income was primarily due to higher selling costs in the first nine months of 2013 of $0.2 million as the Company expanded its product offerings in the biotech and cellular therapy markets.

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Corporate Office Expenses

Corporate office expenses for the third quarter of 2013 were $4.1 million compared to $4.5 million for the third quarter of 2012. This decrease of $0.4 million was due to lower severance and recruiting costs of $0.6 million and lower professional service expenses of $0.5 million, primarily associated with exploring strategic initiatives in the third quarter of 2012. Partially offsetting these decreases were greater salaries, benefits and accrued incentive compensation expense of $0.5 million and increased insurance claim expense of $0.2 million in the third quarter of 2013 compared to the third quarter of 2012.

Corporate offices expenses for the first nine months of 2013 were $12.1 million compared to $12.7 million for the same period a year ago. The reduction of $0.6 million was related to a decrease in professional services of $0.9 million, primarily related to costs incurred in the first nine months of 2012 exploring strategic initiatives, and a decrease in severance and recruiting costs of $0.7 million. These decreases were partially offset by an increase in salaries, benefits and accrued incentive compensation of $0.8 million.

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 September 30, 2013, the only debt outstanding was capital lease obligations and as of December 31, 2012, the majority of debt outstanding was capital lease obligations. As of September 30, 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 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 1.0 to 1.0 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 September 30, 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 September 30, 2013, the Company had borrowing availability of $32.4 million under the Domestic Credit Facility net of standby letters of credit outstanding of $2.6 million. As of September 30, 2013, the Company's foreign subsidiaries had various credit arrangements with banks totaling €9.0 million (approximately $12.2 million) all of which was available for borrowing, primarily restricted to borrowings by the respective foreign subsidiary.

The Company continually explores its core markets for suitable acquisitions, joint ventures, alliances and licensing agreements. If completed, such activities would be financed with existing cash balances, cash generated from operations, under the credit facilities described under "Financing Arrangements" above or other forms of financing, as required.

Operating Cash Flows

Net cash provided by operating activities in the first nine months of 2013 was $10.9 million compared with net cash provided by operating activities of $19.2 million in the first nine months of 2012. In the first nine months of 2013 compared to the same period for 2012, net income increased by $0.6 million. Since December 31, 2012, net operating assets and liabilities increased by $17.8 million, primarily due to increases in accounts receivable of $15.8 million and inventory of $7.0 million, partially offset by higher accounts payable of $4.6 million due to timing of inventory purchases. The increase in accounts receivable was due to higher net sales in the last half of the third quarter of 2013 compared to the last half of the fourth quarter of 2012. The increase in inventory of $7.0 million in 2013 was largely due to an increase in net tooling inventory of $5.5 million in preparation of new part launches and increased production activity.

Investing Cash Flows

In the first nine months of 2013, net cash used for investing activities was $9.7 million compared to net cash provided by investing activities of $5.1 million in the first nine months of 2012. Capital expenditures were $9.5 million during the first nine months of 2013, compared with $7.9 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 addition, during the first nine months of 2013, the Company made an earn-out payment of $0.2 million related to the acquisition of DSM Solutech B.V. which occurred in 2008. In the first nine months of 2012, the Company redeemed its $12.0 million short term investment, which was purchased in 2011. In addition, during the first nine months of 2012 the Company received the remaining $1.0 million due from the sale of the Company's electrical papers product line paid in accordance with a License Agreement.

Financing Cash Flows

In the first nine months of 2013, net cash used for financing activities was $5.5 million compared to net cash used of $3.6 million in the first nine months of 2012. Debt repayments were $0.5 million and $0.8 million for the first nine months of 2013 and 2012, respectively. The Company received $1.2 million from the exercise of stock options in the first nine months of 2013, compared to $0.3 million in the first nine months of 2012. The Company acquired $6.4 million and $3.1 million in company stock through its stock repurchase and equity compensation plans during the first nine months of 2013 and 2012, 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, 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 September 30, 2013.

During the third quarter of 2013, 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. Current developments with customers caused the Company to determine that it was probable that Solutech net sales would not meet previous expectations for 2013. Due to the lower than expected sales, caused by a delay in commercialization of Solutech products to the marketplace by Solutech's customers, negative cash flows are expected in 2013. As a result of these expected negative cash flows, combined with historical operating losses, the Company determined that it was appropriate to test the Solutech asset group, for recoverability in the third quarter of 2013. Acquisition related intangibles with a remaining useful life of 10 years primarily comprise the carrying value of the asset group of $4.6 million. To determine the recoverability of the Solutech asset group, the Company completed an undiscounted cash flow analysis and compared it to the asset group carrying value. This analysis was primarily dependent on the increase in net sales over the period when the business has technological exclusivity provided by the intangible assets.

The Company determined that the Solutech asset group had undiscounted cash flow which was in excess of its carrying value and, as a result, the asset group was not impaired at September 30, 2013. 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 around cash flows generated from future operations, the estimated economic useful life of the primary asset within the Solutech long-lived asset group, as well as other market information. The Company performed various sensitivity analyses noting that a scenario of high single digit revenue growth and an appropriate related cost structure, the undiscounted cash flows exceeded the carrying value with no impairment indicated. 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 and management's ability to manage costs. In the event that Solutech's cash flows in the future do not meet current expectations, management, based upon conditions at the time, would consider taking actions as necessary to improve cash flow. Accordingly, the above sensitivity analysis, while a useful tool, should not be used as a sole predictor of future impairment. A thorough analysis of all the facts and circumstances existing at the time would need to be performed to determine if recording an impairment loss was appropriate.

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) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures were effective as of September 30, 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 Exchange Act 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.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) and Rule 15d-15(f) under the Exchange Act) during the quarter ended September 30, 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, actions with respect to commercial, intellectual property, employment, personal injury, and environmental matters. The Company believes that it has meritorious defenses against the claims currently asserted against it and intends to defend them vigorously. While the outcome of litigation is inherently uncertain and the Company cannot be sure that it will prevail in any of the cases, the Company is not aware of any matters pending that are expected to have a material adverse effect on the Company's financial position, results of operations or cash flows.

Item 1A. Risk Factors

See Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2012. There has been no material change in the risk factors facing the Company since that report was filed. 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 September 30, 2013, no shares were repurchased under the stock repurchase program. As reflected in the following table, during the three months ended September 30, 2013, the Company acquired 1,012 shares, with an average price paid per share of $16.01, 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.

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
July 1, 2013 - July 31, 2013	-	$ -	-	267,089
August 1, 2013 - August 31, 2013	1,012	$ 16.01	-	267,089
September 1, 2013 - September 30, 2013	-	$ -	-	267,089
	1,012	$ 16.01	-	267,089

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

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 Form 10-K dated March 12, 2004 and incorporated herein by this reference.
10.1	Letter of Agreement between Lydall, Inc. and Mona G. Estey, filed as Exhibit 10.1 to the Registrant's Form 8-K dated September 30, 2013 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.

November 4, 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)

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LYDALL, INC.
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