

LYDALL INC /DE/
Form 10-Q/A
November 22, 2002
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

**Form 10-Q/A
Amendment Number 1**

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

For the quarterly period ended June 30, 2001

OR

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

For the transition period from to

Commission File Number: 1-7665

LYDALL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

06-0865505
(I.R.S. Employer Identification No.)

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

06040
(zip code)

(860) 646-1233
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

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

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

Common stock \$.10 par value per share.

Total Shares outstanding November 14, 2002

16,016,930

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Number****Part I. Financial Information**

This amendment to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 is being filed to revise the consolidated condensed financial statements as set forth in Note 9 to the Notes to Consolidated Condensed Financial Statements, from those previously filed on August 10, 2001. In this amendment the disclosures have not been updated other than to reflect the adjustments specifically discussed in Note 9 to the Notes to Consolidated Condensed Financial Statements.

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

| | June 30, 2001 | December 31, 2000 |
|---|---|----------------------|
| | (Restated See Note 9) (Unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,811 | \$ 2,220 |
| Accounts receivable, net | 39,915 | 39,993 |
| Inventories: | | |
| Finished goods | 10,336 | 9,933 |
| Work in process | 7,404 | 5,820 |
| Raw materials | 8,010 | 6,272 |
| LIFO reserve | (555) | (555) |
| Total inventories | 25,195 | 21,470 |
| Income taxes receivable | | 2,705 |
| Prepaid expenses | 1,454 | 1,632 |
| Net investment in discontinued operations | 1,048 | 14,285 |
| Assets held for sale | 1,751 | 6,200 |
| Deferred tax assets | 7,500 | 7,290 |
| Total current assets | 79,674 | 95,795 |
| Property, plant and equipment, at cost | 129,172 | 126,711 |
| Accumulated depreciation | (56,538) | (52,291) |
| | 72,634 | 74,420 |
| Other assets, net | 25,438 | 24,749 |
| Total assets | \$ 177,746 | \$ 194,964 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 7,928 | \$ 7,101 |
| Accounts payable | 17,928 | 19,154 |
| Accrued taxes | 1,621 | 844 |
| Accrued payroll and other compensation | 3,532 | 7,244 |
| Liabilities related to assets held for sale | | 421 |
| Other accrued liabilities | 7,749 | 6,481 |
| Total current liabilities | 38,758 | 41,245 |
| Long-term debt | 7,865 | 24,927 |
| Deferred tax liabilities | 10,365 | 11,183 |
| Other long-term liabilities | 6,093 | 5,856 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock | | |

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| | | |
|--|-------------------|-------------------|
| Common stock | 2,201 | 2,196 |
| Capital in excess of par value | 40,806 | 40,335 |
| Retained earnings | 140,452 | 137,664 |
| Accumulated other comprehensive loss | (7,152) | (6,800) |
| | <u>176,307</u> | <u>173,395</u> |
| Treasury stock, at cost | (61,642) | (61,642) |
| | <u>114,665</u> | <u>111,753</u> |
| Total stockholders equity | 114,665 | 111,753 |
| | <u>114,665</u> | <u>111,753</u> |
| Total liabilities and stockholders equity | \$ 177,746 | \$ 194,964 |
| | <u>\$ 177,746</u> | <u>\$ 194,964</u> |

See accompanying Notes to Consolidated Condensed Financial Statements.

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LYDALL, INC.
CONSOLIDATED CONDENSED STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME
(In Thousands Except Per-Share Data)

| | Three Months Ended June 30, | |
|--|---|-----------|
| | 2001 | 2000 |
| | (Restated See Note 9) (Unaudited) | |
| Net sales | \$ 58,940 | \$ 68,265 |
| Cost of sales | 42,529 | 50,677 |
| Gross margin | 16,411 | 17,588 |
| Selling, product development and administrative expenses | 11,595 | 13,118 |
| Impairment and restructuring charges | 2,629 | |
| Operating income | 2,187 | 4,470 |
| Other (income) expense: | | |
| Investment income | (54) | (142) |
| Interest expense | 243 | 349 |
| Foreign currency transaction losses (gains), net | 50 | (71) |
| Other, net | 10 | 105 |
| | 249 | 241 |
| Income from continuing operations before income taxes | 1,938 | 4,229 |
| Income tax expense | 618 | 1,415 |
| Income from continuing operations | 1,320 | 2,814 |
| Discontinued operations: | | |
| Income from operations of discontinued segments, net of tax expense of \$218 | | 372 |
| Loss from disposal of discontinued segments, net of tax benefit of \$49 | (79) | |
| (Loss) Income from discontinued operations | (79) | 372 |
| Net income | \$ 1,241 | \$ 3,186 |
| Basic earnings (loss) per common share: | | |
| Continuing operations | \$.08 | \$.18 |
| Discontinued operations | (.01) | .02 |
| Net income | \$.07 | \$.20 |
| Diluted earnings (loss) per common share: | | |
| Continuing operations | \$.08 | \$.18 |
| Discontinued operations | (.01) | .02 |
| Net income | \$.07 | \$.20 |
| Weighted average common shares outstanding | 15,889 | 15,784 |
| Weighted average common shares and equivalents outstanding | 16,117 | 15,866 |
| | \$ 1,241 | \$ 3,186 |

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| | | |
|---|-------------------|-------------------|
| Net income | | |
| Other comprehensive loss, before tax: | | |
| Foreign currency translation adjustments | (325) | (61) |
| Change in fair value of derivative instrument | (15) | |
| Reclassification for gains included in net income | | (19) |
| | <u> </u> | <u> </u> |
| Other comprehensive loss, before tax | (340) | (80) |
| Income tax benefit related to items of other comprehensive loss | 118 | 27 |
| | <u> </u> | <u> </u> |
| Other comprehensive loss, net of tax | (222) | (53) |
| | <u> </u> | <u> </u> |
| Comprehensive income | \$ 1,019 | \$ 3,133 |
| | <u> </u> | <u> </u> |

See accompanying Notes to Consolidated Condensed Financial Statements.

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LYDALL, INC.
CONSOLIDATED CONDENSED STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME
(In Thousands Except Per-Share Data)

| | Six Months Ended June 30, | |
|--|---|-----------------|
| | 2001 | 2000 |
| | (Restated See Note 9) (Unaudited) | |
| Net sales | \$ 117,205 | \$ 137,998 |
| Cost of sales | 84,422 | 102,812 |
| Gross margin | 32,783 | 35,186 |
| Selling, product development and administrative expenses | 25,104 | 26,192 |
| Impairment and restructuring charges | 3,389 | |
| Operating income | 4,290 | 8,994 |
| Other (income) expense: | | |
| Investment income | (91) | (158) |
| Interest expense | 576 | 839 |
| Foreign currency transaction losses, net | 198 | 5 |
| Gain from sale of operations | | (6,065) |
| Other, net | 43 | (207) |
| | 726 | (5,586) |
| Income from continuing operations before income taxes | 3,564 | 14,580 |
| Income tax expense | 1,152 | 5,247 |
| Income from continuing operations | 2,412 | 9,333 |
| Discontinued operations: | | |
| (Loss) income from operations of discontinued segments, net of tax (benefit) expense of (\$181) and \$313, respectively | (308) | 587 |
| Gain on disposal of discontinued segments, net of tax expense of \$400 and \$44, respectively | 684 | 71 |
| Income from discontinued operations | 376 | 658 |
| Net income | \$ 2,788 | \$ 9,991 |
| Basic earnings per common share: | | |
| Continuing operations | \$.15 | \$.59 |
| Discontinued operations | .02 | .04 |
| Net income | \$.17 | \$.63 |
| Diluted earnings per common share: | | |
| Continuing operations | \$.15 | \$.59 |
| Discontinued operations | .02 | .04 |
| Net income | \$.17 | \$.63 |

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| | | |
|---|-------------------|-------------------|
| Weighted average common shares outstanding | 15,876 | 15,745 |
| Weighted average common shares and equivalents outstanding | 16,050 | 15,800 |
| Net income | \$ 2,788 | \$ 9,991 |
| Other comprehensive loss, before tax: | | |
| Foreign currency translation adjustments | (708) | (1,392) |
| Change in fair value of derivative instrument | (140) | |
| | <u> </u> | <u> </u> |
| Other comprehensive loss, before tax | (848) | (1,392) |
| Income tax benefit related to other comprehensive loss | 295 | 484 |
| | <u> </u> | <u> </u> |
| Other comprehensive loss, net of tax | (553) | (908) |
| Cumulative effect of change in accounting principle, net of tax | 201 | |
| | <u> </u> | <u> </u> |
| Comprehensive income | \$ 2,436 | \$ 9,083 |
| | <u> </u> | <u> </u> |

See accompanying Notes to Consolidated Condensed Financial Statements.

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

| | Six Months Ended June 30, | |
|---|---|-----------|
| | 2001 | 2000 |
| | (Restated See Note 9) (Unaudited) | |
| Cash flows from operating activities: | | |
| Net income | \$ 2,788 | \$ 9,991 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 4,918 | 5,187 |
| Amortization | 776 | 775 |
| Gain on disposal of discontinued segments | (1,289) | (71) |
| Gain on sale of operation | | (6,065) |
| Gain on sale of investments | | (136) |
| Impairment and restructuring charges | 3,389 | |
| Loss on disposition of property, plant and equipment | | 296 |
| Foreign currency transaction losses | 198 | 5 |
| Gain on receipt of common stock from demutualization of insurance companies | | (393) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 657 | (856) |
| Income taxes receivable | 2,583 | 4,022 |
| Inventories | (3,834) | (1,269) |
| Prepaid expenses and other assets | (812) | (1,050) |
| Accounts payable | 47 | (428) |
| Accrued taxes | 64 | 1,317 |
| Accrued payroll and other compensation | (4,422) | 4,254 |
| Deferred income taxes | (950) | 1,661 |
| Other long-term liabilities | 217 | 35 |
| Other accrued liabilities | (1,998) | (3,093) |
| Total adjustments | (456) | 4,191 |
| Net cash provided by operating activities | 2,332 | 14,182 |
| Cash flows from investing activities: | | |
| Proceeds from sale of discontinued segments | 14,163 | 1,819 |
| Proceeds from sale of operations | 872 | 12,037 |
| Proceeds from sales of investments | | 529 |
| Proceeds from post-closing net equity adjustment | 1,357 | |
| Additions of property, plant and equipment | (4,194) | (10,271) |
| Net cash provided by investing activities | 12,198 | 4,114 |
| Cash flows from financing activities: | | |
| Long-term debt payments | (30,070) | (100,424) |
| Long-term debt proceeds | 15,756 | 82,141 |
| Issuance of common stock | 475 | 582 |
| Net cash used for financing activities | (13,839) | (17,701) |

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| | | |
|---|----------|----------|
| Effect of exchange rate changes on cash | (100) | (63) |
| Increase in cash and cash equivalents | 591 | 532 |
| Cash and cash equivalents at beginning of period | 2,220 | 1,154 |
| Cash and cash equivalents at end of period | \$ 2,811 | \$ 1,686 |
| Supplemental Schedule of Cash Flow Information | | |
| Cash paid during the period for: | | |
| Interest | \$ 581 | \$ 739 |
| Income taxes | 959 | 682 |

See accompanying Notes to Consolidated Condensed Financial Statements.

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LYDALL, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

- The accompanying consolidated condensed financial statements include the accounts of Lydall, Inc. and its wholly owned subsidiaries (collectively, the Company or the Registrant). All financial information is unaudited for the interim periods reported. All significant intercompany transactions have been eliminated in the consolidated condensed financial statements. Management believes that all adjustments, which include only normal recurring adjustments necessary to present a fair statement of the financial position, results of operations and cash flows for the periods reported, have been included. The year-end consolidated condensed balance sheet was derived from the December 31, 2000 audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. 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, 2000.
- Basic earnings per common share are based on income from continuing operations and net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share are based on income from continuing operations and net income divided by the weighted average number of common shares outstanding during the period, including the effect of stock options, where such effect is dilutive.

| | Quarter Ended June 30, 2001 | | | Quarter Ended June 30, 2000 | | |
|----------------------------------|--|------------------------------|---------------------|--|------------------------------|---------------------|
| | (Unaudited) (Restated See Note 9) | | | (Unaudited) | | |
| | Income from Continuing Operations (\$000 s) | Average Shares (000 s) | Per-Share Amount | Income from Continuing Operations (\$000 s) | Average Shares (000 s) | Per-Share Amount |
| Basic earnings per share | \$ 1,320 | 15,889 | \$.08 | \$ 2,814 | 15,784 | \$.18 |
| Effect of dilutive stock options | | 228 | | | 82 | |
| Diluted earnings per share | \$ 1,320 | 16,117 | \$.08 | \$ 2,814 | 15,866 | \$.18 |
| | | | | | | |
| | Net Income (\$000 s) | Average Shares (000 s) | Per-Share Amount | Net Income (\$000 s) | Average Shares (000 s) | Per-Share Amount |
| Basic earnings per share | \$ 1,241 | 15,889 | \$.07 | \$ 3,186 | 15,784 | \$.20 |
| Effect of dilutive stock options | | 228 | | | 82 | |
| Diluted earnings per share | \$ 1,241 | 16,117 | \$.07 | \$ 3,186 | 15,866 | \$.20 |
| | | | | | | |
| | Six Months Ended June 30, 2001 | | | Six Months Ended June 30, 2000 | | |
| | (Unaudited) (Restated See Note 9) | | | (Unaudited) | | |
| | Income from Continuing Operations (\$000 s) | Average Shares (000 s) | Per-Share Amount | Income from Continuing Operations (\$000 s) | Average Shares (000 s) | Per-Share Amount |
| Basic earnings per share | \$ 2,412 | 15,876 | \$.15 | \$ 9,333 | 15,745 | \$.59 |
| Effect of dilutive stock options | | 174 | | | 55 | |
| Diluted earnings per share | \$ 2,412 | 16,050 | \$.15 | \$ 9,333 | 15,800 | \$.59 |

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| | Net Income (\$000 s) | Average Shares (000 s) | Per-Share Amount | Net Income (\$000 s) | Average Shares (000 s) | Per-Share Amount |
|----------------------------------|----------------------------|------------------------------|---------------------|----------------------------|------------------------------|---------------------|
| Basic earnings per share | \$ 2,788 | 15,876 | \$.17 | \$ 9,991 | 15,745 | \$.63 |
| Effect of dilutive stock options | | 174 | | | 55 | |
| Diluted earnings per share | \$ 2,788 | 16,050 | \$.17 | \$ 9,991 | 15,800 | \$.63 |

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LYDALL, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

3. In February 2001, the Company's Board of Directors adopted a plan to discontinue the operations of the Paperboard Segment, consisting principally of the Southern Products and Lydall & Foulds Divisions. Accordingly, the operating results of this segment have been segregated from continuing operations and reported as discontinued operations for all periods presented.

On February 1, 2001, the Company announced that the Lydall & Foulds Division would be closed on April 1, 2001. Additionally, on February 5, 2001, the Company sold the Southern Products Division for approximately \$14.2 million in cash. In total, the disposition of the Paperboard Segment resulted in a gain, net of tax, of \$.8 million, or \$.05 per diluted share. The sale of the Southern Products Division resulted in a gain, net of tax, of \$3.6 million, or \$.23 per diluted share. The closing of the Lydall & Foulds Division resulted in a loss, net of tax, of \$2.8 million, or \$.18 per diluted share, representing costs incurred from the measurement date through June 30, 2001, other exit costs to be incurred during the phase-out period, and the adjustment to net realizable value for certain current and long-lived assets.

Paperboard Segment net assets to be disposed of consisting primarily of accounts receivable, inventory and property, plant and equipment of the Lydall & Foulds Division, with a total net realizable value of \$1.0 million, have been classified in the Consolidated Condensed Balance Sheet at June 30, 2001 as Net investment in discontinued operations.

During the second quarter of 2001, the Company recorded an additional loss of \$.1 million related to the disposition of the Wovens segment.

4. During the quarter ended March 31, 2001, the Company recorded an impairment charge before tax of \$.8 million, or \$.03 per diluted share after-tax, related to assets held for sale owned by its fiberboard operation. On April 2, 2001, the Company sold certain assets of this operation for approximately \$.9 million in cash and a note receivable for \$1.0 million, and announced that the operation would be closed. During the second quarter of 2001, the Company recorded a pre-tax charge of \$2.6 million, or \$.10 per diluted share after-tax, for closing costs, severance benefits and additional impairment on assets held for sale. Approximately \$.9 million of closing costs and severance benefits have been paid through June 30, 2001.
5. Lydall's reportable segments are: Thermal/Acoustical and Filtration/Separation. All other products and services are aggregated in Other Products and Services. Reconciling Items include Corporate Office operating expenses and intercompany eliminations. For a full description of each segment, refer to the Notes to Consolidated Financial Statements reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. The table below presents net sales and operating income (loss) by segment for the quarter and six months ended June 30, 2001 and 2000.

| <u>In thousands Quarter Ended</u> | <u>Thermal/ Acoustical</u> | <u>Filtration/ Separation</u> | <u>Other Products and Services</u> | <u>Reconciling Items</u> | <u>Consolidated Totals</u> |
|--|--------------------------------|-----------------------------------|--|------------------------------|--------------------------------|
| June 30, 2001 (Restated See Note 9) | | | | | |
| Net sales | \$33,349 | \$17,640 | \$ 8,483 | (\$ 532) | \$58,940 |
| Operating income (loss) | \$ 5,572 | \$ 1,444 | (\$ 1,575) | (\$3,254) | \$ 2,187 |
| June 30, 2000 | | | | | |
| Net sales | \$40,908 | \$17,433 | \$10,958 | (\$1,034) | \$68,265 |
| Operating income | \$ 3,368 | \$ 2,757 | \$ 1,460 | (\$3,115) | \$ 4,470 |
| In thousands Six Months Ended | | | | | |
| June 30, 2001 (Restated See Note 9) | | | | | |
| Net sales | \$65,450 | \$35,206 | \$17,799 | (\$1,250) | \$117,205 |
| Operating income (loss) | \$ 9,969 | \$ 3,228 | (\$ 1,658) | (\$7,249) | \$ 4,290 |
| June 30, 2000 | | | | | |
| Net sales | \$85,139 | \$33,654 | \$21,229 | (\$2,024) | \$137,998 |
| Operating income | \$ 7,651 | \$ 5,179 | \$ 2,338 | (\$6,174) | \$ 8,994 |

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The operating losses for Other Products and Services for the quarter and six months ended June 30, 2001 include pre-tax impairment and restructuring charges of \$2.6 million and \$3.4 million, respectively, related to the closing of the fiberboard operation.

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LYDALL, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

6. During the quarter ended June 30, 2001, the Company received \$1.4 million as a post-closing net equity adjustment related to its December 1998 acquisition of Gerhardi.
7. On January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by Statement of Financial Accounting Standards No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, an amendment of FASB Statement No. 133 and Statement of Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133 (collectively referred to hereafter as FAS 133). In accordance with the transition provisions of FAS 133, the Company recorded a \$.2 million, net-of-tax, cumulative-effect adjustment in other comprehensive income as of January 1, 2001 representing the fair value of an interest rate swap designated as a cash flow hedge.

The interest rate swap has been formally designated as a cash flow hedge that is utilized to convert the base rate component of the variable interest rate on the Company's term loan to a fixed rate. In accordance with FAS 133, the swap is recorded at its fair value as of the balance sheet date. Subsequent changes in the fair value of the swap are recorded in other comprehensive income. The Company formally reassesses the effectiveness of the hedge on an ongoing basis. If it is determined that the interest rate swap has ceased to be highly effective as a hedge, the Company will discontinue hedge accounting prospectively and changes in the fair value of the interest rate swap will then be reported in current-period earnings.

8. Statement of Financial Accounting Standards No. 141, Business Combinations, (FAS 141), effective for business combinations initiated after June 30, 2001, provides guidance on accounting for business combinations and requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001.

Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, (FAS 142), effective for fiscal years beginning after December 15, 2001, requires that goodwill recorded from business combinations completed on or before June 30, 2001 shall no longer be amortized after the effective date. In addition, goodwill recorded as a result of a business combination completed after June 30, 2001 will not be amortized. Goodwill, however, must be reviewed for impairment in connection with the implementation of this standard and subsequently on an annual basis. The effect of adopting FAS 142 is still being assessed.

9. On November 6, 2002, Lydall executives became aware of possible accounting irregularities at the Company's Columbus, Ohio automotive operation. An investigation was initiated immediately and identified that certain Columbus employees, acting in collusion, had circumvented the local internal control system by delaying accounting recognition of liabilities and related expenses and, accordingly, caused misstatements of previously reported financial results. As a result, the Company is amending its Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 to restate its financial position, results of operations and cash flows as of and for the quarter and six months ended June 30, 2001. The impact of correcting these misstatements was to increase cost of sales by approximately \$0.4 million and \$0.6 million for the quarter and six months ended June 30, 2001, respectively, and consequently, to reduce gross margin and operating income by approximately \$0.4 million and \$0.6 million for such periods.

The effect on the operating results for the quarter and six months ended June 30, 2001, previously reported in the Company's Quarterly Report on Form 10-Q filed on August 10, 2001, is as follows:

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LYDALL, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

| | <u>Quarter Ended June 30, 2001</u> | | <u>Six Months Ended June 30, 2001</u> | |
|---|--|-----------------|---|-----------------|
| | <u>As Previously Reported</u> | <u>Restated</u> | <u>As Previously Reported</u> | <u>Restated</u> |
| In thousands except per-share data | (Unaudited) | | (Unaudited) | |
| Net sales | \$ 58,940 | \$ 58,940 | \$ 117,205 | \$ 117,205 |
| Cost of sales | 42,133 | 42,529 | 83,805 | 84,422 |
| Gross margin | 16,807 | 16,411 | 33,400 | 32,783 |
| Operating income | 2,583 | 2,187 | 4,907 | 4,290 |
| Income from continuing operations before income taxes | 2,334 | 1,938 | 4,181 | 3,564 |
| Income tax expense | 757 | 618 | 1,368 | 1,152 |
| Income from continuing operations | 1,577 | 1,320 | 2,813 | 2,412 |
| Net income | 1,498 | 1,241 | 3,189 | 2,788 |
| Basic earnings per share: | | | | |
| Continuing operations | \$ 0.10 | \$ 0.08 | \$ 0.18 | \$ 0.15 |
| Discontinued operations | (0.01) | (0.01) | 0.02 | 0.02 |
| Net income | 0.09 | 0.07 | 0.20 | 0.17 |
| Diluted earnings per share: | | | | |
| Continuing operations | \$ 0.10 | \$ 0.08 | \$ 0.18 | \$ 0.15 |
| Discontinued operations | (0.01) | (0.01) | 0.02 | 0.02 |
| Net income | 0.09 | 0.07 | 0.20 | 0.17 |

The effect on the balance sheet as of June 30, 2001, previously reported in the Company's Quarterly Report on Form 10-Q filed on August 10, 2001, is as follows:

| | <u>June 30, 2001</u> | |
|---------------------------|---------------------------------------|-----------------|
| | <u>As Previously Reported</u> | <u>Restated</u> |
| In thousands | (Unaudited) | |
| Total inventories | \$ 25,124 | \$ 25,195 |
| Deferred tax assets | 7,284 | 7,500 |
| Total current assets | 79,387 | 79,674 |
| Total assets | 177,459 | 177,746 |
| Accounts payable | 17,240 | 17,928 |
| Total current liabilities | 38,070 | 38,758 |
| Retained earnings | 140,853 | 140,452 |
| Shareholders' equity | 115,066 | 114,665 |

There is no impact on net cash provided by operating activities.

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The following Management's Discussion and Analysis of Financial Condition and Results of Operations reflects the Company's restatement of certain 2001 amounts (see Note 9).

Results of Operations*Net Sales*

Lydall, Inc. recorded net sales of \$58.9 million in the second quarter of 2001 compared with \$68.3 million for the same quarter of 2000, a decline of \$9.3 million or 13.7 percent. Second quarter 2000 net sales included \$12.9 million of sales from operations that were disposed of prior to the second quarter of 2001. After adjusting net sales for the disposed of operations, sales from the Company's core operations for the second quarter of 2001 increased \$3.6 million or 6.5 percent from the same period last year.

For the six months ended June 30, 2001 net sales were \$117.2 million, a decrease of \$20.8 million, or 15.1 percent, from \$138.0 million for the comparable period of the prior year. The decrease is mainly attributable to the disposition of several operations during 2000 and the first quarter of 2001. The disposed operations accounted for \$26.7 million of the decrease in net sales during the first six months of 2001 compared to the same period in 2000. After adjusting sales for the dispositions, sales from core operations increased \$5.9 million or 5.3 percent for the six-month period ended June 30, 2001 compared to the same period for 2000.

Gross Margin

Gross margin for the second quarter of 2001 was 27.8 percent compared to 25.8 percent for the same quarter of 2000 and 28.0 percent and 25.5 percent for the six months ended June 30, 2001 and 2000, respectively. The disposition of the two German operations accounted for a majority of the gross margin improvement as these operations generated gross margins significantly below the Company's average. In addition, increased sales volume for Lydall's automotive thermal/acoustical products improved gross margins for the quarter and period ended June 30, 2001 when compared to the same periods of the prior year. Competitive market conditions in the Company's air filtration business, inventory write-offs related to medical products not expected to be sold prior to FDA expiration dates, and manufacturing cost overruns associated with bio-processing products negatively impacted gross margin for the quarter and six months ended June 30, 2001.

Selling, Product Development and Administrative Expenses

For the quarter and six months ended June 30, 2001 selling, product development and administrative expense was \$11.6 million and \$25.1 million compared with \$13.1 million and \$26.2 million from the same periods of 2000. For the quarter ended June 30, 2001, selling, product development and administrative expense was 19.7 percent of net sales, down from 23.2 percent in the first quarter of 2001 and in line with the second quarter of 2000 as the Company continues its focus on reducing this expense.

Impairment and Restructuring Charges

During the quarter ended June 30, 2001, the Company recorded a pre-tax charge of \$2.6 million or \$.10 per share after-tax for closing costs, severance benefits and additional impairment of fiberboard operation assets held for sale. On April 2, 2001, the Company sold certain assets of this operation for approximately \$1.9 million and announced that the operation would be closing. During the quarter ended March 31, 2001, the Company recorded an impairment charge before tax of \$.8 million, or \$.03 per share after-tax, related to assets held for sale owned by its fiberboard operation.

Other Income/Expense

For the quarter ended June 30, 2001, other expense, primarily interest expense, was \$.2 million. For the quarter ended June 30, 2000, other expense was \$.2 million and was comprised of \$.3 million of interest expense offset by \$.1 million in investment income.

For the six-month period ended June 30, 2001, other expense was \$.7 million and consisted of interest expense of \$.6 million and foreign currency transaction losses of \$.2 million, offset by \$.1 million of investment income. For the six-month period ended June 30, 2000 other income was \$5.6 million and consisted of a \$6.1 million gain on the sale of the Hoosick Falls Operation and investment and other income of approximately \$.4 million, offset by interest expense of \$.8 million.

Table of Contents**Segment Results***Thermal/Acoustical*

Thermal/Acoustical net sales decreased \$7.6 million (18.5%) and \$19.7 million (23.1%) for the second quarter and first six months ended June 30, 2001, respectively, compared to the same periods of 2000. Net sales for the second quarter and first six months ended June 30, 2000 included \$10.9 million and \$24.5 million, respectively, of sales from two German operations that were divested at the end of the third quarter of 2000. After adjusting comparable prior-period net sales for the divested operations, sales increased approximately \$3.3 million and \$4.8 million for the second quarter and first six months of 2001, respectively, primarily due to increased sales volume of the Company's automotive thermal/acoustical products.

Thermal/Acoustical operating income for the second quarter and first six months of 2001 increased \$2.2 million (65.4%) and \$2.3 million (30.3%), respectively, over the same periods in 2000. Operating margin improved from 8.2 percent and 9.0 percent for the quarter and six-month period ended June 30, 2000 to 16.7 percent and 15.2 percent for the same periods in 2001 primarily due to increased sales volume and the disposition of the two unprofitable German operations.

Filtration/Separation

Filtration/Separation net sales for the second quarter of 2001 increased \$.2 million (1.2%) over the same period in 2000. Net sales for first six months of 2001 increased \$1.6 million or (4.6%) compared to the first six months of 2000. The majority of the sales growth resulted from increased volume for the Company's bio-processing products.

Filtration/Separation operating income decreased \$1.3 million (47.6%) for the second quarter of 2001 and \$2.0 million (37.7%) for the six-month period ended June 30, 2001 compared to the same periods of 2000. There were several factors contributing to this decrease, including, competitive market conditions in the Company's air filtration business, inventory write-offs related to medical products not expected to be sold prior to FDA expiration dates, and manufacturing cost overruns associated with bio-processing products.

Other Products and Services

Other Products and Services net sales decreased \$2.5 million (22.6%) and \$3.4 million (16.2%) for the quarter and six month period ended June 30, 2001, respectively, compared to the same periods in 2000. The fiberboard business, closed on April 2, 2001, generated net sales of \$1.6 million in the second quarter of 2000 and accounted for a majority of the decrease. The absence of approximately \$.5 million of gasket sales from a business that was sold in the first quarter of 2000, accounted for an additional portion of the six month decrease. The remaining decrease for the quarter and six-month period is due to lower demand for the Company's specialty substrates caused by a slow down in the economy.

Other Products and Services operating income decreased \$.4 million (27.8%) for the quarter ended June 30, 2001 and \$.6 million (26.0%) for the six month period ended June 30, 2001, after adjusting for pre-tax impairment and restructuring charges of \$2.6 million and \$3.4 million, for the quarter and six month periods, respectively, related to the closing of the fiberboard operation, compared to the same periods in 2000. The decrease was primarily due to lower sales volumes of specialty substrates and the closing of the fiberboard operation.

Outlook

The Company is projecting a difficult third quarter and does not expect to meet its third quarter of 2000 performance, adjusted for the impact from the sale of operations, of \$.22 per diluted share. Automotive OEM's have announced extended summer shutdowns, and no immediate improvement is forecasted for the filtration market or the general economy. As a result of performance year to date and the forecast for the remainder of the year, the Company has revised its 2001 year-end forecast from \$.90 to \$1.05 per share on sales of \$245 million to \$260 million to between \$.62 and \$.72 per diluted share on sales of \$230 million to \$240 million.

For the long-term, Lydall's thermal/acoustical and filtration/separation businesses remain healthy and are expected to strengthen. Lydall has booked new automotive thermal/acoustical business of approximately \$20 million on an annualized basis beginning at the end of 2001 and ramping up in 2002. Demand for the Company's bio-processing products is projected to increase, and management is currently working to improve manufacturing efficiencies for this product. Lydall continues to leverage its market position in the air and water filtration market by expanding the Company's technology and range of products.

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Liquidity and Capital Resources

At June 30, 2001, cash and cash equivalents were \$2.8 million compared to \$2.2 million at December 31, 2000. Working capital at June 30, 2001 was \$40.9 million compared with \$54.6 million at December 31, 2000. The reduction in working capital is mainly due to the sale of the Southern Products Division of the Paperboard Segment during the first quarter of 2001 and the sale and write-down of certain assets of the fiberboard operation during the first and second quarters of 2001.

Capital expenditures were \$4.2 million for the first six months of 2001 compared with \$10.3 million for the same period in 2000 when the Company was in the process of completing several major capital projects.

As of June 30, 2001, the Company had unused borrowing capacity of approximately \$51.8 million under various credit facilities. Management believes that the Company's cash and cash equivalents, operating cash flow, and unused borrowing capacity at June 30, 2001 are sufficient to meet current and anticipated requirements for the foreseeable future.

Accounting Standards

On January 1, 2001 the Company adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by Statement of Financial Accounting Standards No. 137, Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133, an amendment of FASB Statement No. 133 and Statement of Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133 (collectively referred to hereafter as FAS 133). In accordance with the transition provisions of FAS 133, the Company recorded a \$.2 million, net-of-tax, cumulative-effect adjustment in other comprehensive income as of January 1, 2001 representing the fair value of an interest rate swap designated as a cash flow hedge.

Statement of Financial Accounting Standards No. 141, Business Combinations, (FAS 141), effective for business combinations initiated after June 30, 2001, provides guidance on accounting for business combinations and requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001.

Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, (FAS 142), effective for fiscal years beginning after December 15, 2001, requires that goodwill recorded from business combinations completed on or before June 30, 2001 shall no longer be amortized after the effective date. In addition, goodwill recorded as a result of a business combination completed after June 30, 2001 will not be amortized. Goodwill, however, must be reviewed for impairment in connection with the implementation of this standard and subsequently on an annual basis. The effect of adopting FAS 142 is still being assessed.

Table of Contents**Forward-Looking Information**

In the interest of more meaningful disclosure, Lydall and its management make statements regarding the future outlook of the Company that constitute forward-looking statements under the securities laws. These forward-looking statements are intended to provide management's current expectations for the future operating and financial performance of the company, based on assumptions and estimates currently believed to be valid. Forward-looking statements are included under the Outlook section of Item 2 and elsewhere within this report and are generally identified through the use of language such as believe, expect, estimate, anticipate and other words of similar meaning in connection with discussion of future operating or financial performance.

All forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the forward-looking statements. Some of the factors that might cause such a difference include risks and uncertainties which are detailed in Note 14 and in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no significant changes in market risks from those disclosed in Item 7A of Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

During the second quarter of 2001, a subsidiary of the Company received a draft consent order from the State of Connecticut Department of Environmental Protection proposing penalties for alleged violations of its wastewater discharge permit and treatment system failures of a now discontinued operation. The Company believes that no harm to the environment occurred and is currently evaluating the order, but believes that the potential impact will not be material to the Company's consolidated financial position, results of operations or cash flows.

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

The Company's Annual Meeting of Stockholders was held on May 9, 2001. Stockholders elected ten Directors to serve for one-year terms, until the next Annual Meeting to be held in 2002. The results of the voting were as follows:

1. Election of Nominees to the Board of Directors

| | <u>For</u> | <u>Withheld</u> |
|----------------------------|------------|-----------------|
| Lee A. Asseo | 12,333,857 | 1,133,148 |
| Samuel P. Cooley | 12,339,764 | 1,127,241 |
| W. Leslie Duffy | 12,313,576 | 1,153,429 |
| David Freeman | 12,341,763 | 1,125,242 |
| Suzanne Hammett | 12,341,663 | 1,125,342 |
| Robert E. McGill, III | 12,320,426 | 1,146,579 |
| Christopher R. Skomorowski | 11,294,070 | 2,152,935 |
| Elliott F. Whitely | 12,309,803 | 1,157,202 |
| Roger M. Widmann | 12,311,974 | 1,155,031 |
| Albert E. Wolf | 12,340,763 | 1,126,242 |

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits

- 3.1 Certificate of Incorporation of the Registrant, filed as Exhibit 3.1 to the Registrant's Annual Report on Form 10-K dated March 21, 2001, and incorporated herein by reference.

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- 3.2 By-laws of the Registrant, filed as Exhibit 3(ii) to the Registrant's Quarterly Report on Form 10-Q dated November 12, 1999, and incorporated herein by this reference.
- 99.7 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 99.8 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

b. Reports on Form 8-K

The Company did not file any reports on Form 8-K during the quarter or six months ended June 30, 2001.

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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.

(Registrant)

November 22, 2002

By:

/s/ THOMAS P. SMITH

Thomas P. Smith
Vice President Controller
(On behalf of the Registrant
and as Principal Accounting Officer)

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CERTIFICATIONS

I, Christopher R. Skomorowski, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Lydall, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

November 22, 2002
Christopher R. Skomorowski
President and Chief Executive Officer

/s/ CHRISTOPHER R. SKOMOROWSKI

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CERTIFICATIONS

I, Walter A. Ruschmeyer, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Lydall, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

November 22, 2002
Walter A. Ruschmeyer
Executive Vice President Finance
and Administration, Chief Financial Officer

/s/ WALTER A. RUSCHMEYER

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**LYDALL, INC.
Index to Exhibits**

**Exhibit
Number**

- | | |
|------|---|
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