

LYDALL INC /DE/
Form 10-Q
November 06, 2018

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

FORM 10-Q

¼QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR

½TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 1-7665

LYDALL, INC.

(Exact name of registrant as specified in its charter)

Delaware

06-0865505

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

One Colonial Road, Manchester, Connecticut

06042

(Address of principal executive offices)

(zip code)

(860) 646-1233

(Registrant's telephone number, including area code)

None

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

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

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

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

Edgar Filing: LYDALL INC /DE/ - Form 10-Q

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Common Stock \$.01 par value per share.

Total Shares outstanding October 17, 2018 17,407,427

LYDALL, INC.
INDEX

| | Page Number |
|--|----------------|
| Cautionary Note Concerning Forward – Looking Statements | 3 |
| Part I. Financial Information | |
| Item 1. <u>Financial Statements</u> | |
| <u>Condensed Consolidated Statements of Operations (Unaudited)</u> | 5 |
| <u>Condensed Consolidated Statements of Comprehensive Income (Unaudited)</u> | 7 |
| <u>Condensed Consolidated Balance Sheets (Unaudited)</u> | 8 |
| <u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u> | 9 |
| <u>Condensed Consolidated Statements of Changes in Stockholders' Equity (Unaudited)</u> | 10 |
| <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u> | 11 |
| Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | 35 |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 46 |
| Item 4. <u>Controls and Procedures</u> | 46 |
| Part II. Other Information | |
| Item 1. <u>Legal Proceedings</u> | 48 |
| Item 1A. <u>Risk Factors</u> | 48 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 50 |
| Item 6. <u>Exhibits</u> | 51 |
| Signature | 53 |

Lydall, Inc. and its subsidiaries are hereafter collectively referred to as “Lydall,” the “Company” or the “Registrant.” Lydall and its subsidiaries’ names, abbreviations thereof, logos, and product and service designators are all either the registered or unregistered trademarks or trade names of Lydall and its subsidiaries.

CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

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

- Overall economic and business conditions and the effects on the Company’s markets;
- Outlook for the fourth quarter of 2018, including the Company’s ability to improve operational effectiveness in the Thermal Acoustical Solutions segment;
- Expected vehicle production in the North American, European or Asian markets;
- Growth opportunities in markets served by the Company;
- Ability to integrate the Interface Performance Materials business, which was acquired in the third quarter of 2018;
- Expected future financial and operating performance of Interface Performance Materials;
- Expected costs and future savings associated with restructuring programs;
- Expected gross margin, operating margin and working capital improvements from the application of Lean Six Sigma;
- Product development and new business opportunities;
- Future strategic transactions, including but not limited to: acquisitions, joint ventures, alliances, licensing agreements and divestitures;
- Pension plan funding;
 - Future cash flow and uses of cash;
 - Future amounts of stock-based compensation expense;
- Future earnings and other measurements of financial performance;
- Ability to meet cash operating requirements;
- Future levels of indebtedness and capital spending;
- Ability to meet financial covenants in the Company’s amended revolving credit facility, which was further revised and outstanding borrowings increased in the third quarter of 2018;
- Future impact of the variability of interest rates and foreign currency exchange rates;
- Expected future impact of recently issued accounting pronouncements upon adoption;
- Future effective income tax rates, including the impact of the U.S. Tax Cuts and Jobs Act, and realization of deferred tax assets;

- Estimates of fair values of reporting units and long-lived assets used in assessing goodwill and long-lived assets for possible impairment; and
- The expected outcomes of legal proceedings and other contingencies, including environmental matters.

3

All forward-looking statements are inherently subject to a number of risks and uncertainties that could cause the actual results of the Company to differ materially from those reflected in forward-looking statements made in this Quarterly Report on Form 10-Q, as well as in press releases and other statements made from time to time by the Company's authorized officers. Such risks and uncertainties include, among others, worldwide economic cycles and political changes and uncertainties that affect the markets which the Company's businesses serve, which could have an effect on demand for the Company's products and impact the Company's profitability; challenges encountered by the Company in the execution of restructuring programs; challenges encountered in the integration of the acquired Interface Performance Materials business; disruptions in the global credit and financial markets, including diminished liquidity and credit availability; changes in international trade agreements and policies, including tariff regulation and trade restrictions; swings in consumer confidence and spending; unstable economic growth; volatility in foreign currency exchange rates; raw material pricing and supply issues; fluctuations in unemployment rates; retention of key employees; increases in fuel prices; and outcomes of legal proceedings, claims and investigations, as well as other risks and uncertainties identified in Part II, Item 1A - Risk Factors of this Quarterly Report on Form 10-Q, and Part I, Item 1A - Risk Factors of Lydall's Annual Report on Form 10-K for the year ended December 31, 2017. The Company does not assume any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LYDALL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands Except Per Share Data)

| | Quarter Ended September 30, | |
|--|--------------------------------|-----------|
| | 2018 | 2017 |
| | (Unaudited) | |
| Net sales | \$197,886 | \$180,041 |
| Cost of sales | 162,747 | 139,987 |
| Gross profit | 35,139 | 40,054 |
| Selling, product development and administrative expenses | 25,406 | 24,700 |
| Operating income | 9,733 | 15,354 |
| Interest expense | 1,505 | 705 |
| Other (income) expense, net | (40 |) 601 |
| Income before income taxes | 8,268 | 14,048 |
| Income tax expense | 2,076 | 3,404 |
| Income from equity method investment | (64 |) (31 |
| Net income | \$6,256 | \$10,675 |
| Earnings per share: | | |
| Basic | \$0.36 | \$0.63 |
| Diluted | \$0.36 | \$0.62 |
| Weighted average number of common shares outstanding: | | |
| Basic | 17,216 | 17,055 |
| Diluted | 17,349 | 17,267 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2018 | 2017 |
| | (Unaudited) | |
| Net sales | \$575,959 | \$520,407 |
| Cost of sales | 465,186 | 396,528 |
| Gross profit | 110,773 | 123,879 |
| Selling, product development and administrative expenses | 74,755 | 73,339 |
| Operating income | 36,018 | 50,540 |
| Interest expense | 2,617 | 2,106 |
| Other (income) expense, net | (93 |) 1,727 |
| Income before income taxes | 33,494 | 46,707 |
| Income tax expense | 5,854 | 11,201 |
| (Income) loss from equity method investment | (120 |) 37 |
| Net income | \$27,760 | \$35,469 |
| Earnings per share: | | |
| Basic | \$1.61 | \$2.08 |
| Diluted | \$1.60 | \$2.05 |
| Weighted average number of common shares outstanding: | | |
| Basic | 17,189 | 17,028 |
| Diluted | 17,339 | 17,270 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|--|--------------------------------|----------|---------------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| | (Unaudited) | | (Unaudited) | |
| Net income | \$6,256 | \$10,675 | \$27,760 | \$35,469 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | (658) | 9,438 | (9,262) | 23,951 |
| Pension liability adjustment, net of tax | 198 | 172 | 595 | 516 |
| Unrealized gain (loss) on hedging activities, net of tax | 14 | 37 | 89 | (7) |
| Comprehensive income | \$5,810 | \$20,322 | \$19,182 | \$59,929 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|---|--------------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$44,074 | \$ 59,875 |
| Accounts receivable, less allowances (2018 - \$1,505; 2017 - \$1,507) | 163,984 | 116,712 |
| Contract assets | 24,756 | — |
| Inventories | 91,879 | 80,339 |
| Taxes receivable | 4,177 | 5,525 |
| Prepaid expenses | 5,846 | 4,858 |
| Other current assets | 7,490 | 6,186 |
| Total current assets | 342,206 | 273,495 |
| Property, plant and equipment, at cost | 452,060 | 397,152 |
| Accumulated depreciation | (240,129) | (226,820) |
| Net, property, plant and equipment | 211,931 | 170,332 |
| Goodwill | 198,233 | 68,969 |
| Other intangible assets, net | 142,670 | 40,543 |
| Other assets, net | 8,199 | 7,532 |
| Total assets | \$903,239 | \$ 560,871 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$10,182 | \$ 277 |
| Accounts payable | 88,195 | 71,931 |
| Accrued payroll and other compensation | 15,317 | 15,978 |
| Accrued taxes | 3,555 | 2,230 |
| Other accrued liabilities | 14,507 | 11,690 |
| Total current liabilities | 131,756 | 102,106 |
| Long-term debt | 327,674 | 76,913 |
| Deferred tax liabilities | 41,064 | 14,714 |
| Benefit plan liabilities | 20,394 | 9,743 |
| Other long-term liabilities | 5,302 | 3,999 |
| Commitments and Contingencies (Note 15) | | |
| Stockholders' equity: | | |
| Preferred stock | — | — |
| Common stock | 251 | 250 |
| Capital in excess of par value | 91,834 | 88,006 |
| Retained earnings | 404,141 | 374,783 |
| Accumulated other comprehensive loss | (28,726) | (20,148) |
| Treasury stock, at cost | (90,451) | (89,495) |
| Total stockholders' equity | 377,049 | 353,396 |
| Total liabilities and stockholders' equity | \$903,239 | \$ 560,871 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Nine Months Ended September 30, 2018 2017 (Unaudited) | |
|---|--|-----------|
| Cash flows from operating activities: | | |
| Net income | \$27,760 | \$35,469 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 22,442 | 19,386 |
| Long-lived asset impairment charge | — | 772 |
| Inventory step-up amortization | 1,390 | 1,108 |
| Deferred income taxes | 340 | (466) |
| Stock-based compensation | 3,187 | 3,240 |
| (Income) loss from equity method investment | (120) | 37 |
| Loss on disposition of property, plant and equipment | 100 | — |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (25,407) | (12,138) |
| Contract assets | (5,443) | — |
| Inventories | (12,160) | (11,795) |
| Accounts payable | 8,296 | 18,071 |
| Accrued payroll and other compensation | (1,406) | 2,044 |
| Accrued taxes | 981 | (2,826) |
| Benefit plan liabilities | (7,635) | (3,797) |
| Other, net | 2,173 | (2,913) |
| Net cash provided by operating activities | 14,498 | 46,192 |
| Cash flows from investing activities: | | |
| Business acquisitions, net of cash acquired | (269,972) | (335) |
| Capital expenditures | (20,091) | (19,918) |
| Proceeds from the sale of property, plant and equipment | 282 | — |
| Net cash used for investing activities | (289,781) | (20,253) |
| Cash flows from financing activities: | | |
| Proceeds from borrowings | 338,000 | — |
| Debt repayments | (76,794) | (35,674) |
| Debt issuance cost payments | (538) | — |
| Common stock issued | 846 | 409 |
| Common stock repurchased | (956) | (2,592) |
| Net cash provided by (used for) financing activities | 260,558 | (37,857) |
| Effect of exchange rate changes on cash | (1,076) | 4,690 |
| Decrease in cash and cash equivalents | (15,801) | (7,228) |
| Cash and cash equivalents at beginning of period | 59,875 | 71,934 |
| Cash and cash equivalents at end of period | \$44,074 | \$64,706 |

Non-cash capital expenditures of \$6.1 million and \$3.6 million were included in accounts payable at September 30, 2018 and 2017, respectively.

See accompanying Notes to Condensed Consolidated Financial Statements.

LYDALL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

| In thousands of dollars and shares | Common Stock Shares | Common Stock Amount | Capital in Excess of Par Value | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock | Total Stockholders' Equity |
|--|---------------------------|---------------------------|--|----------------------|---|-------------------|----------------------------------|
| Balance at December 31, 2017 | 25,018 | \$ 250 | \$88,006 | \$374,783 | \$ (20,148) | \$(89,495) | \$ 353,396 |
| Net Income | | | | 27,760 | | | 27,760 |
| Other comprehensive income, net of tax | | | | | (8,578) | | (8,578) |
| Stock repurchased | | | | | | (956) | (956) |
| Stock issued under employee plans | 83 | 1 | 847 | | | | 848 |
| Stock-based compensation expense | | | 2,847 | | | | 2,847 |
| Stock issued to directors | 3 | | 134 | | | | 134 |
| Adoption of ASC 606 | | | | 1,598 | | | 1,598 |
| Balance at September 30, 2018 | 25,104 | 251 | 91,834 | 404,141 | (28,726) | (90,451) | 377,049 |

See accompanying Notes to Condensed Consolidated Financial Statements.

LYDALL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Financial Statement Presentation

Description of Business

Lydall, Inc. and its subsidiaries (the “Company” or “Lydall”) design and manufacture specialty engineered nonwoven filtration media, industrial thermal insulating solutions, and thermal and acoustical barriers for filtration/separation and heat abatement and sound dampening applications.

On July 12, 2018, the Company acquired certain assets and assumed certain liabilities of the Precision Filtration division of Precision Custom Coatings (“PCC”) based in Totowa, NJ for \$1.6 million in cash with additional cash payments of up to \$2.0 million to be made based on the achievement of certain future financial targets through 2022. Precision Filtration is a producer of high-quality, air filtration media principally serving the commercial and residential HVAC markets with products in the efficiency range of MERV 7-11. The acquired business is included in the Company’s Performance Materials operating segment.

On August 31, 2018, the Company acquired an engineered sealing materials business operating under Interface Performance Materials (“Interface”), based in Lancaster, Pennsylvania for \$268.4 million, net of cash acquired of \$5.2 million. A globally-recognized leader in the delivery of engineered sealing solutions, the Interface operations manufacture wet-laid gasket and specialty materials primarily serving OEM and Tier I manufacturers in the agriculture, construction, earthmoving, industrial, and automotive segments. The acquired business is included in the Company's Performance Materials operating segment.

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 accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The year-end Condensed Consolidated Balance Sheet was derived from the December 31, 2017 audited financial statements, but does not include all disclosures required by U.S. GAAP. 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 audited consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Effective January 1, 2018 the Company adopted the requirements of Accounting Standards Update (“ASU”) No. 2014-09 (“ASC 606”) using the modified retrospective method. Therefore, the comparative information has not been adjusted and continues to be reported under the prior guidance of ASC 605. The details of the significant changes and quantitative impact of the changes are disclosed in Note 2 “Revenue from Contracts with Customers.”

Effective January 1, 2018, the Company combined the Thermal/Acoustical Metals and Thermal/Acoustical Fibers operating segments into a single operating segment named Thermal Acoustical Solutions. Combining these automotive segments into one segment is expected to allow the Company to better serve its customers, leverage

operating disciplines and drive efficiencies across the global automotive operations. Refer to Note 14 "Segment Information" for further information. Prior period segment amounts throughout the Notes to the Condensed Consolidated Financial Statements have been recast to reflect the new segment structure. The recast of historical business segment information had no impact on the Company's consolidated financial results.

Effective September 30, 2018, as a result of the Interface acquisition, the Performance Materials segment changed the disaggregation of revenue at the product level to be categorized as "Filtration" and "Sealing and Advanced Solutions".

Prior period segment amounts throughout the Notes to the Condensed Consolidated Financial Statements have been recast to reflect the results of the new segment structure. The recast of historical business segment information had no impact on the consolidated financial results.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". The amended guidance establishes a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and will supersede most of the existing revenue recognition guidance, including industry-specific guidance.

The amended guidance clarifies that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the amended guidance, an entity will (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the contract's performance obligations; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASC 606 is effective for the Company's interim and annual reporting periods beginning January 1, 2018, and is to be adopted using either a full retrospective or modified retrospective transition method.

The Company adopted the amended guidance and all related amendments using the modified retrospective approach on January 1, 2018, at which time it became effective for the Company. The Company recognized the cumulative effect of initially applying the new revenue standard to all contracts that were not completed on the date of adoption as an adjustment to the opening balance of retained earnings. (See Note 2. "Revenue from Contracts with Customers"). At the adoption date, the cumulative impact of revenue that would have been recognized over time, was \$19.6 million. The impact was primarily driven by tooling net sales of \$16.3 million from customer contracts within the Thermal Acoustical Solutions ("TAS") segment. The related adoption impact to retained earnings was \$1.6 million, net of tax. Refer to Note 2.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall" (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities". This ASU revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. This ASU is effective for fiscal years beginning after December 15, 2017. In February 2018, the FASB issued ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities", which clarifies various aspects of the guidance issued in ASU 2016-01. The adoption of these amendments is not required for public business entities with fiscal years beginning between December 15, 2017 and June 15, 2018 until the interim period beginning after June 15, 2018, however early adoption is permitted. The Company adopted both ASUs effective January 1, 2018. The adoption of these ASUs did not have any impact on the Company's consolidated financial statements and disclosures.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments", which provides guidance on eight specific cash flow classification issues. Prior to this ASU, GAAP did not include specific guidance on these eight cash flow classification issues. This ASU is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The adoption of this ASU did not have any impact on the Company's consolidated financial statements and disclosures.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory" as part of the Board's initiative to reduce complexity in accounting standards. This ASU eliminates an exception in ASC 740, which prohibits the immediate recognition of income tax consequences of intra-entity asset transfers other than inventory. This ASU requires entities to recognize the immediate current and deferred income tax effects of intra-entity asset transfers. This ASU is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The adoption of this ASU did not have any impact on the Company's consolidated financial statements and disclosures.

In November 2016, the FASB issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash", which clarifies guidance and presentation related to restricted cash in the statement of cash flows, including stating that restricted cash should be included within cash and cash equivalents on the statement of cash flows. The ASU was

effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company adopted this ASU effective January 1, 2018. The adoption of this ASU did not have any impact on the Company's consolidated financial statements and disclosures.

In January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business", which adds guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments of this ASU provide a screen to determine when an integrated set of assets and activities is not a business. This ASU was effective for fiscal years beginning after December 15, 2017. The Company evaluated this ASU in connection with its third quarter 2018 transactions and determined both to meet the definition of a business.

In March 2017, the FASB issued ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost". This ASU requires an entity to report the service cost component of net benefit costs in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period. This ASU also requires the other components of net benefit cost, which includes interest costs and actual return on plan assets to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. This ASU was effective for fiscal year beginning after December 15, 2017. As

required for retrospective adoption, the Company reclassified net benefit costs of \$0.1 million from cost of sales and \$0.1 million from the selling, product development and administrative expenses to other expense, net, in the Consolidated Statement of Operations for the quarter ended September 30, 2017. The Company reclassified net benefit costs of \$0.2 million from cost of sales and \$0.4 million from the selling, product development and administrative expenses to other expense, net, in the Consolidated Statement of Operations for the nine months ended September 30, 2017. The adoption of this ASU had minimal impact on the Company's consolidated financial statements and disclosures for the quarter and nine months ended September 30, 2018.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting". This ASU requires an entity to apply modification accounting in Topic 718 when there are changes to the terms or conditions of a share-based payment award, unless the fair value, vesting conditions, and classification of the modified award are the same as the original award immediately before the original award is modified. This ASU was effective for fiscal years beginning after December 15, 2017. The adoption of this ASU did not have any impact on the Company's consolidated financial statements and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)". This ASU requires entities that lease assets with lease terms of more than 12 months to recognize right-of-use assets and lease liabilities created by those leases on their balance sheets. This ASU will also require new qualitative and quantitative disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. This ASU is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. In July 2018, the FASB amended the leasing guidance to add a transition option. The Company plans to elect the transition option to continue to apply the legacy guidance ASC 840, Leases, including disclosure requirements, in the comparative periods presented in the year of adoption. With this election, a cumulative-effect adjustment will be recorded to retained earnings in the period of adoption. Based on the effective date, this amended guidance will apply to the Company beginning on January 1, 2019. Significant implementation matters being addressed by the Company include implementing an integrated third-party lease accounting application, assessing the impact to its internal control over financial reporting and documenting the new lease accounting process. The Company is still in the process of evaluating the effect of adoption on its consolidated financial statements and currently assessing the accounting treatment of the leases under the new standard, the Company anticipates the ASU will have a material impact on its assets and liabilities due to the addition of right-of-use assets and lease liabilities to the balance sheet; however, it does not expect the ASU to have a material impact on the Company's consolidated cash flows or results of operations.

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718) ("ASU 2018-07"). ASU 2018-07 was issued in order to expand the guidance for stock-based compensation, to include share-based payment transactions for acquiring goods and services from nonemployees. The pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company does not expect the adoption of the new accounting standard to have a material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement ("ASU 2018-13"), which adds, amends and removes certain disclosure requirements related to fair value measurements. Among other changes, this standard requires certain additional disclosure surrounding Level 3 assets, including changes in unrealized gains or losses in other comprehensive income and certain inputs in those measurements. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amended or eliminated disclosures in this standard may be adopted early, while certain additional disclosure requirements in this standard can be adopted on its effective date. In addition, certain changes in the standard require retrospective

adoption, while other changes must be adopted prospectively. The Company is currently evaluating the impact of this update on its consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU No. 2018-14, "Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans." This ASU requires entities to disclose the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates. This ASU also requires entities to disclose an explanation for significant gains and losses related to changes in the benefit obligation for the period. This ASU is effective for fiscal years beginning after December 15, 2020 with early adoption permitted. The Company is currently evaluating the method and impact the adoption of ASU 2018-14 will have on the Company's consolidated financial statements and disclosures.

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40); Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The amendments in this update require implementation costs incurred by customers in cloud computing arrangements (i.e., hosting arrangements) to be capitalized under the same premises of authoritative guidance for internal-use software, and deferred over the noncancellable term of the cloud computing arrangement plus any option renewal periods that are reasonably certain to be exercised by the customer or for which the exercise is controlled by the service provider. The Company is required to adopt

this new guidance in the first quarter of 2020. Early adoption is permitted. The Company is currently evaluating the impact of this update on its consolidated financial statements and related disclosures.

Significant Accounting Policies

The Company's significant accounting policies are detailed in Note 1 "Significant Accounting Policies" within Part IV Item 15 of the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Significant changes to these accounting policies as a result of adopting ASC 606 "Revenue from Contracts with Customers" are discussed within Note 2, "Revenue from Contracts with Customers."

2. Revenue from Contracts with Customers

The Company accounts for revenue in accordance with ASC 606, Revenue from Contracts from Customers. These revenues are generated from the design and manufacture of specialty engineered filtration media, industrial thermal insulating solutions, automotive thermal and acoustical barriers for filtration/separation and thermal/acoustical applications. The Company's revenue recognition policies require the Company to make significant judgments and estimates. In applying the Company's revenue recognition policy, determinations must be made as to when control of products passes to the Company's customers which can be either at a point in time or over time. Revenue is generally recognized at a point in time when control passes to customers upon shipment of the Company's products and revenue is generally recognized over time when control of the Company's products transfers to customers during the manufacturing process (see description below). The Company analyzes several factors, including but not limited to, the nature of the products being sold and contractual terms and conditions in contracts with customers to help the Company make such judgments about revenue recognition.

The Company accounts for revenue from contracts with customers when there is approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable. Revenue is primarily derived from customer purchase orders, master sales agreements, and negotiated contracts, all of which represent contracts with customers.

The Company next identifies the performance obligations in the contract. A performance obligation is a promise to provide distinct goods or services. Performance obligations are the unit of account for purposes of applying the revenue standard and therefore determines when and how revenue is recognized. The Company determines the performance obligations at contract inception based on the goods that are promised in a contract with a customer. Typical performance obligations include automotive parts, automotive tooling, rolled good media and filter bags.

The transaction price in the contract is determined based on the consideration to which the Company will be entitled in exchange for transferring products to the customer, excluding amounts collected on behalf of third parties (for example, sales taxes). The transaction price is typically stated on the purchase order or in a negotiated agreement. Certain contracts may include variable consideration in the transaction price, such as rebates, pricing discounts, price concessions, sales incentives, index pricing or other provisions that can decrease the transaction price. Estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based on reasonably available information (customer historical, current and forecasted data). In certain circumstances where a particular outcome is probable, the Company utilizes the most likely amount to which the Company expects to be entitled. The Company accounts for consideration payable to a customer as a reduction of the transaction price thereby reducing the amount of revenue recognized. Consideration payable to a customer includes cash amounts that the Company pays, or expects to pay, to a customer based on certain contract requirements.

The Company recognizes revenue as performance obligations are satisfied, which can be either over time or at a point in time, depending on when control of the Company's products transfers to its customers.

In circumstances when control transfers over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. Due to the nature of the work required to be performed on many of the Company's performance obligations, the estimation of total revenue and cost at completion is complex, subject to many variables and requires significant judgment.

The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products to be provided. The Company generally uses the cost-to-cost measure of progress for contracts because it best depicts the transfer of control to the customer which occurs as costs are incurred on contracts. Under the cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenues are recorded proportionally as costs are incurred.

For tooling revenue recognized over time, the Company makes significant judgments which includes, but not limited to, estimated costs to completion, costs incurred to date, and assesses risks related to changes in estimates of revenues and costs. In doing so,

management must make assumptions regarding the work required to fulfill the performance obligations, which is dependent upon the execution by the Company's subcontractors, among other variables and contract requirements.

Changes in estimates for revenue recognized over time are recorded by the Company in the period they become known. Changes are recognized on a cumulative catch-up basis in net sales, costs of sales, and operating income. The cumulative catch up adjustment recognizes in the current period the cumulative effect of changes in estimates on current and prior periods.

Performance Obligations

The following is a description of products and performance obligations, separated by reportable segments, from which the Company generates its revenue. For more detailed information about reportable segments, see Note 14 "Segment Information."

Segment Performance Materials

Products Products for this segment include filtration media solutions primarily for air, fluid power, life science and industrial applications, gasket and sealing solutions, thermal insulation, energy storage, and other engineered products.

These contracts typically have distinct performance obligations, which is the promise to transfer the media solutions to the Company's customers.

Performance Obligations The Company recognizes revenue at a point in time or over time, based upon when control of the underlying product transfers to the customer. If revenue is recognized at a point in time, the performance obligation is typically satisfied upon shipment and in accordance with shipping terms. In circumstances when control transfers over time, revenue is recognized based on the extent of progress towards completion of the performance obligation.

Customer payment terms are negotiated on a contract-by-contract basis and typically range from 30 to 90 days.

Segment Technical Nonwovens

Products This segment produces needle punch nonwoven solutions including industrial filtration and advanced materials products. Industrial Filtration products include nonwoven rolled-good felt media and filter bags used primarily in industrial air and liquid filtration applications. Advanced materials products include nonwoven rolled good media used in commercial applications and predominantly serves the geosynthetic, automotive, industrial, medical, and safety apparel markets. The automotive media is provided to tier-one suppliers as well as the Company's Thermal Acoustical Solutions segment.

These contracts typically have distinct performance obligations, which is the promise to transfer the industrial filtration or advanced materials products to the Company's customers.

Performance Obligations The Company recognizes revenue at a point in time or over time, based upon when control transfers to the customer. If revenue is recognized at a point in time, the performance obligation is typically satisfied upon shipment and in accordance with shipping terms. In circumstances when control transfers over time, revenue is recognized based on the extent of progress towards completion of the performance obligation.

Customer payment terms are negotiated on a contract-by-contract basis and typically range from 30 to 90 days.

For filter bag sales, the Company may enter into warranty agreements that are implied or sold with the product to provide assurance that a product will function as expected and in accordance with certain specifications. Therefore, this type of warranty is not a separate performance obligation.

Segment Thermal Acoustical Solutions

Products Parts - The segment produces a full range of innovative engineered products tailored for the transportation sector to thermally shield sensitive components from high heat, improve exhaust gas treatment and lower harmful emissions as well as assist in the reduction of noise vibration and harshness. The majority of products are sold to original equipment manufacturers and tier-one suppliers.

Tooling - The Company enters into contractual agreements with certain customers within the automotive industry, to design and develop molds, dies and tools (collectively, "tooling").

Parts - Customer contracts typically have distinct performance obligations, which is the promise to transfer manufactured parts to these customers. The Company recognizes parts revenue at a point in time or over time, based upon when control transfers to the customer. If revenue is recognized at a point in time, the performance obligation is typically satisfied upon shipment and in accordance with shipping terms. In circumstances when control transfers over time, revenue is recognized based on the extent of progress towards completion of the performance obligation.

Performance Obligations Customer payment terms are negotiated on a contract-by-contract basis and typically range from 30 to 90 days.

Tooling - Customer contracts typically have distinct performance obligations and are generally completed within one year. The Company periodically enters into multiple contracts with a customer at or near the same time which may be combined for purposes of determining the appropriate transaction price. The Company allocates the transaction price to each performance obligation in the contract based on a relative stand-alone selling price using costs incurred plus expected margin. The corresponding revenues are recognized over time as the related performance obligations are satisfied.

Tooling customer payment terms typically range from 30 to 90 days after title transfers to the customer. Occasionally customers make progress payments as the tool is constructed.

Practical Expedients and Exemptions

The Company has elected to adopt the contract cost practical expedient. This expedient allows the Company to recognize its incremental costs of obtaining contracts, such as sales commissions, as an expense when incurred if the related contract revenue is expected to be recognized in one year or less. These costs are included in selling, product development and administrative expenses.

The Company has made an accounting policy election to record shipping and handling activities occurring after control has passed to the customer to be treated as a fulfillment cost rather than as a distinct performance obligation. Shipping and handling expenses

consist primarily of costs incurred to deliver products to customers and internal costs related to preparing products for shipment and are recorded as a cost of sales. Amounts billed to customers as shipping and handling are classified as revenue when services are performed.

ASC 606 requires the disclosure of unsatisfied performance obligations related to contracts from customers at the end of each reporting period. The Company has elected the practical expedient because the Company's contracts generally have a duration of one year or less, therefore no disclosure is required.

The Company has elected to adopt the practical expedient to disregard the need to adjust the promised amount of consideration for the effects of a significant financing component as the Company expects that the period of time between when the products are transferred to the customer and when the Company is paid for those products will be one year or less.

Contract Assets and Liabilities

The Company's contract assets primarily include unbilled amounts typically resulting from sales under contracts when the over time method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer. These unbilled accounts receivable in contract assets are transferred to accounts receivable upon invoicing, typically when the right to payment becomes unconditional in which case payment is due based only upon the passage of time.

The Company's contract liabilities primarily relate to billings and advance payments received from customers, and deferred revenue. These contract liabilities represent the Company's obligation to transfer its products to its customers for which the Company has received, or is owed consideration from its customers. Contract liabilities are included in other accrued liabilities on the Company's Condensed Consolidated Balance Sheets.

Contract assets and liabilities consisted of the following (in thousands):

| | September 30, January 1, Dollar | | |
|----------------------|---------------------------------|-----------|----------|
| | 2018 | 2018 | Change |
| Contract assets | \$ 24,756 | \$ 19,125 | \$ 5,631 |
| Contract liabilities | \$ 3,188 | \$ 2,820 | \$ 368 |

The \$5.6 million increase in contract assets from January 1, 2018 to September 30, 2018 was primarily due to timing of billings to customers and contract assets increased \$0.2 million relating to the acquisition of Interface. See Note 3 "Acquisitions."

The \$0.4 million increase in contract liabilities from January 1, 2018 to September 30, 2018 was primarily due to an increase in customer deposits partially offset by revenue recognized of \$2.5 million in the first nine months of 2018 related to contract liabilities at January 1, 2018.

Impacts on Financial Statements

The cumulative effect of the changes made to the Company's Condensed Consolidated January 1, 2018 Balance Sheet for the adoption of ASC 606 was as follows:

| In thousands | Adjustments | | |
|------------------------------|--------------------------|-----------------------|--------------------|
| | December for 31, 2017 | Adoption of ASC606 | January 1, 2018 |
| Assets: | | | |
| Contract assets | \$— | \$ 19,125 | \$ 19,125 |
| Inventories | \$ 80,339 | \$ (15,184) | \$ 65,155 |
| Liabilities: | | | |
| Accounts payable | \$ 71,931 | \$ 663 | \$ 72,594 |
| Other accrued liabilities | \$ 11,690 | \$ 1,209 | \$ 12,899 |
| Deferred tax liabilities | \$ 14,714 | \$ 471 | \$ 15,185 |
| Stockholders' equity: | | | |
| Retained earnings | \$ 374,783 | \$ 1,598 | \$ 376,381 |

The cumulative effect of the changes made to the Company's Condensed Consolidated Balance Sheet for the adoption of ASC 606 was as follows:

| In thousands | September 30, 2018 Balances | | |
|--------------------------------------|--------------------------------------|------------------------|----------------|
| | Without Adoption of ASC 606 | ASC 606 Adjustments | As Reported |
| Assets: | | | |
| Contract assets | \$— | \$ 24,756 | \$ 24,756 |
| Inventories | \$ 113,718 | \$ (21,839) | \$ 91,879 |
| Liabilities: | | | |
| Accounts payable | \$ 86,502 | \$ 1,693 | \$ 88,195 |
| Other accrued liabilities | \$ 16,655 | \$ (2,148) | \$ 14,507 |
| Deferred tax liabilities | \$ 40,306 | \$ 758 | \$ 41,064 |
| Stockholders' equity: | | | |
| Retained earnings | \$ 401,489 | \$ 2,652 | \$ 404,141 |
| Accumulated other comprehensive loss | \$ (28,688) | \$ (38) | \$ (28,726) |

The cumulative effect of the changes made to the Company's Condensed Consolidated Statement of Operations for the adoption of ASC 606 for the quarter and nine months ended September 30, 2018 were as follows:

| In thousands | Quarter Ended September 30, 2018 | | |
|--|--|--|----------------|
| | Results Without Adoption of ASC606 | Effect of Change Higher (Lower) | As Reported |
| Net sales | \$ 198,949 | \$(1,063) | \$ 197,886 |
| Cost of sales | 164,793 | (2,046) | 162,747 |
| Gross profit | 34,156 | 983 | 35,139 |
| Selling, product development and administrative expenses | 25,406 | — | 25,406 |
| Operating income | 8,750 | 983 | 9,733 |
| Interest expense | 1,505 | — | 1,505 |
| Other income, net | (40) | — | (40) |
| Income before income taxes | 7,285 | 983 | 8,268 |
| Income tax expense | 1,846 | 230 | 2,076 |
| Income from equity method investment | (64) | — | (64) |
| Net income | \$ 5,503 | \$ 753 | \$ 6,256 |
| Earnings per share: | | | |
| Basic | \$ 0.32 | \$ 0.04 | \$ 0.36 |
| Diluted | \$ 0.32 | \$ 0.04 | \$ 0.36 |
| Weighted average number of common shares outstanding: | | | |
| Basic | 17,216 | — | 17,216 |
| Diluted | 17,349 | — | 17,349 |

In the third quarter of 2018, ASC 606 had a negative impact to net sales of \$1.1 million primarily due to tooling sales. However, ASC 606 had a positive impact to gross profit of \$1.0 million as tooling sales had a minimal effect on gross profit. ASC 606 resulted in lower tooling net sales and cost of sales of approximately \$5.0 million as tooling projects, with minimal gross profit and over time revenue recognition under ASC 606, were closed and invoiced to customers. The gross profit effect of \$1.0 million was due to over time non-tooling sales recognized in the third quarter under ASC 606 of approximately \$3.9 million at a gross profit of approximately \$1.0 million.

| In thousands | Nine Months Ended September 30, 2018 | | |
|--|--------------------------------------|---------------------------------|-------------|
| | Results Without Adoption of ASC606 | Effect of Change Higher (Lower) | As Reported |
| Net sales | \$569,160 | \$ 6,799 | \$575,959 |
| Cost of sales | 459,728 | 5,458 | 465,186 |
| Gross profit | 109,432 | 1,341 | 110,773 |
| Selling, product development and administrative expenses | 74,755 | — | 74,755 |
| Operating income | 34,677 | 1,341 | 36,018 |
| Interest expense | 2,617 | — | 2,617 |
| Other income, net | (93) | — | (93) |
| Income before income taxes | 32,153 | 1,341 | 33,494 |
| Income tax expense | 5,567 | 287 | 5,854 |
| Income from equity method investment | (120) | — | (120) |
| Net income | \$26,706 | \$ 1,054 | \$27,760 |
| Earnings per share: | | | |
| Basic | \$1.55 | \$ 0.06 | \$1.61 |
| Diluted | \$1.54 | \$ 0.06 | \$1.60 |
| Weighted average number of common shares outstanding: | | | |
| Basic | 17,189 | — | 17,189 |
| Diluted | 17,339 | — | 17,339 |

Disaggregated Revenue

The Company disaggregates revenue from customers by geographic region, as it believes this disclosure best depicts how the nature, amount, timing and uncertainty of the Company's revenue and cash flows are affected by economic factors. Disaggregated revenue by geographical region for the quarter and nine months ended September 30, 2018 were as follows:

| In thousands | Quarter Ended September 30, 2018 | | | | Consolidated Net Sales |
|-----------------|----------------------------------|---------------------|------------------------------|------------------------|------------------------|
| | Performance Materials | Technical Nonwovens | Thermal Acoustical Solutions | Eliminations and Other | |
| North America | \$29,048 | \$ 44,092 | \$ 58,484 | \$ (4,891) | \$ 126,733 |
| Europe | 12,120 | 18,757 | 24,183 | (225) | 54,835 |
| Asia | 552 | 10,222 | 5,544 | — | 16,318 |
| Total Net Sales | \$41,720 | \$ 73,071 | \$ 88,211 | \$ (5,116) | \$ 197,886 |

| In thousands | Nine Months Ended September 30, 2018 | | | | Consolidated Net Sales |
|--------------|--------------------------------------|---------------------|------------------------------|------------------------|------------------------|
| | Performance Materials | Technical Nonwovens | Thermal Acoustical Solutions | Eliminations and Other | |

Edgar Filing: LYDALL INC /DE/ - Form 10-Q

| | | | | | |
|-----------------|-----------|------------|------------|------------|--------------|
| North America | \$69,088 | \$ 128,788 | \$ 190,385 | \$(19,249) |) \$ 369,012 |
| Europe | 34,007 | 56,197 | 76,753 | (580) |) 166,377 |
| Asia | 552 | 27,339 | 12,679 | — | 40,570 |
| Total Net Sales | \$103,647 | \$ 212,324 | \$ 279,817 | \$(19,829) |) \$ 575,959 |

20

3. Acquisitions

On August 31, 2018, the Company completed the previously announced acquisition of Interface Performance Materials ("Interface"), based in Lancaster, Pennsylvania. A globally-recognized leader in the delivery of engineered sealing solutions, the Interface operations manufacture wet-laid gasket and specialty materials primarily serving OEM and Tier I manufacturers in the Agriculture, Construction, Earthmoving, Industrial, and Automotive segments. The transaction strengthens the Company's position as an industry-leading global provider of filtration materials and expands the Company's end markets into attractive adjacencies. The Company acquired one hundred percent of Interface for \$268.4 million, net of cash acquired of \$5.2 million, subject to a post-closing purchase price adjustment that is expected to be finalized in the fourth quarter of 2018. The purchase price was financed with a combination of cash on hand and \$261.4 million of borrowings from the Company's amended \$450 million credit facility. The assets and liabilities of Interface have been included in the Company's Consolidated Balance Sheet at September 30, 2018. The acquired business is included in the Company's Performance Materials reporting segment.

During the quarter and nine months ended September 30, 2018, the Company incurred \$1.5 million and \$2.6 million, respectively, of transaction costs, related to the acquisition of Interface. These transaction costs include legal fees and other professional services fees to complete the transaction. These corporate office expenses have been recognized in the Company's Condensed Consolidated Statements of Operations as selling, product development and administrative expenses.

The results of operations of Interface have been included in the Company's results from the date of the acquisition, and for the quarter and nine months ended September 30, 2018, Interface reported net sales and operating loss of \$11.8 million and \$0.3 million, respectively. Interface's operating loss for the quarter and nine months ended September 30, 2018 included \$1.4 million of purchase accounting inventory fair value step-up adjustments in cost of sales upon the sale of inventory and \$0.9 million of intangible amortization expense in selling, product development and administrative expenses.

The following table presents the preliminary determination of the fair value of identifiable assets acquired and liabilities assumed from the Company's acquisition of Interface. The final determination of the fair value of certain assets and liabilities will be completed within the one year measurement period as required by the FASB ASC Topic 805, "Business Combinations." As the Company finalizes the fair value of assets acquired and liabilities assumed, additional purchase price adjustments may be recorded during the measurement period in the last quarter of 2018 and the first eight months of 2019. Fair value estimates are based on a complex series of judgments about future events and uncertainties and rely heavily on estimates and assumptions. The judgments used to determine the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives, can materially impact the Company's results of operations. The finalization of the purchase accounting assessment may result in a change in the valuation of assets acquired and liabilities assumed and may have a material impact on the Company's results of operations and financial position.

The following is a preliminary estimate of the assets acquired and the liabilities assumed by the Company at the date of the acquisition:

| In thousands | |
|---|----------|
| Accounts receivable | \$25,182 |
| Inventories | 17,313 |
| Prepaid expenses and other current assets | 2,382 |
| Property, plant and equipment | 40,902 |
| Goodwill (Note 5) | 130,462 |

| | |
|---|-------------|
| Other intangible assets (Note 5) | 107,800 |
| Other assets | 308 |
| Total assets acquired, net of cash acquired | \$324,349 |
| Current liabilities | \$(11,319) |
| Deferred tax liabilities | (25,275) |
| Benefit plan liabilities | (18,352) |
| Other long-term liabilities | (1,031) |
| Total liabilities assumed | (55,977) |
| Total purchase price, net of cash acquired | \$268,372 |

The following table reflects the unaudited pro forma operating results of the Company for the quarter and nine months ended September 30, 2018 and 2017, which gives effect to the acquisition of Interface as if it had occurred on January 1, 2017. The pro forma information includes the historical financial results of the Company and Interface. The pro forma results are not necessarily indicative of the operating results that would have occurred had the acquisition been effective January 1, 2017, nor are they intended to be indicative of results that may occur in the future. The pro forma information does not include the effects of any synergies related to the acquisition.

| | (Unaudited Pro Forma) | | (Unaudited Pro Forma) | |
|---------------------|--------------------------------|-----------|---------------------------------------|-----------|
| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
| In thousands | 2018 | 2017 | 2018 | 2017 |
| Net sales | \$220,937 | \$214,503 | \$678,418 | \$627,197 |
| Net income | \$6,147 | \$8,474 | \$28,461 | \$26,061 |
| Earnings per share: | | | | |
| Basic | \$0.36 | \$0.50 | \$1.66 | \$1.53 |
| Diluted | \$0.35 | \$0.49 | \$1.64 | \$1.51 |
| Basic | 17,216 | 17,055 | 17,189 | 17,028 |
| Diluted | 17,349 | 17,267 | 17,339 | 17,270 |

Pro forma adjustments to historical financial statements during the quarter ended September 30, 2018 resulted in an additional \$7.9 million of net income. Earnings were adjusted to exclude non-recurring items such as acquisition related expenses for both Lydall and Interface, purchase accounting adjustments for inventory step-up and tax valuation allowance expenses. Earnings were also adjusted to include items such as additional intangibles amortization expense and additional interest expense associated with borrowings under the Company's Amended Credit Facility.

Pro forma adjustments during the quarter ended September 30, 2017 reduced net income by \$1.7 million. Earnings for the quarter ended September 30, 2017 were adjusted to include items such as additional intangibles amortization expense and additional interest expense associated with borrowings under the Company's Amended Credit Facility. Earnings were adjusted to exclude items such as Interface management fee expenses and tax valuation allowance expenses.

Pro forma adjustments during the nine months ended September 30, 2018 resulted in an additional \$5.6 million of net income. Earnings were adjusted to exclude items such as acquisition related expenses for both Lydall and Interface, purchase accounting adjustments for inventory step-up and tax valuation allowance expenses. Earnings for the nine months ended September 30, 2018 were adjusted to include items such as additional intangibles amortization expense and additional interest expense associated with borrowings under the Company's Amended Credit Facility.

Pro forma adjustments during the nine months ended September 30, 2017 reduced net income by \$11.6 million. Earnings for the nine months ended September 30, 2017 were adjusted to include items such as acquisition related expenses for both Lydall and Interface, additional intangibles amortization expense, purchase accounting adjustments for inventory step-up and additional interest expense associated with borrowings under the Company's Amended Credit Facility. Earnings were adjusted to exclude items such as Interface management fee expenses and tax valuation allowance expenses.

On July 12, 2018, the Company acquired certain assets and assumed certain liabilities of the Precision Filtration division of Precision Custom Coatings ("PCC") based in Totowa, NJ. Precision Filtration is a producer of high-quality, air filtration media principally serving the commercial and residential HVAC markets with a range of low efficiency through high-performing air filtration media. The Company acquired the assets and liabilities of PCC for \$1.6 million in cash with additional cash payments of up to \$2.0 million to be made based on the achievement of certain future financial targets through 2022. The assets and liabilities related to the acquisition of PCC have been included in the Company's Performance Materials reporting segment and in the Consolidated Balance Sheets at September 30, 2018. PCC had a minimal impact on the Company's sales and operating income for the quarter and nine months ended September 30, 2018.

4. Inventories

Inventories as of September 30, 2018 and December 31, 2017 were as follows:

| In thousands | September 30, December 31, | |
|-------------------------|----------------------------|-----------|
| | 2018 | 2017 |
| Raw materials | \$ 41,182 | \$ 28,672 |
| Work in process | 21,630 | 29,427 |
| Finished goods | 29,067 | 23,901 |
| | 91,879 | 82,000 |
| Less: Progress billings | — | (1,661) |
| Total inventories | \$ 91,879 | \$ 80,339 |

Included in work in process is gross tooling inventory of \$5.2 million and \$20.2 million at September 30, 2018 and December 31, 2017, respectively. Tooling inventory, net of progress billings, was \$18.5 million at December 31, 2017. Effective January 1, 2018 the Company adopted ASC 606, Revenue from Contracts with Customers, under the modified retrospective transition method. The adoption of ASC 606 resulted in the reclassification of progress billings to contract liabilities. See Note 2, Revenue from Contracts with Customers, for further discussion of contract liabilities.

5. Goodwill and Other Intangible Assets

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, 2018 were as follows:

| In thousands | December 31, 2017 | Currency translation adjustments | Additions | September 30, 2018 |
|-----------------------|----------------------|--|------------|-----------------------|
| Performance Materials | \$ 13,307 | \$ (142) | \$ 130,980 | \$ 144,145 |
| Technical Nonwovens | 55,662 | (1,574) | — | 54,088 |
| Total goodwill | \$ 68,969 | \$ (1,716) | \$ 130,980 | \$ 198,233 |

The additional goodwill of \$131.0 million within the Performance Materials segment results from the two acquisitions completed in the third quarter of 2018. The Interface acquisition accounted for \$130.5 million of the \$131.0 million increase. The amount allocated to goodwill is reflective of the benefits the Company expects to realize from the expansion of the Company's engineered materials offering, new product development and Interface's assembled workforce. None of the goodwill associated with the Interface acquisition is expected to be deductible for income tax purposes.

Other Intangible Assets:

The table below presents the gross carrying amount and, as applicable, the accumulated amortization of the Company's acquired intangible assets other than goodwill included in "Other intangible assets, net" in the Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017:

| In thousands | September 30, 2018 | | December 31, 2017 | |
|--------------|--------------------|-----------------------------|-------------------|-----------------------------|
| | Gross Carrying | Accumulated Amortization | Gross Carrying | Accumulated Amortization |

Edgar Filing: LYDALL INC /DE/ - Form 10-Q

| | Amount | | Amount | |
|-----------------------------------|------------|-------------|-------------|-------------|
| Amortized intangible assets | | | | |
| Customer Relationships | \$ 143,651 | \$ (8,538) |) \$ 39,474 | \$ (4,460) |
| Patents | 4,376 | (3,796) |) 4,504 | (3,821) |
| Technology | 2,500 | (769) |) 2,500 | (644) |
| Trade Names | 7,368 | (2,263) |) 4,288 | (1,461) |
| License Agreements | 625 | (625) |) 640 | (640) |
| Other | 564 | (423) |) 586 | (423) |
| Total amortized intangible assets | \$ 159,084 | \$ (16,414) |) \$ 51,992 | \$ (11,449) |

23

In connection with the acquisition of Interface on August 31, 2018, the Company recorded intangible assets of \$107.8 million, which included \$104.6 million of customer relationships and \$3.2 million of trade names. The average useful lives of the acquired assets were 13 years and 3 years, respectively.

6. Long-term Debt and Financing Arrangements

On August 31, 2018, the Company amended and restated its \$175 million senior secured revolving credit agreement ("Amended Credit Agreement") that increased the available borrowing from \$175 million to \$450 million, added three additional lenders and extended the maturity date from July 7, 2021 to August 31, 2023.

Under the terms of the Amended Credit Agreement, the lenders are providing up to a \$450 million credit facility (the "Facility") to the Company, under which the lenders provided a term loan commitment of \$200 million and revolving loans to or for the benefit of the Company and its subsidiaries of up to \$250 million. The Facility may be increased by an aggregate amount not to exceed \$150 million through an accordion feature, subject to specified conditions. The Facility is secured by substantially all of the assets of the Company.

Interest is charged on borrowings at the Company's option of either: (i) Base Rate plus the Applicable Rate, or (ii) the Eurodollar Rate plus the Applicable Rate. The Base Rate is a fluctuating rate equal to the highest of (a) the federal funds rate plus 0.50%, (b) the prime rate as set by Bank of America, and (c) the Eurocurrency Rate plus 1.00%. The Eurocurrency Rate means (i) if denominated in LIBOR quoted currency, a fluctuating LIBOR per annum rate equal to the London Interbank Offered Rate; (ii) if denominated in Canadian Dollars, the rate per annum equal to the Canadian Dollar Offered Rate; or (iii) the rate per annum as designated with respect to such alternative currency at the time such alternative currency is approved by the Lenders. The Applicable Rate is determined based on the Company's Consolidated Leverage Ratio (as defined in the Amended Credit Agreement). The Applicable Rate added to the Base Rate Committed Loans ranges from 0.00% to 1.25%, and the Applicable Rate added to Eurocurrency Rate Committed Loans and Letters of Credit ranges from 0.75% to 2.00%. The Company pays a quarterly fee ranging from 0.15% to 0.275% on the unused portion of the revolving commitment.

The Company is permitted to prepay term and revolving borrowings in whole or in part at any time without premium or penalty, subject to certain minimum payment requirements, and the Company is generally permitted to irrevocably cancel unutilized portions of the revolving commitments under the Amended Credit Agreement. The Company is required to repay the term commitment in an amount of \$2.5 million per quarter beginning with the quarter ending December 31, 2018 through the quarter ending June 30, 2023.

The Amended Credit Agreement contains covenants required of the Company and its subsidiaries, including various affirmative and negative financial and operational covenants. The Company is required to meet certain quarterly financial covenants calculated from the four fiscal quarters most recently ended, including: (i) a minimum consolidated fixed charge coverage ratio, which requires that at the end of each fiscal quarter the ratio of (a) consolidated EBITDA to (b) the sum of consolidated interest charges, redemptions, non-financed maintenance capital expenditures, restricted payments and taxes paid, each as defined in the Amended Credit Agreement, may not be lower than 1.25 to 1.0; and (ii) a consolidated net leverage ratio, which requires that at the end of each fiscal quarter the ratio of consolidated funded indebtedness minus consolidated domestic cash to consolidated EBITDA, as defined in the Amended Credit Agreement, may not be greater than 3.5 to 1.0. The Company was in compliance with all covenants at September 30, 2018.

In April 2017, the Company entered into a three-year interest rate swap agreement transacted with a bank which converts the interest on the first notional \$60.0 million of the Company's one-month LIBOR-based borrowings from a

variable rate, plus the borrowing spread, to a fixed rate of 1.58% plus the borrowing spread. The notional amount reduces quarterly by \$5.0 million through March 31, 2020. The Company is accounting for the interest rate swap agreement as a cash flow hedge. Effectiveness of this derivative agreement is assessed quarterly by ensuring that the critical terms of the swap continue to match the critical terms of the hedged debt.

At September 30, 2018, the Company had borrowing availability of \$108.1 million under the Facility, net of \$338.0 million of borrowings outstanding and standby letters of credit outstanding of \$3.9 million. The borrowings outstanding included a \$200.0 million term loan, net of \$0.5 million in debt issuance costs being amortized to interest expense over the debt maturity period.

In addition to the amounts outstanding under the Facility, the Company has various acquired foreign credit facilities totaling approximately \$8.4 million. At September 30, 2018, the Company's foreign subsidiaries had \$0.1 million in borrowings outstanding as well as \$2.3 million in standby letters of credit outstanding.

Total outstanding debt consists of:

| In thousands | Effective Rate | Maturity | September 30, 2018 | December 31, 2017 |
|--|----------------|-------------|--------------------------|-------------------------|
| Revolver Loan | 3.87 | % 8/31/2023 | \$ 138,000 | \$ 76,600 |
| Term Loan, net of debt issuance costs | 3.87 | % 8/31/2023 | 199,471 | — |
| Capital Leases | 1.65% - 2.09% | 2019 - 2020 | 385 | 590 |
| | | | 337,856 | 77,190 |
| Less portion due within one year | | | (10,182) | (277) |
| Total long-term debt, net of debt issuance costs | | | \$327,674 | \$ 76,913 |

The carrying value of the Company's \$450 million Facility approximates fair value given the variable rate nature of the debt. The fair values of the Company's long-term debt are determined using discounted cash flows based upon the Company's estimated current interest cost for similar type borrowings or current market value, which falls under Level 2 of the fair value hierarchy.

The weighted average interest rate on long-term debt was 2.9% for the nine months ended September 30, 2018 and 2.2% for the year ended December 31, 2017.

7. Derivatives

The Company selectively uses financial instruments to manage market risk associated with exposure to fluctuations in interest rates. These financial exposures are monitored and managed by the Company as an integral part of its risk management program. The Company's interest rate exposure is most sensitive to fluctuations in interest rates in the United States and Europe, which impact interest paid on its debt. The Company has debt with variable rates of interest based generally on LIBOR. From time to time, the Company enters into interest rate swap agreements to manage interest rate risk. These instruments are designated as cash flow hedges and are recorded at fair value using Level 2 observable market inputs.

Derivative instruments are recognized as either assets or liabilities on the balance sheet in either current or non-current other assets or other accrued liabilities or other long-term liabilities depending upon maturity and commitment. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods in which the hedge transaction affects earnings. Any ineffective portion, or amounts related to contracts that are not designated as hedges, are recorded directly to earnings. The Company's policy for classifying cash flows from derivatives is to report the cash flows consistent with the underlying hedged item. The Company does not use derivatives for speculative or trading purposes.

In April 2017, the Company entered into a three-year interest rate swap agreement transacted with a bank which converts the interest on the first notional \$60.0 million of the Company's one-month LIBOR-based borrowings under its Amended Credit Facility from a variable rate, plus the borrowing spread, to a fixed rate of 1.58% plus the borrowing spread. The notional amount reduces quarterly by \$5.0 million through March 31, 2020. The interest rate swap agreement was accounted for as cash flow hedge. Effectiveness of this derivative agreement is assessed quarterly by ensuring that the critical terms of the swap continue to match the critical terms of the hedged debt.

The following table sets forth the fair value amounts of derivative instruments held by the Company:

| In thousands | September 30, 2018 | December 31, 2017 |
|--------------|--------------------|-------------------|
|--------------|--------------------|-------------------|

Edgar Filing: LYDALL INC /DE/ - Form 10-Q

| | Asset | Liability | Asset | Liability |
|--|-------------|-------------|-------------|-------------|
| | Derivatives | Derivatives | Derivatives | Derivatives |
| Derivatives designated as hedging instruments: | | | | |
| Interest rate contract | \$ 272 | \$ | —\$ 157 | \$ — |
| Total derivatives | \$ 272 | \$ | —\$ 157 | \$ — |

The following table sets forth the income recorded in accumulated other comprehensive income (loss), net of tax, for the quarters and nine months ended September 30, 2018 and 2017 for derivatives held by the Company and designated as hedging instruments:

| | Quarter Ended September 30, 2018 | Quarter Ended September 30, 2017 | Nine Months Ended September 30, 2018 | Nine Months Ended September 30, 2017 |
|------------------------|--|--|---|---|
| Cash flow hedges: | | | | |
| Interest rate contract | \$ 14 | \$ 37 | \$ 89 | \$(7) |
| | \$ 14 | 37 | \$ 89 | \$(7) |

8. Equity Compensation Plans

As of September 30, 2018, 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 accounts for the expense of all share-based compensation by measuring the awards at fair value on the date of grant. The Company recognizes expense on a straight-line basis over the vesting period of the entire award. Options issued by the Company under its stock option plans have a term of ten years and generally vest ratably over a period of three to four years. Time-based restricted stock grants are expensed over the vesting period of the award, which is typically two to four years. The number of performance based restricted shares that vest or forfeit depend upon achievement of certain targets during the performance period. The Company accounts for forfeitures as they occur. Compensation expense for performance based awards is recorded based upon the service period and management's assessment of the probability of achieving the performance goals and will be adjusted based upon actual achievement.

The Company incurred equity compensation expense of \$0.6 million and \$1.0 million for the quarters ended September 30, 2018 and September 30, 2017, respectively, and \$3.2 million for each of the nine months ended September 30, 2018 and September 30, 2017., for the Plans, including restricted stock awards. No equity 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, 2018:

| In thousands except per share amounts | Shares | Weighted-Average Exercise Price | Aggregate Intrinsic Value |
|---------------------------------------|--------|---------------------------------|---------------------------|
| Outstanding at September 30, 2018 | 398 | \$ 35.57 | \$ 4,688 |
| Exercisable at September 30, 2018 | 188 | \$ 23.18 | \$ 3,944 |
| Unvested at September 30, 2018 | 210 | \$ 46.64 | \$ 744 |

There were no stock options granted and 19,250 stock options exercised during the quarter ended September 30, 2018. There were 11,180 stock options granted and 46,291 stock options exercised during the nine months ended September 30, 2018. The amount of cash received from the exercise of stock options was \$0.2 million during the quarter ended September 30, 2018. The amount of cash received from the exercise of stock options was \$0.8 million during the nine months ended September 30, 2018. The intrinsic value of stock options exercised was \$0.6 million with a tax benefit of \$0.1 million during the quarter ended September 30, 2018. The intrinsic value of stock options exercised was \$1.3 million with a tax benefit of \$0.3 million during the nine months ended September 30, 2018.

There were no stock options granted and 6,170 stock options exercised during the quarter ended September 30, 2017 and no stock options granted and 34,634 stock options exercised during the nine months ended September 30, 2017. The amount of cash received from the exercise of stock options was \$0.1 million during the quarter ended September 30, 2017 and \$0.4 million during the nine months ended September 30, 2017. The intrinsic value of stock options exercised was \$0.2 million with a tax benefit of \$0.1

million during the quarter ended September 30, 2017 and the intrinsic value of stock options exercised was \$1.4 million with a tax benefit of \$0.4 million during the nine months ended September 30, 2017.

At September 30, 2018, the total unrecognized compensation cost related to non-vested stock option awards was approximately \$2.6 million, with a weighted average expected amortization period of 2.6 years.

Restricted Stock

Restricted stock includes both performance-based and time-based awards. There were 10,790 time-based restricted stock shares granted during the quarter ended September 30, 2018 and 18,896 time-based restricted stock shares granted during the nine months ended September 30, 2018. There were no performance-based restricted shares granted during the quarter ended September 30, 2018 and 15,190 performance-based restricted shares granted during the nine months ended September 30, 2018. There were no performance-based restricted shares that vested during the quarter ended September 30, 2018 and 48,035 performance-based restricted shares that vested during nine months ended September 30, 2018, in accordance with plan provisions. There were 14,570 time-based restricted shares that vested during the quarter ended September 30, 2018 and 19,734 time-based restricted shares that vested during nine months ended September 30, 2018.

There were no time-based restricted stock shares granted during the quarter and nine month period ended September 30, 2017. There were no performance-based restricted shares granted during the quarter ended September 30, 2017 and 18,100 performance-based restricted shares granted for the nine months ended September 30, 2017. There were no performance-based restricted shares that vested during the quarter ended September 30, 2017 and 108,600 performance-based restricted shares that vested during the nine months ended September 30, 2017 in accordance with plan provisions. There were 6,000 time-based restricted shares that vested during the quarter ended September 30, 2017 and 15,288 time-based restricted shares that vested during the nine months ended September 30, 2017.

At September 30, 2018, there were 179,772 unvested restricted stock awards with total unrecognized compensation cost related to these awards of \$4.3 million with a weighted average expected amortization period of 1.9 years. Compensation expense for performance based awards is recorded based on the service period and management's assessment of the probability of achieving the performance goals.

9. Stock Repurchases

During the nine months ended September 30, 2018, the Company purchased 20,726 shares of common stock valued at \$0.9 million, through withholding, pursuant to provisions in agreements with recipients of restricted stock granted under the Company's equity compensation plans, in which the Company withholds that number of shares having fair value equal to each recipient's minimum tax withholding due.

10. Restructuring

In April 2017, the Company commenced a restructuring plan in the Technical Nonwovens segment which includes plant consolidations and transfer of equipment to other facilities within the segment's Europe and China operations. The consolidation of certain plants, which is expected to conclude in 2019, is expected to reduce operating costs, increase efficiency and enhance the Company's flexibility by better aligning its manufacturing footprint with the segment's customer base. Accordingly, the Company expects to record total pre-tax expenses of approximately \$5.0 million, in connection with this restructuring plan, of which approximately \$4.8 million is expected to result in cash expenditures over the period of consolidation. The Company also expects to incur cash expenditures of approximately

\$3.5 million for capital expenditures associated with this plan.

During the quarter ended September 30, 2018, the Company recorded pre-tax restructuring expenses of \$0.5 million. Restructuring expenses of \$0.4 million, primarily related to equipment move costs, were recorded in cost of sales and \$0.1 million of severance costs were recorded in selling, product development and administrative expenses. During the nine months ended September 30, 2018, the Company recorded pre-tax restructuring expenses of \$1.9 million as part of this restructuring plan. Restructuring expenses of \$1.7 million, primarily related to equipment move costs and severance, were recorded in cost of sales and \$0.2 million of severance and engineering costs were recorded in selling, product development and administrative expenses during the nine months ended September 30, 2018. The Company expects to record approximately \$0.6 million of restructuring expenses in the fourth quarter of 2018 and \$2.5 million for the year ending December 31, 2018.

Actual pre-tax expenses incurred and total estimated pre-tax expenses for the restructuring program by type are as follows:

| In thousands | Severance and Related Expenses | Contract Termination Expenses | Facility Exit, Move and Set-up Expenses | Total |
|---|--------------------------------|-------------------------------|---|---------|
| Total estimated expenses | \$ 1,200 | \$ 300 | \$ 3,500 | \$5,000 |
| Expenses incurred through December 31, 2017 | 181 | 154 | 327 | 662 |
| Estimated remaining expense at December 31, 2017 | \$ 1,019 | \$ 146 | \$ 3,173 | \$4,338 |
| Expense incurred during quarter ended: | | | | |
| March 31, 2018 | \$ 315 | \$ — | \$ 219 | \$534 |
| June 30, 2018 | 185 | — | 700 | 885 |
| September 30, 2018 | 105 | — | 414 | 519 |
| Total pre-tax expense incurred | \$ 786 | \$ 154 | \$ 1,660 | \$2,600 |
| Estimated remaining expense at September 30, 2018 | \$ 414 | \$ 146 | \$ 1,840 | \$2,400 |

There were cash outflows of \$0.6 million and \$1.4 million for the restructuring program for the quarter and nine months ended September 30, 2018, respectively.

Accrued restructuring costs were as follows at September 30, 2018:

| In thousands | Total |
|--|---------|
| Balance as of December 31, 2017 | \$333 |
| Pre-tax restructuring expenses, excluding depreciation | 1,768 |
| Cash paid | (1,407) |
| Balance as of September 30, 2018 | \$694 |

11. Employer Sponsored Benefit Plans

As of September 30, 2018, the Company maintains a defined benefit pension plan that covers certain domestic Lydall employees ("Lydall Pension Plan") that is closed to new employees and benefits are no longer accruing. The Lydall 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. Contributions of \$3.0 million and \$7.2 million were made during the quarter and nine months ended September 30, 2018, respectively. No further contributions are expected to the Lydall Pension Plan for the remainder of 2018. Contributions of \$1.2 million and \$3.6 million were made during the quarter and nine months ended September 30, 2017, respectively.

On August 31, 2018, the Company acquired the Interface business, and as part of this transaction the Company acquired two domestic pension plans ("Interface Pension Plans") and a multi-employer plan. The Interface Pension Plans cover Interface's union and non-union employees, the plans are closed to new employees and benefits are no longer accruing for the majority of participants. Certain union employees of Interface business participate in a multi-employer pension plan. Contributions to this multi-employer plan are required to be made monthly based upon the total monthly hours worked by the covered employees multiplied by the employer contribution rate published by the fund. Total contributions related to the multi-employer plan from the date of acquisition through September 30, 2018 were immaterial. As of the acquisition date, the Company remeasured the fair value of plan liabilities and funded status of the plans. An underfunded liability of \$11.2 million was included in benefit plan liabilities within the Company's Condensed Consolidated Balance Sheets. The Company made no contributions into the Interface Pension Plans for the quarter ended September 30, 2018. The Company expects to make a required contribution of

approximately \$0.3 million to the Interface Pension Plans during the fourth quarter of 2018.

The Company also acquired Interface's domestic post-retirement benefit plan and recorded a liability of \$4.1 million and German pension plans and recorded a liability of \$2.9 million included in benefit plan liabilities within the Company's Condensed Consolidated Balance Sheets. The Interface post-retirement benefits include life insurance and medical benefits for certain domestic

28

employees and these plans are closed to new employees. The Company acquired a German noncontributory plan closed to new employees and also participates in a government program.

As of January 1, 2018 the Company adopted ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost". This ASU required the other components of net benefit cost, which includes interest costs, expected return on plan assets, and amortization of actuarial loss be presented in the income statement outside a subtotal of income from operations for the quarter and nine months ended September 30, 2018. The retrospective adoption of this ASU resulted in the reclassification of net benefit costs of \$0.1 million from cost of sales and \$0.1 million from the selling, product development and administrative expenses to the other expense, net line in the Consolidated Statement of Operations for the quarter ended September 30, 2017. Net benefit costs of \$0.2 million from cost of sales and \$0.4 million from the selling, product development and administrative expenses were reclassified to the other expense, net line in the Consolidated Statement of Operations for the nine months ended September 30, 2017.

The following is a summary of the components of net periodic benefit cost for the Lydall and acquired Interface Pension Plans:

| | Quarter Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---|--|-------|--|---------|
| In thousands | 2018 | 2017 | 2018 | 2017 |
| Components of net periodic benefit cost | | | | |
| Service Cost | \$12 | \$— | \$12 | \$— |
| Interest cost | 640 | 514 | 1,579 | 1,543 |
| Expected return on assets | (893) | (594) | (2,193) | (1,782) |
| Amortization of actuarial loss | 256 | 273 | 768 | 819 |
| Net periodic benefit cost | \$15 | \$193 | \$166 | \$580 |

12. Income Taxes

On December 22, 2017, the United States enacted significant changes to U.S. tax law following the passage and signing of the Tax Cuts and Jobs Act (the "Tax Reform Act"). The Company has followed guidance in Staff Accounting Bulletin No.118 ("SAB 118"), which provides a measurement period, not to exceed one year from the enactment of the Tax Reform Act, and recorded provisional items related to the one-time mandatory repatriation of foreign earnings and the revaluation of deferred tax assets and liabilities for the year ended December 31, 2017. For the quarter ended September 30, 2018, the Company continued to perform analysis and evaluate interpretations and additional regulatory guidance. As a result of this analysis, the Company recorded an expense to adjust the provisional one-time mandatory repatriation of foreign earnings tax of \$0.7 million during the third quarter of 2018. All items related to tax reform remain provisional and no items were deemed complete.

The Company's effective tax rate was 25.1% and 24.2% for the quarters ended September 30, 2018 and 2017, respectively, and 17.5% and 24% for the nine months ended September 30, 2018 and 2017, respectively. The Company's effective tax rate for the three months ended September 30, 2018 was primarily driven by the reduction of the U.S. corporate tax rate from 35% to 21% under the Tax Reform Act and a tax benefit from a valuation allowance release, partially offset by the adjustment to the provisional one-time mandatory repatriation of foreign earnings tax and non-deductible transaction costs as a result of the Interface Performance Materials acquisition. The Company's effective tax rate for the quarter ended September 30, 2017 was primarily driven by a net tax benefit of \$1.4 million from the completion of a tax audit in the third quarter of 2017. The decrease in the Company's effective tax rate for the nine months ended September 30, 2018 compared to September 30, 2017 was primarily related to the reduction of the

U.S. corporate tax rate from 35% to 21% under the Tax Reform Act, offset by the adjustment to the provisional one-time mandatory repatriation of foreign earnings tax of \$0.7 million, lower tax benefits from stock vesting and the absence a net tax benefit of \$1.4 million from the completion of a tax audit in the third quarter of 2017.

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, China, the United Kingdom, Canada and the Netherlands. With few exceptions, the Company is no longer subject to U.S. federal examinations for years before 2015, state and local examinations for years before 2013, and non-U.S. income tax examinations for years before 2003.

The Company's effective tax rates in future periods could be affected by an increase or decrease in earnings in countries where tax rates differ from the United States federal tax rate, the relative impact of permanent tax adjustments on earnings from domestic operations, changes in net deferred tax asset valuation allowances, stock vesting, the completion of acquisitions or divestitures, changes in tax rates or tax laws and the completion of tax projects and audits.

13. Earnings Per Share

For the quarters and nine months ended September 30, 2018 and 2017, 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 | 2018 | 2017 | 2018 | 2017 |
| Basic average common shares outstanding | 17,216 | 17,055 | 17,189 | 17,028 |
| Effect of dilutive options and restricted stock awards | 133 | 212 | 150 | 242 |
| Diluted average common shares outstanding | 17,349 | 17,267 | 17,339 | 17,270 |

For each of the quarters ended September 30, 2018 and 2017, stock options for 162,830 shares and 38,280 shares of Common Stock were not considered in computing diluted earnings per common share because they were antidilutive.

For each of the nine months ended September 30, 2018 and 2017, stock options for 150,005 shares and 38,280 shares of Common Stock were not considered in computing diluted earnings per common share because they were antidilutive.

14. Segment Information

As of September 30, 2018, the Company's reportable segments are Performance Materials, Technical Nonwovens, and Thermal Acoustical Solutions.

On July 12, 2018, the Company acquired certain assets and assumed certain liabilities the Precision Filtration division of Precision Custom Coatings ("PCC") based in Totowa, NJ. Precision Filtration is a producer of high-quality, air filtration media principally serving the commercial and residential HVAC markets with products in the efficiency range of MERV 7-11. The acquired business is included in the Company's Performance Materials operating segment.

On August 31, 2018, the Company acquired an engineered sealing materials business operating under Interface Performance Materials ("Interface"), based in Lancaster, Pennsylvania. A globally-recognized leader in the delivery of engineered sealing solutions, the Interface operations manufacture wet-laid gasket and specialty materials primarily serving OEM and Tier I manufacturers in the agriculture, construction, earthmoving, industrial, and automotive segments. The acquired business is included in the Company's Performance Materials operating segment.

Effective September 30, 2018, as a result of the Interface acquisition, the Performance Materials segment changed the disaggregation of revenue at the product level to be categorized as "Filtration" and "Sealing and Advanced Solutions".

Effective January 1, 2018, the Thermal/Acoustical Metals and Thermal/Acoustical Fibers operating segments were combined into a single operating segment named Thermal Acoustical Solutions. These automotive segments were combined into one segment to allow the Company to better serve its customers, leverage operating disciplines and drive efficiencies across the global automotive operations.

Prior period segment amounts throughout the Notes to the Condensed Consolidated Financial Statements have been recast to reflect the results of the new segment structure. The recast of historical business segment information had no impact on the consolidated financial results.

Performance Materials Segment

The Performance Materials segment includes filtration media solutions primarily for air, fluid power, life science and industrial applications (“Filtration”), and gasket and sealing solutions, thermal insulation, energy storage, and other engineered products (“Sealing and Advanced Solutions”).

Filtration products include LydAir® MG (Micro-Glass) Air Filtration Media, LydAir® MB (Melt Blown) Air Filtration Media, LydAir® SC (Synthetic Composite) Air Filtration Media, and Arioso® Membrane Composite Media. These products constitute the critical media component of clean-air systems for applications in clean-space, commercial, industrial and residential HVAC, power generation, respiratory protection, 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 series address a variety of application needs in fluid power including hydraulic filters, air-water and air-oil coalescing, industrial fluid processes and diesel fuel filtration. LyPore® media and Solupor® ultra-high molecular weight polyethylene membranes also serve critical liquid filtration/separation applications such as biopharmaceutical pre-filtration and clarification, lateral flow diagnostic and analytical testing, potable water filtration and high purity process filtration such as those found in food and beverage and medical applications.

Sealing and Advanced Solutions includes nonwoven specialty engineered materials for a myriad of applications. Fiber-reinforced gasket materials serve the heavy-duty diesel, automobile, small engine, transmission and compressor markets, providing sealing solutions for demanding applications, including Select-a-Seal® rubber edged composite (REC) technology that provides robust sealing, compression, adhesion, and shear strength for driveline applications. High performance insulating materials include nonwoven veils, papers and specialty composites for the building products, appliance, energy and industrial markets including Manniglas® Thermal Insulation Papers, and Lytherm® Insulation Media for high temperature technology applications. 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. Additional Specialty Composite Materials include calendar bowl products to service the printing and textile industries and press pad materials for industrial lamination processes.

Technical Nonwovens Segment

The Technical Nonwovens segment primarily produces needle punch nonwoven solutions for a myriad of industries and applications. Products are manufactured and sold globally under the leading brands of Lydall Industrial Filtration, Southern Felt, Gutsche, and Texel. Industrial Filtration products include nonwoven rolled-good felt media and filter bags used primarily in industrial air and liquid filtration applications. Nonwoven filter media is the most effective solution to satisfy increasing emission control regulations in a wide range of industries, including power, cement, steel, asphalt, incineration, mining, food, and pharmaceutical. Advanced Materials products include nonwoven rolled-good media used in commercial applications and predominantly serves the geosynthetics, automotive, industrial, medical, and safety apparel markets. Automotive media is provided to Tier I/II suppliers as well as the Company's Thermal Acoustical Solutions segment.

Technical Nonwovens segment products include air and liquid filtration media sold under the brand names Fiberlox® high performance filtration felts, Checkstatic™ conductive filtration felts, Microfelt® high efficiency filtration felts, Pleatlox® pleatable filtration felts, Ultratech™ PTFE filtration felts, Powertech® and Powerlox® power generation filtration felts, Microcap® high efficiency liquid filtration felts, Duotech membrane composite filtration felts, along with our porotex® family of high temperature filtration felts including microvel® and optivel® products. Technical Nonwovens Advanced Materials products are sold under the brand names Thermofit® thermo-formable products, Ecoduo® recycled content materials, Duotex® floor protection products, and Versaflex® composite molding materials. Technical Nonwovens also offers extensive finishing and coating capabilities which provide custom engineered properties tailored to meet the most demanding applications. The business leverages a wide range of fiber types and extensive technical capabilities to provide products that meet our customers' needs across a variety of applications providing both high performance and durability.

Thermal Acoustical Solutions Segment

The Thermal Acoustical Solutions segment offers a full range of innovative engineered products tailored for the transportation and industrial sectors to thermally shield sensitive components from high heat, improve exhaust gas

treatment and lower harmful emissions as well as assist in the reduction of noise, vibration and harshness (NVH). Within the transportation sector, Lydall's products are found in the interior (dash insulators, cabin flooring), underbody (wheel well, aerodynamic belly pan, fuel tank, exhaust, tunnel, spare tire) and under hood (engine compartment, outer dash, powertrain, catalytic converter, turbo charger, manifolds) of cars, trucks, SUVs, heavy duty trucks and recreational vehicles.

Thermal Acoustical Solutions segment products offer thermal and acoustical insulating solutions comprised of organic and inorganic fiber composites that provide weight reduction, superior noise suppression and increased durability over conventional designs, as well as products that efficiently combine multiple layers of metal and thermal - acoustical insulation media to provide an engineered shielding solution for an array of application areas. Lydall's dBCore® is a lightweight acoustical composite that emphasizes absorption principles over heavy-mass type systems. Lydall's dBLyte® is a high-performance acoustical barrier with sound absorption and blocking properties and can be used throughout a vehicle's interior to minimize intrusive noise from an engine compartment and road. Lydall's ZeroClearance® is an innovative thermal solution that utilizes an adhesive backing for attachment and is used to protect vehicle components from excessive heat. Lydall's flux® product family includes several patented or IP-rich products that address applications which include: Direct Exhaust Mount heat shields, which are assembled to high temperature components like catalytic converters, turbochargers or exhaust manifolds using aluminized and stainless steel and high performance and high temperature heat insulating materials; Powertrain heat shields that absorb noise at the source and do not contribute to the

engine's noise budget; and durable, thermally robust solutions for temperature sensitive plastic components such as fuel tanks that are in proximity to high temperature heat sources.

The tables below present net sales and operating income by segment for the quarters and nine months ended September 30, 2018 and 2017, 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 | | Nine Months Ended | |
|--|---------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Performance Materials Segment (1): | | | | |
| Filtration | \$22,643 | \$22,263 | \$68,846 | \$65,483 |
| Sealing and Advanced Solutions | 19,077 | 7,284 | 34,801 | 22,116 |
| Performance Materials Segment net sales | 41,720 | 29,547 | 103,647 | 87,599 |
| Technical Nonwovens Segment: | | | | |
| Industrial Filtration | 40,945 | 38,346 | 120,346 | 108,884 |
| Advanced Materials (2) | 32,126 | 34,960 | 91,978 | 90,438 |
| Technical Nonwovens net sales | 73,071 | 73,306 | 212,324 | 199,322 |
| Thermal Acoustical Solutions Segment: | | | | |
| Parts | 77,723 | 75,195 | 248,764 | 237,657 |
| Tooling | 10,488 | 9,181 | 31,053 | 17,505 |
| Thermal Acoustical Solutions Segment net sales | 88,211 | 84,376 | 279,817 | 255,162 |
| Eliminations and Other (2) | (5,116) | (7,188) | (19,829) | (21,676) |
| Consolidated Net Sales | \$197,886 | \$180,041 | \$575,959 | \$520,407 |

Operating income by segment:

| In thousands | Quarter Ended | | Nine Months | |
|-------------------------------|---------------|----------|-------------|-----------|
| | September 30, | | Ended | |
| | 2018 | 2017 | 2018 | 2017 |
| Performance Materials (1) | \$1,753 | \$3,133 | \$8,043 | \$8,725 |
| Technical Nonwovens | 6,271 | 8,589 | 17,395 | 19,792 |
| Thermal Acoustical Solutions | 7,923 | 10,607 | 29,357 | 40,798 |
| Corporate Office Expenses | (6,214) | (6,975) | (18,777) | (18,775) |
| Consolidated Operating Income | \$9,733 | \$15,354 | \$36,018 | \$50,540 |

(1) The Performance Materials segment reports the results of Interface and PCC for the period following the date of acquisitions of August 31, 2018 and July 12, 2018, respectively.

(2) Included in the Technical Nonwovens segment and Eliminations and Other is \$4.3 million and \$6.5 million in intercompany sales to the Thermal Acoustical Solutions segment for the quarters ended September 30, 2018 and 2017, respectively, and \$17.2 million and \$19.5 million for the nine months ended September 30, 2018 and 2017, respectively.

(3) The quarter and nine months ended September 30, 2017 segment operating income amounts of \$0.2 million and \$0.6 million, respectively, have been reclassified to other expense (income), net, to give effect to the adoption of

ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost".

15. Commitments and Contingencies

Environmental Remediation

The Company elected to remediate environmental contamination discovered prior to the closing of the Texel acquisition in 2016 at a certain property in the province of Quebec, Canada ("the Property") that was acquired by Lydall. The Company records accruals for environmental costs when such losses are probable and reasonably estimable. In 2016, the Company, through the

32

engagement of a third-party environmental service firm, determined the final scope and timing of the remediation project and estimated the cost of the remediation project to range between \$0.9 million and \$1.5 million, which was further refined in July of 2017 to the top end of this range at \$1.5 million and remains as the Company's best estimate as of September 30, 2018. During 2017, the environmental liability was reduced by \$0.7 million, reflecting payments made to vendors, resulting in a balance of \$0.8 million at December 31, 2017. During the nine months ended September 30, 2018, the environmental liability was further reduced by \$0.6 million, reflecting payments to vendors. The remaining balance for the environmental liability of \$0.2 million (which remains fully offset as described below) is included within other long-term liabilities on the Company's balance sheet at September 30, 2018.

Pursuant to the Share Purchase Agreement, ADS, Inc. ("ADS") has agreed to indemnify the Company from all costs and liabilities associated with the contamination and remediation work, including the costs of preparation and approval of the remediation plan and other reports in relation therewith. This indemnity was secured by an environmental escrow account, which was established in the amount of \$3.0 million Canadian Dollars (approximately \$2.3 million U.S. Dollars as of September 30, 2018). As of September 30, 2018, for any costs and liabilities that exceeded the environmental escrow amount, the Company had access to the general indemnity escrow account, which was originally established in the amount of \$14.0 million Canadian Dollars (approximately \$10.8 million U.S. Dollars as of September 30, 2018). Based on the Share Purchase Agreement, the general indemnity escrow account was initially reduced to approximately \$7.0 million Canadian Dollars (approximately \$5.4 million U.S. Dollars as of September 30, 2018) on the first anniversary date of the closing date and then liquidated, in full on or about the second anniversary date of the closing date (i.e., July 9, 2018). Based on the foregoing, an indemnification asset of \$0.9 million was also recorded in other assets at December 31, 2016, and subsequently increased to \$1.5 million in July of 2017, as the Company believed, and still believes collection from ADS is probable. The indemnification asset was decreased by \$0.7 million, reflecting indemnification from ADS for payments made by the Company to its vendors during 2017. During the nine months ended September 30, 2018, the indemnification asset was further reduced by \$0.6 million, reflecting indemnification from ADS for payments made by the Company to its vendors. The resulting indemnification asset balance was \$0.2 million at September 30, 2018. The accrual for remediation costs will be adjusted as further information develops, estimates change and payments to vendors are made for remediation, with an off-setting adjustment to the indemnification asset from ADS if collection is deemed probable.

In the fourth quarter of 2016, as part of a groundwater discharging permitting process, water samples collected from wells and process water basins at the Company's Rochester New Hampshire manufacturing facility, within the Performance Materials segment, showed concentrations of Perfluorinated Compounds ("PFCs") in excess of state ambient groundwater quality standards.

In January 2017, the Company received a notification from the State of New Hampshire Department of Environmental Services ("NHDES") naming Lydall Performance Materials, Inc. a responsible party with respect to the discharge of regulated contaminants and, as such, is required to take action to investigate and remediate the impacts in accordance with standards established by the NHDES. The Company conducted a site investigation, the scope of which was reviewed by the NHDES, in order to assess the extent of potential soil and groundwater contamination and develop a remedial action. Based on input received from NHDES in March 2017 with regard to the scope of the site investigation, the Company recorded \$0.2 million of expense in the first quarter of 2017 associated with the expected costs of conducting this site investigation.

In the fourth quarter of 2017, the Company completed its state-approved site investigation report and submitted it to the NHDES. During the year ended December 31, 2017, the environmental liability of \$0.2 million was reduced by \$0.2 million reflecting payments made to vendors, resulting in no balance at December 31, 2017.

In the first quarter of 2018, the Company received a response from the NHDES to the site investigation report outlining proposed remedial actions. The Company recorded \$0.1 million of expense in the first quarter of 2018

associated with the expected costs to remediate the impacts of the discharge of regulated contaminants in accordance with standards established by the NHDES.

In May of 2018, the Company met with the NHDES to finalize the proposed remedial actions from the site investigation report. The Company recorded a minimal incremental amount in the second quarter of 2018 associated with the cost of the proposed remedial actions resulting in an environmental liability of \$0.1 million at June 30, 2018. During the quarter ended September 30, 2018, the environmental liability was reduced by \$0.1 million reflecting payments made to vendors, resulting in no balance at September 30, 2018. Additionally, the Company incurred \$0.2 million of capital expenditures in 2018, in relation to the lining of the Company's fresh water waste lagoons.

The site investigation is ongoing. The Company cannot be sure that costs will not exceed the current estimates until this matter is closed with the NHDES, nor that any future corrective action at this location would not have a material effect on the Company's financial condition, results of operations or liquidity. Provisions for such matters are charged to expense when it is probable that a liability has been incurred and reasonable estimates of the liability can be made. Estimates of environmental liabilities are based on a variety of matters, including, but not limited to, the stage of investigation, the stage of the remedial design, evaluation of existing remediation technologies, and presently enacted laws and regulations. In future periods, a number of factors could significantly impact any estimates of environmental remediation costs.

16. Changes in Accumulated Other Comprehensive Income (Loss)

The following table discloses the changes by classification within accumulated other comprehensive income (loss) for the nine months ended September 30, 2018 and 2017:

| In thousands | Foreign Currency Translation Adjustment | Defined Benefit Pension Adjustment | Gains and Losses on Cash Flow Hedges | Total Accumulated Other Comprehensive (Loss) Income |
|--|--|---|---|---|
| Balance at December 31, 2016 | \$ (27,885) | \$ (20,065) | \$ — | \$ (47,950) |
| Other comprehensive income (loss) | 23,951 | — | (7) (b) | 23,944 |
| Amounts reclassified from accumulated other comprehensive loss | — | 516 | (a) — | 516 |
| Balance at September 30, 2017 | (3,934) | (19,549) | (7) | (23,490) |
| Balance at December 31, 2017 | (2,221) | (18,049) | 122 | (20,148) |
| Other comprehensive (loss) income | (9,262) | — | 89 (b) | (9,173) |
| Amounts reclassified from accumulated other comprehensive loss | — | 595 | (a) — | 595 |
| Balance at September 30, 2018 | \$ (11,483) | \$ (17,454) | \$ 211 | \$ (28,726) |

Amount represents amortization of actuarial losses, a component of net periodic benefit cost. This amount was \$0.6 (a) million, net of \$0.2 million tax benefit, and \$0.5 million, net of \$0.3 million tax benefit, for the nine months ended September 30, 2018 and 2017, respectively.

(b) Amount represents unrealized gains on the fair value of hedging activities, net of taxes, for the nine months ended September 30, 2018 and 2017.

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 nonwoven filtration media, industrial thermal insulating solutions, and thermal and acoustical barriers for filtration/separation and heat abatement and sound dampening applications. Lydall principally conducts its business through three reportable segments: Performance Materials, Technical Nonwovens and Thermal Acoustical Solutions, with sales globally. The Performance Materials segment includes filtration media solutions primarily for air, fluid power, life science and industrial applications ("Filtration"), and gasket and sealing solutions, thermal insulation, energy storage, and other engineered products ("Sealing and Advanced Solutions"). The Technical Nonwovens ("TNW") segment consists of Industrial Filtration products that include nonwoven rolled-goods felt media and filter bags used primarily in industrial air and liquid filtration applications as well as Advanced Materials products that include nonwoven rolled-good media that is used in other commercial applications and predominantly serves the geosynthetics, automotive, industrial and medical markets. Advanced Materials products also include automotive rolled-good material for use in the Thermal Acoustical Solutions segment manufacturing process. Nonwoven filter media is used to satisfy increasing emission control regulations in a wide range of industries, including power, cement, steel, asphalt, incineration, food, and pharmaceutical. The Thermal Acoustical Solutions ("TAS") segment offers innovative engineered products to assist in noise and heat abatement within the transportation and industrial sectors.

Effective January 1, 2018, the Company combined the Thermal/Acoustical Metals and Thermal/Acoustical Fibers operating segments into a single operating segment named Thermal Acoustical Solutions. Combining these automotive segments into one segment is expected to allow the Company to better serve its customers, leverage operating disciplines and drive efficiencies across the global automotive operations.

Third Quarter 2018 Highlights

Below are financial highlights comparing Lydall's quarter ended September 30, 2018 ("Q3 2018") results to its quarter ended September 30, 2017 ("Q3 2017") results:

Net sales were \$197.9 million in Q3 2018, compared to \$180.0 million in Q3 2017, an increase of \$17.8 million, or 9.9%. The change in consolidated net sales is summarized in the following table:

| Components (in thousands) | Change in Net Sales | Percent Change |
|---------------------------------|---------------------------|-------------------|
| Acquisitions | \$13,389 | 7.4 % |
| Parts volume and pricing change | 4,957 | 2.8 % |
| Change in tooling sales | 1,450 | 0.8 % |
| Foreign currency translation | (1,949) | (1.1)% |
| Total | \$17,847 | 9.9 % |

Gross margin decreased 440 basis points to 17.8% in the third quarter of 2018, primarily driven by the Thermal Acoustical Solutions segment, and to a lesser extent the Technical Nonwovens segment. The Thermal Acoustical Solutions segment negatively impacted consolidated gross margin by approximately 300 basis points due to higher

labor and overhead costs of approximately 140 basis points, primarily associated with new product launch activity. Also, commodity inflation, primarily aluminum, contributed approximately 110 basis points with the remainder of the reduction primarily from lower customer pricing. The reduction in the Technical Nonwovens segment gross margin was principally driven by commodity inflation and product mix.

Operating income was \$9.7 million, or 4.9%, of net sales in Q3 2018, compared to \$15.4 million, or 8.5% of net sales, in Q3 2017. Operating margin declined due to the negative impact of lower gross margin of 440 basis points.

Decreased gross margin was partially offset by a 90 basis point reduction in selling, product development and administrative expenses as a percentage of net sales compared to the third quarter of 2017. The following components are included in operating income for Q3 2018 and Q3 2017 and impact the comparability of each quarter:

| Components (in thousands except per share amounts) | Q3 2018 | | Q3 2017 | |
|--|-------------------------------|---------------|-------------------------------|---------------|
| | Operating income effect | EPS impact | Operating income effect | EPS impact |
| TNW restructuring expenses | (519) | \$(0.03) | (154) | \$(0.01) |
| Strategic initiatives expenses | (1,514) | \$(0.09) | (326) | \$(0.01) |
| Inventory step-up purchase accounting adjustments | (1,390) | \$(0.06) | (83) | \$— |
| Intangible assets amortization expenses | (2,344) | \$(0.10) | (1,129) | \$(0.05) |
| Automotive segments consolidation expenses | — | \$— | (1,197) | \$(0.05) |
| Total | (5,767) | \$(0.28) | (2,889) | \$(0.12) |

Net income was \$6.3 million, or \$0.36 per diluted share, in Q3 2018 and \$10.7 million, or \$0.62 per diluted share, in Q3 2017.

Acquisitions

On July 12, 2018, the Company acquired certain assets and assumed certain liabilities of the Precision Filtration division of Precision Custom Coatings based in Totowa, NJ for \$1.6 million in cash with additional cash payments of up to \$2.0 million to be made based on the achievement of certain future financial targets through 2022. Precision Filtration is a long-time producer of high-quality, air filtration media principally serving the commercial and residential HVAC markets with a range of low efficiency through high-performing air filtration media. The acquired business is included in the Company's Performance Materials operating segment.

On August 31, 2018, the Company acquired an engineered sealing materials business operating under Interface Performance Materials ("Interface"), based in Lancaster, Pennsylvania for \$268.4 million, net of cash acquired of \$5.2 million, subject to a post-closing purchase price adjustment that is expected to be finalized in the fourth quarter of 2018. The purchase price was financed with a combination of cash on hand and \$261.4 million of borrowings from the Company's amended \$450 million credit facility. A globally-recognized leader in the delivery of engineered sealing solutions, the Interface operations manufacture wet-laid gasket and specialty materials primarily serving OEM and Tier I manufacturers in the agriculture, construction, earthmoving, industrial, and automotive segments. The acquired business is included in the Company's Performance Materials operating segment.

Liquidity

Cash was \$44.1 million at September 30, 2018, compared to \$59.9 million at December 31, 2017. Net cash provided by operations was \$6.5 million in the third quarter of 2018 compared to \$18.4 million in the third quarter of 2017. Lower operating income and working capital expansion, including increased accounts receivable from higher sales, drove lower cash generation.

On August 31, 2018, in connection with the Interface acquisition, the Company amended and restated its \$175 million senior secured revolving credit agreement ("Amended Credit Agreement") and increased the available borrowing from \$175 million to \$450 million, added three additional lenders and extended the maturity date from July 7, 2021 to August 31, 2023.

Under the terms of the Amended Credit Agreement, the lenders provided a term loan commitment of \$200 million and revolving loans of up to \$250 million. The Amended Credit Agreement may be increased by an aggregate amount not to exceed \$150 million through an accordion feature, subject to specified conditions. As of September 30, 2018, there was approximately \$108 million of availability under the Credit Agreement.

Outlook

Looking forward to the final quarter of 2018, demand remains steady and the Company expects modest consolidated organic sales growth and improved product mix. The Company remains focused on the integration of Interface and resolute on margin improvement across the Company.

Results of Operations

All of the following tabular comparisons, unless otherwise indicated, are for the quarters ended September 30, 2018 (Q3-18) and September 30, 2017 (Q3-17) and the nine months ended September 30, 2018 (YTD-18) and September 30, 2017 (YTD-17).

Net Sales

| In thousands | Quarter Ended | | | Nine Months Ended | | |
|--------------|---------------|-----------|----------------|-------------------|-----------|----------------|
| | Q3-18 | Q3-17 | Percent Change | YTD-18 | YTD-17 | Percent Change |
| Net sales | \$197,886 | \$180,041 | 9.9 % | \$575,959 | \$520,407 | 10.7 % |

Net sales for the third quarter of 2018 increased by \$17.8 million, or 9.9%, compared to the third quarter of 2017. This increase was primarily related to greater net sales in the Performance Materials segment of \$12.2 million, or 6.8% of consolidated net sales, including \$11.8 million from the Interface acquisition, which occurred on August 31, 2018. There were no Interface sales included in the Performance Materials segment in the third quarter of 2017. The Thermal Acoustical Solutions segment reported sales growth of \$3.8 million, or 2.1% of consolidated net sales, including increased tooling sales of \$1.3 million. Net sales decreased in the Technical Nonwovens segment by \$0.2 million, but increased \$2.0 million when eliminating automotive rolled-good material sold to the Thermal Acoustical Solutions segment. Foreign currency translation had a negative impact on net sales of \$2.0 million, or 1.1% of consolidated net sales, primarily impacting the Technical Nonwovens segment.

Net sales for the nine months ended September 30, 2018 increased by \$55.6 million, or 10.7%, compared to the nine months ended September 30, 2017. Net sales increased in the Thermal Acoustical Solutions segment by \$24.7 million, or 4.7% of consolidated net sales, including increased tooling sales of \$13.5 million. The increase in tooling sales was primarily due to new platform launches and the Company's adoption of ASC 606 which resulted in the recognition of \$2.6 million of tooling sales as the Company's performance obligations were satisfied over time in the first nine months of 2018 compared to the first nine months of 2017 when tooling sales were recognized when delivered and accepted by the customer. The Performance Materials segment reported growth in net sales of \$16.0 million, or 3.1% of consolidated net sales, including \$11.8 million from the Interface acquisition, which occurred on August 31, 2018. The Technical Nonwovens segment reported sales growth of \$13.0 million, or 2.5% of consolidated net sales. Foreign currency translation had a favorable impact on net sales of \$13.5 million, or 2.6% of consolidated net sales, impacting the Thermal Acoustical Solutions, Technical Nonwovens and Performance Materials segments by \$5.8 million, \$5.4 million and \$2.3 million, respectively.

Cost of Sales

| In thousands of dollars | Quarter Ended | | | Nine Months Ended | | |
|-------------------------|---------------|-----------|----------------|-------------------|-----------|----------------|
| | Q3-18 | Q3-17 | Percent Change | YTD-18 | YTD-17 | Percent Change |
| Cost of sales | \$162,747 | \$139,987 | 16.3 % | \$465,186 | \$396,528 | 17.3 % |

Cost of sales for the third quarter of 2018 increased by \$22.8 million, or 16.3%, compared to the third quarter of 2017. The increase was primarily due to increased sales volumes in the Performance Materials segment, primarily related to the Interface acquisition, and included a \$1.4 million purchase accounting adjustment to cost of sales related to inventory step-up, as well as increased sales volumes in the Thermal Acoustical Solutions segment. Additionally, the Thermal Acoustical Solutions segment experienced increased labor and variable overhead expenses, including outsourcing costs, and greater raw material commodity costs, primarily aluminum, increasing cost of sales by approximately \$4.8 million. Cost of sales also increased in the third quarter of 2018 compared to the third quarter of

2017 due to raw material commodity increases in the Technical Nonwovens segment. Foreign currency translation decreased cost of sales by \$1.6 million, or 1.1%.

Cost of sales for the first nine months of 2018 increased by \$68.7 million, or 17.3%, compared to the first nine months of 2017. The increase in cost of sales was primarily due to increased sales volumes across all segments of \$42.0 million, in addition to foreign currency translation which increased cost of sales by \$11.6 million, or 2.9%. The Interface acquisition contributed to \$11.8 million of the sales volume increase. In the Thermal Acoustical Solutions segment, increased labor and variable overhead expenses, including outsourcing costs, expedited freight expenses for customer deliveries caused by equipment downtime and other inefficiencies, and greater raw material commodity costs, primarily aluminum, increased cost of sales by approximately \$16.4 million. Cost of sales also increased in the first nine months of 2018 compared to the first nine months of 2017 due to raw material commodity increases in the Technical Nonwovens segment.

Gross Profit

| In thousands | Quarter Ended | | | Nine Months Ended | | |
|--------------|---------------|----------|----------------|-------------------|-----------|----------------|
| | Q3-18 | Q3-17 | Percent Change | YTD-18 | YTD-17 | Percent Change |
| Gross profit | \$35,139 | \$40,054 | (12.3)% | \$110,773 | \$123,879 | (10.6)% |
| Gross margin | 17.8 | % 22.2 | % | 19.2 | % 23.8 | % |

Gross margin for the third quarter of 2018 was 17.8% compared to 22.2% in the third quarter of 2017. The Thermal Acoustical Solutions segment negatively impacted consolidated gross margin by approximately 300 basis points, primarily related to increased labor and overhead expenses of approximately 140 basis points, including outsourcing costs and overtime associated with new product launch activity. Increased raw material commodity costs, primarily aluminum, were approximately 110 basis points. The Technical Nonwovens segment negatively impacted consolidated gross margin by approximately 180 basis points, primarily related to unfavorable mix and increased raw material commodity costs. The Performance Materials had minimal impact on consolidated gross margin, which included the negative impact of approximately 70 basis points of purchase accounting adjustments relating to inventory step up.

Gross margin for the first nine months of 2018 was 19.2% compared to 23.8% in the first nine months of 2017. The Thermal Acoustical Solutions segment negatively impacted consolidated gross margin by approximately 340 basis points, primarily related to increased labor and overhead expenses of approximately 180 basis points, including outsourcing costs, overtime associated with new product launch activity and expedited freight expenses for customer deliveries caused by equipment downtime and other inefficiencies. Increased commodity costs, primarily aluminum, were approximately 100 basis points. Finally, continued lower customer pricing on certain automotive parts reduced gross margin by approximately 40 basis points in the first nine months of 2018 compared to the first nine months of 2017. The Technical Nonwovens segment negatively impacted consolidated gross margin by approximately 100 basis points, primarily related to incremental restructuring related expenses of \$1.5 million, or 30 basis points, higher raw material commodity costs and increased overhead costs, partially offset by the absence of the negative impact of \$1.1 million, or 20 basis points, of purchase accounting adjustments relating to inventory step up in the first nine months of 2017. The Performance Materials segment had a minimal impact on consolidated gross margin in the first nine months of 2018 compared to the first nine months of 2017.

Selling, Product Development and Administrative Expenses

| In thousands | Quarter Ended | | | Nine Months Ended | | |
|--|---------------|----------|----------------|-------------------|----------|----------------|
| | Q3-18 | Q3-17 | Percent Change | YTD-18 | YTD-17 | Percent Change |
| Selling, product development and administrative expenses | \$25,406 | \$24,700 | 2.9 % | \$74,755 | \$73,339 | 1.9 % |
| Percentage of sales | 12.8 | % 13.7 | % | 13.0 | % 14.1 | % |

Selling, product development and administrative expenses for the third quarter of 2018 increased by \$0.7 million, but decreased 90 basis points as a percentage of sales, compared to the third quarter of 2017. This increase in expense was primarily related to the acquisition of Interface on August 31, 2018. There were no Interface expenses included in the Performance Materials segment in the third quarter of 2017. This increase was partially offset by decreased legacy selling, product development and administrative expenses in the third quarter of 2018 compared to the third quarter of 2017. Included in this decrease was lower accrued incentive compensation expense of \$1.1 million, based on the company's expected achievement of financial targets under its annual incentive program, the absence of \$1.1 million of expenses associated with the combination of the Company's former T/A Metals and T/A Fibers segments in 2017 and reduced corporate consulting expenses of \$0.9 million in support of organic growth initiatives. This decrease was

partially offset by an increase in strategic initiatives expenses of \$1.2 million primarily related to the acquisition of Interface. Legacy selling, product development and administrative expenses decreased 150 basis points as a percentage of net sales compared to the third quarter of 2017.

Selling, product development and administrative expenses for the first nine months of 2018 increased by \$1.4 million, but decreased 110 basis points as a percentage of net sales, compared to the first nine months of 2017. This increase was primarily related to the acquisition of Interface on August 31, 2018. There were no Interface expenses included in the Performance Materials segment in the first nine months of 2017. This increase was partially offset by decreased legacy selling, product development and administrative expenses in the first nine months of 2018 compared to the first nine months of 2017. Included in this decrease was lower accrued incentive compensation expense of \$2.0 million, based on the company's expected achievement of financial targets under its annual incentive program, the absence of \$1.1 million of expenses associated with the combination of the Company's former T/A Metals and T/A Fibers segments in 2017, reduced corporate consulting expenses of \$1.0 million in support of organic growth initiatives and the absence of a non-cash long-lived asset impairment charge of \$0.8 million in the Performance Materials

segment. Partially offsetting those reduced 2018 expenses was greater strategic initiatives expenses of \$2.3 million primarily related to the acquisition of Interface, higher intangibles amortization expense of \$1.1 million from TNW segment acquisitions and increased salaries and benefits of \$0.8 million in the first nine months of 2018 compared to the first nine months of 2017.

Interest Expense

| In thousands | Quarter Ended | | | Nine Months Ended | | |
|--------------------------------|---------------|-------|----------------|-------------------|---------|----------------|
| | Q3-18 | Q3-17 | Percent Change | YTD-18 | YTD-17 | Percent Change |
| Interest expense | \$1,505 | \$705 | 113.5% | \$2,617 | \$2,106 | 24.3% |
| Weighted average interest rate | 3.3 | % 2.4 | % | 2.9 | % 2.1 | % |

The increase in interest expense for the quarter and nine months ended September 30, 2018 compared to the quarter and nine months ended September 30, 2017 was due to higher borrowings incurred to finance the Interface acquisition on August 31, 2018 and increased interest rates.

Other Income/Expense, net

| In thousands | Quarter Ended | | | Nine Months Ended | | |
|-----------------------------|---------------|-------|---------------|-------------------|---------|---------------|
| | Q3-18 | Q3-17 | Dollar Change | YTD-18 | YTD-17 | Dollar Change |
| Other (income) expense, net | \$(40) | \$601 | \$(641) | \$(93) | \$1,727 | \$(1,820) |

The change in other (income) expense, net for the quarter and nine months ended September 30, 2018 compared to the quarter and nine months ended September 30, 2017 was primarily related to net foreign currency gains recognized with the revaluation of trade payables and receivables and intercompany loans denominated in currencies other than the functional currencies of the Company's subsidiaries.

Income Taxes

On December 22, 2017, the United States enacted significant changes to U.S. tax law following the passage and signing of the Tax Cuts and Jobs Act (the "Tax Reform Act"). The Company has followed guidance in Staff Accounting Bulletin No.118 ("SAB 118"), which provides a measurement period, not to exceed one year from the enactment of the Tax Reform Act, and recorded provisional items related to the one-time mandatory repatriation of foreign earnings and the revaluation of deferred tax assets and liabilities for the year ended December 31, 2017. For the quarter ended September 30, 2018, the Company continued to perform analysis and evaluate interpretations and additional regulatory guidance. As a result of this analysis, the Company recorded an expense to adjust the provisional one-time mandatory repatriation of foreign earnings tax of \$0.7 million during the third quarter of 2018. All items related to tax reform remain provisional and no items were deemed complete.

The Company's effective tax rate was 25.1% and 24.2% for the quarters ended September 30, 2018 and 2017, respectively, and 17.5% and 24.0% for the nine months ended September 30, 2018 and 2017, respectively. The Company's effective tax rate for the three months ended September 30, 2018 was primarily driven by the reduction of the U.S. corporate tax rate from 35% to 21% under the Tax Reform Act and a tax benefit from a valuation allowance release, partially offset by the adjustment to the provisional one-time mandatory repatriation of foreign earnings tax and non-deductible transaction costs as a result of the Interface Performance Materials acquisition. The Company's effective tax rate for the quarter ended September 30, 2017 was primarily driven by a net tax benefit of \$1.4 million from the completion of a tax audit in the third quarter of 2017. The decrease in the Company's effective tax rate for the nine months ended September 30, 2018 compared to September 30, 2017 was primarily related to the reduction of the

U.S. corporate tax rate from 35% to 21% under the Tax Reform Act, offset by the adjustment to the provisional one-time mandatory repatriation of foreign earnings tax of \$0.7 million, lower tax benefits from stock vesting and the absence a net tax benefit of \$1.4 million from the completion of a tax audit in the third quarter of 2017.

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, China, the United Kingdom, Canada and the Netherlands. With few exceptions, the Company is no longer subject to U.S. federal examinations for years before 2015, state and local examinations for years before 2013, and non-U.S. income tax examinations for years before 2003.

The Company's effective tax rates in future periods could be affected by an increase or decrease in earnings in countries where tax rates differ from the United States federal tax rate, the relative impact of permanent tax adjustments on earnings from domestic

operations, changes in net deferred tax asset valuation allowances, stock vesting, the completion of acquisitions or divestitures, changes in tax rates or tax laws and the completion of tax projects and audits.

Segment Results

The following tables present net 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, 2018 compared with the quarter ended September 30, 2017:

Net sales by segment:

| In thousands | Quarter Ended | | Dollar Change |
|--|---------------|-----------|---------------|
| | Q3-18 | Q3-17 | |
| Performance Materials Segment (1): | | | |
| Filtration | \$22,643 | \$22,263 | \$380 |
| Sealing and Advanced Solutions | 19,077 | 7,284 | 11,793 |
| Performance Materials Segment net sales | 41,720 | 29,547 | 12,173 |
| Technical Nonwovens Segment: | | | |
| Industrial Filtration | 40,945 | 38,346 | 2,599 |
| Advanced Materials (2) | 32,126 | 34,960 | (2,834) |
| Technical Nonwovens net sales | 73,071 | 73,306 | (235) |
| Thermal Acoustical Solutions Segment: | | | |
| Parts | 77,723 | 75,195 | 2,528 |
| Tooling | 10,488 | 9,181 | 1,307 |
| Thermal Acoustical Solutions Segment net sales | 88,211 | 84,376 | 3,835 |
| Eliminations and Other (2) | (5,116) | (7,188) | 2,072 |
| Consolidated Net Sales | \$197,886 | \$180,041 | \$17,845 |
| Nine Months Ended | | | |
| In thousands | YTD-18 | YTD-17 | Dollar Change |
| Performance Materials Segment (1): | | | |
| Filtration | \$68,846 | \$65,483 | \$3,363 |
| Sealing and Advanced Solutions | 34,801 | 22,116 | 12,685 |
| Performance Materials Segment net sales | 103,647 | 87,599 | 16,048 |
| Technical Nonwovens Segment: | | | |
| Industrial Filtration | 120,346 | 108,884 | 11,462 |
| Advanced Materials (2) | 91,978 | 90,438 | 1,540 |
| Technical Nonwovens net sales | 212,324 | 199,322 | 13,002 |
| Thermal Acoustical Solutions Segment: | | | |
| Parts | 248,764 | 237,657 | 11,107 |
| Tooling | 31,053 | 17,505 | 13,548 |
| Thermal Acoustical Solutions Segment net sales | 279,817 | 255,162 | 24,655 |
| Eliminations and Other (2) | (19,829) | (21,676) | 1,847 |
| Consolidated Net Sales | \$575,959 | \$520,407 | \$55,552 |

Operating income by segment:

| In thousands | Quarter Ended | | Quarter Ended | | Dollar Change |
|-------------------------------|-------------------|--------------------|-------------------|--------------------|---------------|
| | Q3-18 | Q3-17 | Q3-18 | Q3-17 | |
| | Operating Income | Operating Margin % | Operating Income | Operating Margin % | |
| Performance Materials (1) | \$1,753 | 4.2% | \$3,133 | 10.6% | \$(1,380) |
| Technical Nonwovens | 6,271 | 8.6% | 8,589 | 11.7% | (2,318) |
| Thermal Acoustical Solutions | 7,923 | 9.0% | 10,607 | 12.6% | (2,684) |
| Corporate Office Expenses | (6,214) | | (6,975) | | 761 |
| Consolidated Operating Income | \$9,733 | 4.9% | \$15,354 | 8.5% | \$(5,621) |
| In thousands | Nine Months Ended | | Nine Months Ended | | Dollar Change |
| | YTD-18 | YTD-17 | YTD-18 | YTD-17 | |
| | Operating Income | Operating Margin % | Operating Income | Operating Margin % | |
| Performance Materials (1) | \$8,043 | 7.8% | \$8,725 | 10.0% | \$(682) |
| Technical Nonwovens | 17,395 | 8.2% | 19,792 | 9.9% | (2,397) |
| Thermal Acoustical Solutions | 29,357 | 10.5% | 40,798 | 16.0% | (11,441) |
| Corporate Office Expenses | (18,777) | | (18,775) | | (2) |
| Consolidated Operating Income | \$36,018 | 6.3% | \$50,540 | 9.7% | \$(14,522) |

(1) The Performance Materials segment reports results of Interface and PCC for the period following the date of acquisitions of August 31, 2018 and July 12, 2018, respectively.

Included in the Technical Nonwovens segment and Eliminations and Other is \$4.3 million and \$6.5 million in intercompany sales to the Thermal Acoustical Solutions segment for the quarters ended September 30, 2018 and (2) 2017, respectively, and \$17.2 million and \$19.5 million for the nine months ended September 30, 2018 and 2017, respectively.

Performance Materials

Segment net sales increased \$12.2 million, or 41.2%, in the third quarter of 2018 compared to the third quarter of 2017. The increase was primarily due to the Interface acquisition, which occurred on August 31, 2018 and contributed \$11.8 million of net sales. Remaining Performance Materials net sales increased \$0.4 million due to increased net sales of filtration products primarily related to the air filtration market. Foreign currency translation had a minimal impact on net sales in the third quarter of 2018 compared to the third quarter of 2017.

The Performance Materials segment reported operating income of \$1.8 million, or 4.2% of net sales, in the third quarter of 2018, compared to operating income of \$3.1 million, or 10.6% of net sales, in the third quarter of 2017. The decrease in operating margin of 640 basis points was driven by the legacy Performance Materials businesses of 390 basis points and the results of Interface of 250 basis points. The legacy Performance Materials businesses reported lower gross margin of 460 basis points, primarily related to unfavorable product mix, and to a lesser extent, increased overhead costs and higher raw material costs. This gross margin decrease was partially offset by a 70 basis point decrease in selling, product development and administrative expenses as a percentage of net sales. Interface negatively impacted segment operating margin by 250 basis points, including a \$1.4 million, or 330 basis points, purchase accounting adjustment to cost of sales related to inventory step-up and \$0.9 million, or 210 basis points, of intangible asset amortization expense.

Segment net sales increased \$16.0 million, or 18.3%, in the first nine months of 2018 compared to the first nine months of 2017. The increase was primarily due to the Interface acquisition, which occurred on August 31, 2018 and

contributed \$11.8 million of net sales. Additionally, legacy Performance Materials net sales increased \$4.2 million, primarily due to increased net sales of filtration products related to increased demand in the liquid filtration market. Foreign currency translation positively impacted net sales by \$2.3 million, or 2.6%, in the first nine months of 2018 compared to the first nine months of 2017. The Company's adoption of ASC 606 contributed \$0.7 million of the sales increase in the first nine months of 2018.

The Performance Materials segment reported operating income of \$8.0 million, or 7.8% of net sales, in the first nine months of 2018, compared to operating income of \$8.7 million, or 10.0% of net sales, in the first nine months of 2017. The decrease in operating margin of 220 basis points was driven in part by the acquisition of Interface, which negatively impacted operating margin

by 120 basis points, primarily due to a \$1.4 million, or 130 basis points, purchase accounting adjustment to cost of sales related to inventory step-up and \$0.9 million, or 90 basis points, of intangible asset amortization expense. The remaining decrease in operating margin of 100 basis points from the legacy Performance Materials businesses was due to lower gross margin of 220 basis points, primarily related to unfavorable product mix and increased overhead costs. This decrease to legacy Performance Materials gross margin was partially offset by a 120 basis point decrease in selling, product development and administrative expenses as a percentage of net sales, primarily due to the absence of a non-cash long-lived asset impairment charge of \$0.8 million recorded in 2017.

Technical Nonwovens

Segment net sales decreased \$0.2 million, or 0.3%, in the third quarter of 2018 compared to the third quarter of 2017. Foreign currency translation had a negative impact on segment net sales of \$1.4 million, or 1.9%, in the third quarter of 2018 compared to the third quarter of 2017. Advanced materials sales decreased \$2.8 million, or 8.1%, primarily driven by decreased sales of automotive rolled-good material for use in the Thermal Acoustical Solutions segment manufacturing process and the negative impact of foreign currency. Offsetting this decrease were increased sales in industrial filtration of \$2.6 million, or 6.8%, particularly from increased demand in Europe and North America. The Company's adoption of ASC 606 contributed \$3.6 million of sales increase in the third quarter of 2018 compared to the third quarter of 2017.

The Technical Nonwovens segment reported operating income of \$6.3 million, or 8.6% of net sales, in the third quarter of 2018, compared to \$8.6 million, or 11.7% of net sales, in the third quarter of 2017. The decrease in operating income of \$2.3 million and operating margin of 310 basis points was primarily attributable to lower gross margin of 270 basis points. Gross margin was negatively impacted by unfavorable product mix, higher raw material costs and increased overhead costs. Additionally, incremental segment restructuring expenses of \$0.2 million, or 30 basis points, reduced gross margin in the third quarter of 2018 compared to the third quarter of 2017. Selling, product development and administrative expenses increased \$0.3 million, approximately 40 basis points as a percentage of net sales, in the third quarter of 2018 compared to the third quarter of 2017. The increase was primarily related to higher amortization of intangible assets of \$0.3 million, increased salaries and benefits of \$0.2 million, partially offset by lower accrued incentive compensation of \$0.2 million.

Segment net sales increased \$13.0 million, or 6.5%, in the first nine months of 2018 compared to the first nine months of 2017 primarily due to increased volume and favorable foreign currency translation. Industrial filtration sales increased \$11.5 million, or 10.5%, particularly from increased demand in Europe and North America. Additionally, advanced materials net sales increased \$1.5 million, or 1.7%, primarily due to increased demand in Canada. Foreign currency translation had a positive impact on segment net sales of \$5.5 million, or 2.7%, in the first nine months of 2018 compared to the first nine months of 2017. The Company's adoption of ASC 606 contributed \$3.6 million of the sales increase in the first nine months of 2018.

The Technical Nonwovens segment reported operating income of \$17.4 million, or 8.2% of net sales, in the first nine months of 2018, compared to \$19.8 million, or 9.9% of net sales, in the first nine months of 2017. The decrease in operating margin of 170 basis points was attributable to lower gross margin of approximately 190 basis points. Gross margin was negatively impacted by incremental segment restructuring expenses of \$1.5 million, or 70 basis points, unfavorable product mix and higher raw material costs, and was partially offset by inventory step-up of \$1.1 million, or 60 basis points, in the first nine months of 2017. Selling, product development and administrative expenses increased \$1.0 million in the first nine months of 2018 compared to the first nine months of 2017, but decreased by approximately 20 basis points as a percentage of net sales. The increase in selling, product development and administrative expenses was primarily related to higher amortization of intangible assets of \$1.1 million and increased salaries and benefits of \$1.0 million, partially offset by lower accrued incentive compensation of \$0.7 million and a

decrease in other administrative expenses of \$0.4 million.

Thermal Acoustical Solutions

Segment net sales increased \$3.8 million, or 4.5%, in the third quarter of 2018 compared to the third quarter of 2017. Parts net sales increased \$2.5 million, or 3.4%, compared to the third quarter of 2017, due to increased global demand, but primarily in North America. The Company's adoption of ASC 606 had a minimal impact on parts net sales in the third quarter of 2018. Tooling net sales increased \$1.3 million compared to the third quarter of 2017 due to new platform launches primarily in China and Europe. The Company's adoption of ASC 606 resulted in the absence of \$5.0 million of segment tooling sales that under prior accounting rules would have been recognized upon delivery and acceptance by the customer in the third quarter of 2018, but were recognized in an earlier quarter in 2018 under ASC 606. Foreign currency translation had a negative impact on segment net sales of \$0.4 million, or 0.5%, in the third quarter of 2018 compared to the third quarter of 2017.

The Thermal Acoustical Solutions segment reported operating income of \$7.9 million, or 9.0% of net sales, in the third quarter of 2018, compared to operating income of \$10.6 million, or 12.6% of net sales, in the third quarter of 2017. The decrease in operating income of \$2.7 million and operating margin of 360 basis points was due to lower gross margin of 560 basis points. Labor and

variable overhead expenses increased by approximately 320 basis points, including outsourcing costs and overtime associated primarily with new product launch activity and increased commodity costs, primarily aluminum, were approximately 240 basis points. This decrease to gross margin was partially offset by a \$1.5 million decrease in selling product development and administrative expenses, or a 210 basis point decrease as a percentage of net sales, primarily due to the absence of \$1.1 million of expenses associated with the combination of the Company's former T/A Metals and T/A Fibers segments in the third quarter of 2017.

Segment net sales increased \$24.7 million, or 9.7%, in the first nine months of 2018 compared to the first nine months of 2017. Tooling net sales increased \$13.5 million compared to the first nine months of 2017 due to new platform launches and the impact of the Company's adoption of ASC 606. The new standard resulted in the recognition of an additional \$2.6 million of segment tooling sales that under prior accounting rules would have been recognized upon delivery and acceptance by the customer in a later period. Additionally, parts net sales increased \$11.1 million, or 4.7%, compared to the first nine months of 2017, due to increased global demand, partially offset by reduced customer pricing, primarily in North America. The Company's adoption of ASC 606 had a minimal impact on parts net sales in the first nine months of 2018. Foreign currency translation had a positive impact on segment net sales of \$5.8 million, or 2.3%, in the first nine months of 2018 compared to the first nine months of 2017.

The Thermal Acoustical Solutions segment reported operating income of \$29.4 million, or 10.5% of net sales, in the first nine months of 2018, compared to operating income of \$40.8 million, or 16.0% of net sales, in the first nine months of 2017. The decrease in operating income of \$11.4 million and operating margin of 550 basis points was due to lower gross margin of 690 basis points primarily due to increased labor and variable overhead expenses of approximately 340 basis points, including outsourcing costs, overtime associated primarily with new product launch activity and expedited freight expenses for customer deliveries caused by equipment downtime and other inefficiencies. Increased raw material commodity costs, primarily aluminum, were approximately 220 basis points. Also, lower sales from customer shut-downs and the resulting fixed costs under-absorption resulted in lower gross margin of approximately 40 basis points. This decrease to gross margin was partially offset by a \$2.0 million decrease in selling product development and administrative expenses, or a 140 basis point decrease as a percentage of net sales, due to the absence of \$1.1 million of expenses associated with the combination of the Company's former T/A Metals and T/A Fibers segments in 2017, lower salaries and sales commissions of \$0.6 million and decreased other administrative costs of \$0.3 million in the first nine months of 2018 compared to the first nine months of 2017.

Corporate Office Expenses

Corporate office expenses for the third quarter of 2018 were \$6.2 million, compared to \$7.0 million in the third quarter of 2017. The decrease of \$0.8 million was primarily due to lower corporate consulting expenses of \$0.9 million in support of organic growth initiatives, lower accrued incentive compensation of \$0.6 million and decreased other administrative expenses of \$0.5 million, partially offset by increased corporate strategic initiative expenses of \$1.2 million, primarily due to the Interface acquisition.

Corporate office expenses for the first nine months of 2018 compared to the first nine months of 2017 were flat at \$18.8 million. Increased corporate strategic initiatives expense of \$2.4 million were offset by lower accrued incentive compensation of \$1.0, reduced corporate consulting expenses of \$1.0 million in support of organic growth initiatives and decreased other administrative expenses of \$0.4 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, debt service payments, outcomes of contingencies, foreign currency exchange rates and employee benefit plan funding. The Company manages worldwide cash requirements by considering available funds among domestic and foreign subsidiaries. The Company expects to finance its 2018 operating cash and capital spending requirements from existing cash balances, cash provided by operating activities and through borrowings under the Amended Credit Facility, as needed.

At September 30, 2018, the Company held \$44.1 million in cash and cash equivalents, including \$8.0 million in the U.S. with the remaining held by foreign subsidiaries.

Financing Arrangements

On August 31, 2018, the Company amended and restated its \$175 million senior secured credit agreement ("Amended Credit Agreement") that increased the available borrowing from \$175 million to \$450 million, added three additional lenders and extended the maturity date from July 7, 2021 to August 31, 2023.

Under the terms of the Amended Credit Agreement, the lenders are providing up to a \$450 million credit facility (the “Facility”) to the Company, under which the lenders provided a term loan commitment of \$200 million and revolving loans to or for the benefit of the Company and its subsidiaries of up to \$250 million. The Facility may be increased by an aggregate amount not to exceed \$150 million through an accordion feature, subject to specified conditions. The Facility is secured by substantially all of the assets of the Company.

Interest is charged on borrowings at the Company’s option of either: (i) Base Rate plus the Applicable Rate, or (ii) the Eurodollar Rate plus the Applicable Rate. The Base Rate is a fluctuating rate equal to the highest of (a) the federal funds rate plus 0.50%, (b) the prime rate as set by Bank of America, and (c) the Eurocurrency Rate plus 1.00%. The Eurocurrency Rate means (i) if denominated in LIBOR quoted currency, a fluctuating LIBOR per annum rate equal to the London Interbank Offered Rate; (ii) if denominated in Canadian Dollars, the rate per annum equal to the Canadian Dollar Offered Rate; or (iii) the rate per annum as designated with respect to such alternative currency at the time such alternative currency is approved by the Lenders. The Applicable Rate is determined based on the Company’s Consolidated Leverage Ratio (as defined in the Amended Credit Agreement). The Applicable Rate added to the Base Rate Committed Loans ranges from 0.00% to 1.25%, and the Applicable Rate added to Eurocurrency Rate Committed Loans and Letters of Credit ranges from 0.75% to 2.00%. The Company pays a quarterly fee ranging from 0.15% to 0.275% on the unused portion of the revolving commitment.

The Company is permitted to prepay term and revolving borrowings in whole or in part at any time without premium or penalty, subject to certain minimum payment requirements, and the Company is generally permitted to irrevocably cancel unutilized portions of the revolving commitments under the Amended Credit Agreement. The Company is required to repay the term commitment in an amount of \$2.5 million per quarter beginning with the quarter ending December 31, 2018 through the quarter ending June 30, 2023.

The Amended Credit Agreement contains covenants required of the Company and its subsidiaries, including various affirmative and negative financial and operational covenants. The Company is required to meet certain quarterly financial covenants calculated from the four fiscal quarters most recently ended, including: (i) a minimum consolidated fixed charge coverage ratio, which requires that at the end of each fiscal quarter the ratio of (a) consolidated EBITDA to (b) the sum of consolidated interest charges, redemptions, non-financed maintenance capital expenditures, restricted payments and taxes paid, each as defined in the Amended Credit Agreement, may not be lower than 1.25 to 1.0; and (ii) a consolidated net leverage ratio, which requires that at the end of each fiscal quarter the ratio of consolidated funded indebtedness minus consolidated domestic cash to consolidated EBITDA, as defined in the Amended Credit Agreement, may not be greater than 3.5 to 1.0. The Company was in compliance with all covenants at September 30, 2018.

At September 30, 2018, the Company had borrowing availability of \$108.1 million under the Facility, net of \$338.0 million of borrowings outstanding and standby letters of credit outstanding of \$3.9 million. The borrowings outstanding included a \$200.0 million term loan, net of \$0.5 million in debt issuance costs being amortized to expense over the debt maturity period.

In addition to the amounts outstanding under the Facility, the Company has various acquired foreign credit facilities totaling approximately \$8.4 million. At September 30, 2018, the Company's foreign subsidiaries had \$0.1 million in borrowings outstanding as well as \$2.3 million in standby letters of credit outstanding.

In April 2017, the Company entered into a three-year interest rate swap agreement transacted with a bank which converts the interest on the first notional \$60.0 million of the Company's one-month LIBOR-based borrowings from a variable rate, plus the borrowing spread, to a fixed rate of 1.58% plus the borrowing spread. The notional amount reduces quarterly by \$5.0 million through March 31, 2020. The Company is accounting for the interest rate swap

agreement as a cash flow hedge. Effectiveness of this derivative agreement is assessed quarterly by ensuring that the critical terms of the swap continue to match the critical terms of the hedged debt.

Operating Cash Flows

Net cash provided by operating activities in the first nine months of 2018 was \$14.5 million compared with \$46.2 million in the first nine months of 2017. In the first nine months of 2018, net income and non-cash adjustments were \$55.1 million compared to \$59.5 million in the first nine months of 2017. Since December 31, 2017, net operating assets and liabilities increased by \$40.6 million, primarily due to increases of \$25.4 million in accounts receivable, \$12.2 million in inventories and \$5.4 million in contract assets, partially offset by an increase of \$8.3 million in accounts payable. Also, contributions to the Company's defined benefit pension plan increased by \$3.6 million in the first nine months of 2018 compared to 2017 for total contributions of \$7.2 million in 2018. The increase in accounts receivable and contract assets was primarily due to higher net sales across the Technical Nonwovens and Performance Materials segments. The increase in inventory was principally due to higher raw material inventories, primarily associated with strategic purchases within the Technical Nonwovens segment to ensure sufficient levels of inventory to

meet seasonal demands. The increase in accounts payable was primarily driven by the timing of vendor payments within the Technical Nonwovens segment, as well as the timing of payments for capital expenditures during the first nine months of 2018.

Investing Cash Flows

In the first nine months of 2018, net cash used for investing activities was \$289.8 million compared to \$20.3 million in the first nine months of 2017. Investing activities in the first nine months of 2018 consisted of cash outflows of \$268.4 million to fund the Interface acquisition, net of cash acquired of \$5.2 million and cash outflows of \$1.6 million to fund the PCC acquisition. Investing activities in the first nine months of 2018 also included cash outflows of \$20.1 million for capital expenditures. Investing activities in the first nine months of 2017 consisted of cash outflows of \$19.9 million for capital expenditures and a final purchase price adjustment of \$0.3 million related to the Gutsche acquisition. Capital spending for 2018 is expected to be approximately \$30 million to \$35 million.

Financing Cash Flows

In the first nine months of 2018, net cash provided by financing activities was \$260.6 million compared to net cash used for financing activities of \$37.9 million in the first nine months of 2017. In the first nine months of 2018, the Company borrowed \$338.0 million from its Amended Credit Facility of which the Company repaid \$76.6 million in outstanding borrowings under the previous facility and used the remaining proceeds to fund the purchase of the Interface acquisition. The Company had debt repayments of \$35.7 million in the first nine months of 2017. The Company acquired \$1.0 million and \$2.6 million in company stock through its equity compensation plans during the first nine months of 2018 and 2017, respectively. The Company received \$0.8 million from the exercise of stock options in the first nine months of 2018, compared to \$0.4 million in the first nine months of 2017.

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. Note 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, 2017, 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 or nine months ended September 30, 2018, except for those described in Note 2 of this report in relation to the Company's adoption of ASC 606.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Lydall's limited market risk exposures relate to changes in foreign currency exchange rates and interest rates.

Foreign Currency Risk

The Company has operations in France, Germany, China, the United Kingdom, Canada, India and the Netherlands, in addition to the United States. As a result of this, the Company's financial results are affected by factors such as changes in foreign currency exchange rates or economic conditions in the foreign markets where the Company manufactures and distributes its products. The Company's currency exposure is to the US Dollar, the Euro, the Chinese Yuan, the British Pound Sterling, the Canadian Dollar, the Japanese Yen, the Indian Rupee and the Hong Kong Dollar. The Company's foreign and domestic operations attempt to limit foreign currency exchange transaction risk by completing transactions in local functional currencies, whenever practicable. The Company may periodically enter into foreign currency forward exchange contracts to mitigate exposure to foreign currency volatility. In addition, the Company utilizes bank loans and other debt instruments throughout its operations. To mitigate foreign currency risk, such debt is denominated primarily in the functional currency of the operation maintaining the debt.

The Company also has exposure to fluctuations in currency risk on intercompany loans that the Company makes to certain of its subsidiaries. The Company may periodically enter into foreign currency forward contracts which are intended to offset the impact of foreign currency movements on the underlying intercompany loan obligations.

Interest Rate Risk

The Company's interest rate exposure is most sensitive to fluctuations in interest rates in the United States and Europe, which impact interest paid on its debt. The Company has debt with variable rates of interest based generally on LIBOR. Increases in interest rates could therefore significantly increase the associated interest payments that the Company is required to make on this debt. From time to time, the Company may enter into interest rate swap agreements to manage interest rate risk. The Company has assessed its exposure to changes in interest rates by analyzing the sensitivity to Lydall's earnings assuming various changes in market interest rates. Assuming a hypothetical increase of one percentage point in interest rates on the variable interest rate debt as of September 30, 2018, the Company's net income would decrease by an estimated \$2.4 million over a twelve-month period.

In April 2017, the Company entered into a three-year interest rate swap agreement transacted with a bank which converts the interest on the first notional \$60.0 million of the Company's one-month LIBOR-based borrowings under its revolver loan from a variable rate, plus the borrowing spread, to a fixed rate of 1.58% plus the borrowing spread. The notional amount reduces quarterly by \$5.0 million through March 31, 2020.

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 the 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")). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. 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 (the "SEC"), and that such information is accumulated and communicated to management of the Company, with the participation of its CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures were effective as of September 30, 2018 at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

On August 31, 2018, the Company completed the acquisition of Interface Performance Materials ("Interface"). Management considers this transaction to be material to the Company's consolidated financial statements. The Company is currently in the process of evaluating the existing controls and procedures of the Interface business and integrating the business into our Section

404 compliance program under the Sarbanes-Oxley Act of 2002 (the “Act”) and the applicable rules and regulations under such Act. In accordance with such rules, a company is permitted to exclude an acquired business from management’s assessment of the effectiveness of internal control over financial reporting for the year in which the acquisition is consummated. The Company will report on its assessment of the effectiveness of internal control over financial reporting of its consolidated operations (including the Interface Business) within the time period provided by the Act and the applicable SEC rules and regulations concerning business combinations.

Subject to the foregoing, 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, 2018 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, subject to the matter referenced below, the Company is not aware of any matters pending that are expected to have a material adverse effect on the Company's business, financial position, results of operations or cash flows.

In the fourth quarter of 2016, as part of a groundwater discharging permitting process, water samples collected from wells and process water basins at the Company's Rochester New Hampshire manufacturing facility, within the Performance Materials segment, showed concentrations of Perfluorinated Compounds ("PFCs") in excess of state ambient groundwater quality standards.

In January 2017, the Company received a notification from the State of New Hampshire Department of Environmental Services ("NHDES") naming Lydall Performance Materials, Inc. a responsible party with respect to the discharge of regulated contaminants and, as such, is required to take action to investigate and remediate the impacts in accordance with standards established by the NHDES. The Company conducted a site investigation, the scope of which was reviewed by the NHDES, in order to assess the extent of potential soil and groundwater contamination and develop a remedial action. Based on input received from NHDES in March 2017 with regard to the scope of the site investigation, the Company recorded \$0.2 million of expense in the first quarter of 2017 associated with the expected costs of conducting this site investigation.

In the fourth quarter of 2017, the Company completed its state-approved site investigation report and submitted it to the NHDES. During the year ended December 31, 2017, the environmental liability of \$0.2 million was reduced by \$0.2 million reflecting payments made to vendors, resulting in no balance at December 31, 2017.

In the first quarter of 2018, the Company received a response from the NHDES to the site investigation report outlining proposed remedial actions. The Company recorded \$0.1 million of expense in the first quarter of 2018 associated with the expected costs to remediate the impacts of the discharge of regulated contaminants in accordance with standards established by the NHDES.

In May of 2018, the Company met with the NHDES to finalize the proposed remedial actions from the site investigation report. The Company recorded a minimal incremental amount in the second quarter of 2018 associated with the cost of the proposed remedial actions resulting in an environmental liability of \$0.1 million at June 30, 2018. During the quarter ended September 30, 2018, the environmental liability was reduced by \$0.1 million reflecting payments made to vendors, resulting in no balance at September 30, 2018. Additionally, the Company incurred \$0.2 million of capital expenditures in the third quarter 2018 in relation to the lining of the Company's fresh water waste lagoons.

The site investigation is on-going. The Company cannot be sure that costs will not exceed the current estimates until this matter is closed with the NHDES, nor that any future corrective action at this location would not have a material effect on the Company's financial condition, results of operations or liquidity. Provisions for such matters are charged to expense when it is probable that a liability has been incurred and reasonable estimates of the liability can be made. Estimates of environmental liabilities are based on a variety of matters, including, but not limited to, the stage of investigation, the stage of the remedial design, evaluation of existing remediation technologies, and presently enacted laws and regulations. In future periods, a number of factors could significantly impact any estimates of environmental remediation costs.

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, 2017, as updated below. The risks described in the Annual Report on Form 10-K, and the "Cautionary Note Concerning Forward-Looking Statements" 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. The following risk factors have been updated from Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The Interface acquisition exposes the Company to a number of risks and uncertainties, the occurrence of any of which could materially adversely affect the Company's business, cash flows, financial condition and results of operations as well as the market price of Lydall's common stock - On August 31, 2018 the Company acquired the Interface businesses and funded the purchase price for the acquisition from cash on hand and borrowings under the Amended Credit Facility. The acquisition exposes the Company to a number of risks and uncertainties, including the subsequent integration of the acquired businesses with the Company,

the financial performance of the Interface acquisition, risks associated with incurring additional indebtedness and the risks associated with international expansion.

Additionally, Company management has spent, and will continue to spend, a significant amount of its time and efforts directed toward the Interface businesses, which time and efforts otherwise would have been spent on existing businesses and other opportunities that could have been beneficial to Lydall. In addition, the Company may not realize the anticipated benefits of the acquisition of the Interface businesses. The Company's ability to realize such benefits will depend on its ability to successfully and efficiently integrate the Interface businesses, which involves products, markets, and geographies that are new to the Company. Difficulties of integration include coordinating and consolidating separate systems, integrating the management of the acquired businesses, integrating legal and financial controls, retaining market acceptance of products, maintaining employee morale, retaining key employees, and implementing Lydall's management information systems and operational procedures and disciplines. Any such difficulties may make it more difficult to maintain relationships with employees, customers, business partners and suppliers. Also, even if integration is successful, the financial performance of the acquired businesses may not be as expected and there can be no assurance that the Company will realize anticipated revenue and earnings enhancements from the acquisition.

The Company's inability to implement effective internal controls, procedures and policies for the acquired Interface businesses as required by Sarbanes-Oxley Act of 2002 within the time periods prescribed thereby - The Company plans to fully evaluate the internal controls of the Interface businesses and any subsequently acquired companies, and then implement a standard framework established by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission in internal control - integrated framework (2013 Framework) of internal controls at those acquired businesses. The Company cannot provide assurance that it will be able to provide a report that contains no material weaknesses with respect to the Interface businesses or any other acquisition.

The Company incurred a substantial amount of additional indebtedness which could have an adverse effect on the Company's financial health and make it more difficult for Lydall to obtain additional financing in the future - The Company financed the Interface acquisition with available cash and \$261.4 million in borrowings under the Amended Credit Facility executed on August 31, 2018. As of September 30, 2018, total borrowings outstanding under the Amended Credit Facility were \$338.0 million. Existing debt outstanding and leverage ratios may limit Lydall's ability to obtain any necessary financing in the future for working capital, capital expenditures, future acquisitions, debt service requirements or other purposes. Additionally, the Company may not be able to generate sufficient cash flow or otherwise obtain funds necessary to meet the additional debt obligations. Any default under the Amended Credit Facility would likely result in the acceleration of the repayment obligations to our lenders.

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

During the three months ended September 30, 2018, the Company acquired 2,165 shares of common stock 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 | 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, 2018 - July 31, 2018 | 312 | \$ 44.70 | — | — |
| August 1, 2018 - August 31, 2018 | 311 | \$ 43.20 | — | — |
| September 1, 2018 - September 30, 2018 | 1,542 | \$ 41.10 | — | — |
| | 2,165 | \$ 41.92 | — | — |

Item 6. Exhibits

Exhibit
Number Description

- 10.1 Stock Purchase Agreement, dated August 9, 2018, by and among Lydall, Inc., Susquehanna Capital Acquisition Co. and Vulcan Global, LLC, an affiliate of Wind Point Partners, filed as Exhibit 2.1 to the Registrant's Form 8-K dated August 14, 2018 and incorporated herein by reference. (The Company will supplementally furnish any omitted schedules to the Commission upon request.)
- 10.2 Second Amended and Restated Credit Agreement, dated August 31, 2018, by and among Lydall, Inc., as borrower, the Guarantors named therein, and Bank of America, N.A., as Agent for the Lenders, filed as Exhibit 10.2 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.3 Second Amended and Restated Security Agreement, dated August 31, 2018 by and between Lydall, Inc., and Bank of America, N.A., filed as Exhibit 10.3 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.4 Second Amended and Restated Security Agreement, dated August 31, 2018 by and between Lydall Thermal/Acoustical, Inc., and Bank of America, N.A., filed as Exhibit 10.4 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.5 Second Amended and Restated Security Agreement, dated August 31, 2018 by and between Lydall Performance Materials, Inc. (formerly known as Lydall Filtration/Separation, Inc.), and Bank of America, N.A., filed as Exhibit 10.5 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.6 Second Amended and Restated Security Agreement, dated August 31, 2018 by and between Lydall International, Inc., and Bank of America, N.A., filed as Exhibit 10.6 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.7 Amended and Restated Security Agreement, dated August 31, 2018 by and between Lydall Southern Felt Company, Inc., and Bank of America, N.A., filed as Exhibit 10.7 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.8 Security Agreement, dated August 31, 2018, by and between Lydall North America LLC, and Bank of America, N.A., filed as Exhibit 10.8 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.9 Security Agreement, dated August 31, 2018, by and between Susquehanna Capital Acquisition Co., and Bank of America, N.A., filed as Exhibit 10.9 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.10 Security Agreement, dated August 31, 2018, by and between Interface Performance Materials, Inc., and Bank of America, N.A., filed as Exhibit 10.10 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.
- 10.11 Security Agreement, dated August 31, 2018, by and between Interface Sealing Solutions, Inc., and Bank of America, N.A., filed as Exhibit 10.11 to the registrant's Form 8-K dated September 7, 2018 and incorporated herein by reference.

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

51

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

52

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 6, 2018 By: /s/ Randall B. Gonzales
Randall B. Gonzales
Executive Vice President and Chief Financial Officer
(On behalf of the Registrant and as
Principal Financial Officer)