UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X]

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1996

OR

[_]

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-7665

LYDALL, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	06-0865505 (I.R.S. EMPLOYER IDENTIFICATION NO.)
ONE COLONIAL ROAD, P.O. BOX 151, MANCHESTER, CONNECTICUT, (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	06045 (ZIP CODE)

(860) 646-1233
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

NONE
(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST **REPORT.)**

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

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

Common stock $.10 par value per share.
Total shares outstanding November 7, 1996
17,087,330

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LYDALL, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LYDALL, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS
(IN THOUSANDS)

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	SEPTEMBER 30, 1996	DECEMBER 31, 1995
	(UNAUDITED)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 35,298	$ 27,820
Short-term investments	2,518	913
Accounts receivable, net	33,240	34,202
Inventories:		
Finished goods	6,270	6,033
Work in process	3,750	3,367
Raw materials and supplies	6,183	7,217
LIFO reserve	(1,846)	(2,493)
Total inventories	14,357	14,124
Prepaid expenses	965	820
Deferred tax assets	4,583	4,590
Total current assets	90,961	82,469
Property, plant and equipment, at cost	110,520	105,467
Less accumulated depreciation	(50,196)	(45,393)
	60,324	60,074
Other assets, at cost, less amortization	14,606	15,529
	$165,891	$158,072
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 3,492	$ 2,871
Accounts payable	15,580	14,770
Accrued taxes	866	263
Accrued payroll and other compensation	5,393	5,426
Other accrued liabilities	6,431	6,409
Total current liabilities	31,762	29,739
Long-term debt	4,300	7,750
Deferred tax liabilities	14,076	14,207
Other long-term liabilities	4,044	4,565
Stockholders' equity:		
Preferred stock	--	--
Common stock	2,108	2,089
Capital in excess of par value	33,596	32,448
Foreign currency translation adjustment	1,518	2,091
Pension liability adjustment	(506)	(459)
Retained earnings	97,077	78,461
	133,793	114,630
Less: treasury stock, at cost	(22,084)	(12,819)
Total stockholders' equity	111,709	101,811
	$165,891	$158,072

See accompanying Notes to Consolidated Condensed Financial Statements.

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LYDALL, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(IN THOUSANDS EXCEPT PER-SHARE DATA)

	THREE MONTHS ENDED SEPTEMBER 30,	
	1996	1995
	(UNAUDITED)	
Net sales	$ 59,707	$ 61,487
Cost of sales	40,308	42,572
Gross margin	19,399	18,915
Selling, product development and administrative expenses	10,270	9,643
Operating income	9,129	9,272
Other (income) expense		
Investment income	(380)	(288)
Interest expense	143	200
Other, net	62	123
	(175)	35
Income before income taxes	9,304	9,237
Income tax expense	3,524	3,790
Net income	$ 5,780	$ 5,447
Net income per share	$ .32	$ .30
Weighted average common stock and equivalents outstanding	18,049	18,418

See accompanying Notes to Consolidated Condensed Financial Statements.

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LYDALL, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(IN THOUSANDS EXCEPT PER-SHARE DATA)

	NINE MONTHS ENDED SEPTEMBER 30	
	1996	1995
	(UNAUDITED)	
Net sales	$193,170	$189,775
Cost of sales	131,458	131,610
Gross margin	61,712	58,165
Selling, product development and administrative expenses	31,964	30,362
Operating income	29,748	27,803
Other (income) expense		
Investment income	(979)	(718)
Interest expense	457	655
Other, net	283	293
	(239)	230
Income before income taxes	29,987	27,573
Income tax expense	11,371	10,948
Net income	$ 18,616	$ 16,625
Net income per share	$ 1.03	$ .91
Weighted average common stock and equivalents outstanding	18,147	18,285

See accompanying Notes to Consolidated Condensed Financial Statements.

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LYDALL, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

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	NINE MONTHS ENDED SEPTEMBER 30,	
	1996	1995
	(UNAUDITED)	
Cash flows from operating activities:		
Net income	$ 18,616	$ 16,625
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	6,088	5,602
Amortization	1,050	1,134
Changes in operating assets and liabilities:		
Accounts receivable	750	(3,585)
Inventories	(337)	(1,922)
Other assets	(280)	378
Accounts payable	930	191
Accrued taxes	632	(715)
Accrued payroll and other compensation	(21)	(102)
Deferred income taxes	30	906
Other long-term liabilities	(440)	9
Other accrued liabilities	40	1,136
Total adjustments	8,442	3,032
Net cash provided by operating activities	27,058	19,657
Cash flows from investing activities:		
Additions of property, plant & equipment	(7,684)	(8,726)
Disposals of property, plant & equipment, net	693	406
Sale (Purchase) of investments, net	(1,647)	382
Net cash used for investing activities	(8,638)	(7,938)
Cash flows from financing activities:		
Long-term debt payments	(2,821)	(2,816)
Issuance of common stock	1,167	1,808
Acquisition of common stock	(9,265)	--
Net cash used for financing activities	(10,919)	(1,008)
Effect of exchange rate changes on cash	(23)	22
Increase in cash and cash equivalents	7,478	10,733
Cash and cash equivalents at beginning of period	27,820	11,684
Cash and cash equivalents at end of period	$ 35,298	$ 22,417
Supplemental schedule of cash flow information:		
Cash paid during the period for:		
Interest	$ 661	$ 556
Income taxes	10,627	10,977
Non-cash transactions:		
Reclassification between short-term and long-term investments, net	--	447
Effect on Additional Paid in Capital and Common Stock for stock split effected in the form of a stock dividend	--	1,041

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See accompanying Notes to Consolidated Condensed Financial Statements.

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LYDALL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

1. The accompanying consolidated condensed financial statements include the accounts of Lydall, Inc. and its wholly owned subsidiaries. All financial information is unaudited for interim periods reported. All significant intercompany transactions have been eliminated in the consolidated condensed financial statements. Management believes that all adjustments, which include only normal recurring accruals, necessary to present a fair statement of the financial position and results of the periods have been included. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

2. Earnings per common share are based on the weighted average number of common shares outstanding during the period, including the effect of stock options, stock awards and warrants where such effect would be dilutive. Fully diluted earnings per share are not presented since the dilution is not material.

3. In the mid-1980's, the United States Environmental Protection Agency ("EPA") notified a former subsidiary of the Company that it and other entities may be potentially responsible in connection with the release of hazardous substances at a landfill and property located adjacent to a landfill located in Michigan City, Indiana. The two sites have been combined and are viewed by the EPA as one site. The preliminary indication, based on the Site Steering Committee's volumetric analysis, is that the alleged contribution to the waste volume at the site of the plant once owned by a former subsidiary is approximately 0.434 percent of the total volume. The portion of the 0.434 percent specifically attributable to the former subsidiary by the current operator of the plant is approximately
0.286 percent.

There are over 800 potentially responsible parties ("prp") which have been identified by the Site Steering Committee. Of these, 38, not including the Company's former subsidiary, are estimated to have contributed over 80 percent of the total waste volume at the site. These prp's include Fortune 500 companies, public utilities, and the State of Indiana. The Company believes that, in general, these parties are financially solvent and should be able to meet their obligations at the site. The Company has reviewed Dun & Bradstreet reports on several of these prp's, and based on these financial reports, does not believe Lydall will have any material additional volume attributed to it for reparation of this site due to insolvency of other prp's.

During the quarter ended September 30, 1994, the Company learned that the EPA had completed its Record of Decision ("ROD") for the Michigan site and has estimated the total cost of remediation to be between $17 million and $22 million. Based on the alleged volumetric contribution of its former subsidiary to the site, and on the EPA's estimated remediation costs, Lydall's alleged total exposure would be less than $100 thousand, which has been accrued. In June 1995, the Company and its former subsidiary were sued in the Northern District of Indiana by the insurer of the current operator of the former subsidiary's plant seeking contribution. No demand has been formally made in this matter, however, the Company believes it has several defenses to the action.

Management believes the ultimate disposition of this matter will not have a material adverse effect upon the Company's consolidated financial position or results of operations.

4. The Company will adopt the disclosure requirements of SFAS 123, "Accounting for Stock-Based Compensation," for the year ending December 31, 1996. As permitted under SFAS 123, the Company has elected not to adopt the fair- value-based method of accounting for its stock-based compensation plans, but will continue to account for such compensation under the provisions of APB Opinion No. 25. The adoption will have no effect on the Company's consolidated financial position or results of operations.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS:

For the third quarter ended September 30, 1996, net income was $5.8 million compared with $5.4 million for the comparable prior-year quarter--up 6 percent. On an earnings per-share basis, the Company posted a third-quarter record of $.32 compared with $.30 for the same period last year--a 7 percent increase. Sales declined slightly in the quarter--$59.7 million compared with $61.5 million for the 1995 third quarter. Gross margin for the quarter was $19.4 million, 32.5 percent of sales, compared with $18.9 million, or 30.8 percent of sales, in the third quarter 1995. After-tax return on sales was 9.7 percent compared with 8.9 percent for the same period last year.

Net income for the nine months ended September 30, 1996 was $18.6 million, or $1.03 per share, compared with $16.6 million, or $.91 per share--a 13 percent increase in earnings per share. Sales for the nine months ended September 30, 1996 were $193.2 million compared with $189.8 million for the first three quarters of 1995--up 2 percent. Gross margin was $61.7 million, or 31.9 percent of sales, for the nine months ended September 30, 1996, and the after-tax return on sales was 9.6 percent. For the same nine-month period in 1995, gross margin was $58.2 million, or 30.6 percent of sales, and the after- tax return on sales was 8.8 percent.

The increase in the Company's gross margin percentage is largely attributable to the continuing emphasis placed on cost of quality. Substantial progress was made at acquisitions with gross margin for the quarter increasing to 21.1% from 12.2% for the same period in 1995.

Selling, new product development and administrative expenses increased 5.3 percent in the first nine months of the year versus the same period in 1995. As a percentage of sales, these expenses amounted to 16.5 percent in 1996 in comparison to 16.0 percent in 1995. Year to date 1996 figures include higher legal fees due to the successful defense of a lawsuit alleging patent infringement which was concluded in March of this year. The Company anticipates that these expenses will approximate 17.0 percent through the end of the year. A factor in this increased level of expenditures is the Company's plan to implement a new information technology system throughout the entire organization.

The Company anticipates achieving its twelfth year of growth in 1996. However, the second half of 1996 is proving to be less robust than earlier anticipated. Results are tracking somewhat below previously announced projections for 1996 of earnings per share of about $1.41 and sales in the range of $265 million. Earnings are now projected to be more in the range of $1.35 to $1.36 per share with sales slightly ahead of last year's sales of $252 million.

Domestic sales are up slightly from 1995. International sales, including sales attributable to the Company's French operation and exports, have fallen 15.8 percent for the third quarter 1996 in comparison to the same period for 1995 and are relatively flat on a year-to-date comparison. International sales account for 19.6 percent and 21.1 percent of total sales on a quarterly and year to date basis, respectively, for 1996.

Lydall has many growth opportunities on the horizon and this period of slower growth is viewed as a temporary plateau. In the thermal area, sales of automotive heat shields continue to be healthy. Compared with the same quarter last year, sales of these products for the third quarter of 1996 exhibited low double-digit growth, while automotive builds were reported to be up only around 4 percent. Growth of the battery insulator product line also continues to be good.

Although high-efficiency air filtration products continue to present opportunities for growth through new product introduction, market penetration, and geographic expansion, sales of these products in the quarter were about equal to the record levels achieved last year. Air filtration sales have grown at a phenomenal rate over the past two years; however, they slowed modestly in the third quarter. In general, the long-term trend for this business is very positive with demand for clean rooms expanding across a wide variety of industries. In addition, there are opportunities for increasing demand in developing countries. The home air filtration market also has growth potential, domestically and overseas.

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One of Lydall's more mature businesses, electrical materials sold to the European battery aftermarket, declined by approximately $1.1 million in the third quarter 1996 compared with the same quarter last year.

In addition, sales of material handling products continued to be off from record highs last year. This has always been a good growth business for Lydall, and it continues to be solid. This year's lower sales resulted primarily in a deflationary issue. In contrast, raw material prices increased dramatically last year, and the Company passed through corresponding price increases. This is one area of business where the market pushes for price reductions that directly track decreases in raw material costs.

The effective tax rate for the Company's domestic operations was 37.8 percent for the third quarter of 1996 and 37.9 percent on a year to date basis. This compares to 37.7 percent for the third quarter and 38.7 percent year to date in 1995. Had the Company not invested cash balances in a variety of tax exempt or tax advantaged investments, the year to date rates would have been 38.8 percent in 1996 and 39.2 percent in 1995. The tax rate at our Axohm Division in France remained unchanged at 36.6 percent in 1996 and 1995 on a year to date basis but the effect on Lydall's consolidated results was minimal.

Stockholders are referred to Lydall's Form 8-K, filed on June 4, 1996, which outlines certain risks regarding the Company's forward-looking statements. Such risks include: a major downturn of the U.S. automotive market which accounts for about 30 percent of Lydall's total sales; a meaningful decrease in the number of clean rooms being built worldwide; and significant, unforeseen changes in raw material pricing, specifically, virgin fiber used in producing the Company's materials handling slipsheets.

LIQUIDITY AND CAPITAL RESOURCES:

Lydall generated operating cash flow (earnings before taxes, interest expense and investment income or expense plus depreciation and amortization) of $11.4 million in the third quarter of 1996, bringing operating cash flow year-to-date to a record $36.6 million. At September 30, 1996, cash, cash equivalents and short-term investments were $37.8 million compared with $28.7 million at the end of 1995. Working capital was $59.2 million compared with $52.7 million at the end of last year. The current ratio improved to 2.86 at the end of the third quarter from 2.77 at the end of 1995, and total debt to total capitalization was 7 percent reduced from 9 percent at December 31, 1995.

The Company expects to continue to finance its day-to-day operating needs from accumulated cash plus cash generated from operations.

Lydall continues to actively seek strategic acquisitions and to reinvest in the Company with the primary focus on the ongoing comprehensive quality program.

ACCOUNTING STANDARDS:

The Company will adopt the disclosure requirements of SFAS 123, "Accounting for Stock-Based Compensation," for the year ending December 31, 1996. As permitted under SFAS 123. The Company has elected to account for such compensation under the provisions of APB Opinion No. 25. The adoption will have no effect on the Company's consolidated financial position or results of operations.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

11.1--Schedule of Computation of Weighted Average Shares Outstanding

27.1--Financial Data Schedule

(b) Reports on Form 8-K

The Company did not file any reports on Form 8-K during the three months ended September 30, 1996.

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SIGNATURE

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED THEREUNTO DULY AUTHORIZED.

Lydall, Inc.
(Registrant)

By /s/ John E. Hanley

JOHN E. HANLEY
Vice President--Finance and Treasurer
(Principal Accounting and Financial Officer)

November 7, 1996

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LYDALL, INC.

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27.1	Financial Data Schedule	

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LYDALL, INC.
Exhibit 11.1

Schedule of Computation of Weighted Average Shares Outstanding

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1996	1995	1996	1995
	(Unaudited)		(Unaudited)	
Primary				
Weighted average number of common shares	17,097	17,259	17,155	17,251
Additional shares assuming conversion of stock options and warrants	952	1,159	992	1,034
Weighted average common shares and equivalents outstanding	18,049	18,418	18,147	18,285
Fully Diluted				
Weighted average number of common shares	17,097	17,259	17,155	17,251
Additional shares assuming conversion of stock options and warrants	973	1,170	1,011	1,061
Weighted average common shares and equivalents outstanding	18,070	18,429	18,166	18,312

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ARTICLE 5
MULTIPLIER: 1,000

PERIOD TYPE	9 MOS
FISCAL YEAR END	DEC 31 1996
PERIOD START	JUL 01 1996
PERIOD END	SEP 30 1996
CASH	35,298
SECURITIES	2,518
RECEIVABLES	34,533
ALLOWANCES	2,009
INVENTORY	14,357
CURRENT ASSETS	90,961
PP&E	110,520
DEPRECIATION	50,196
TOTAL ASSETS	165,891
CURRENT LIABILITIES	31,762
BONDS	7,792
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	2,108
OTHER SE	109,601
TOTAL LIABILITY AND EQUITY	165,891
SALES	193,170
TOTAL REVENUES	193,170
CGS	131,458
TOTAL COSTS	131,458
OTHER EXPENSES	(239)
LOSS PROVISION	159
INTEREST EXPENSE	457
INCOME PRETAX	29,987
INCOME TAX	11,371
INCOME CONTINUING	18,616
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	18,616
EPS PRIMARY	1.03
EPS DILUTED	1.03

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