LYDALL INC /DE/
Form 10-Q
November 08, 2006
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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, 2006

OR

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

For the transition period from to

Commission File Number: 1-7665

LYDALL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**06-0865505**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
One Colonial Road, Manchester, Connecticut	**06042**
(Address of principal executive offices)	**(zip code)**

(860) 646-1233

(Registrant s telephone number, including area code)

None

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

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 October 27, 2006	**16,221,443**

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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, 2006	Quarter Ended September 30, 2005
	(Unaudited)	
Net sales	$ 80,124	$ 74,999
Cost of sales	62,498	58,334
Gross margin	17,626	16,665
Selling, product development and administrative expenses	13,570	14,517
Operating income	4,056	2,148
Interest expense	261	465
Other income, net	(24)	(15)
Income before income taxes	3,819	1,698
Income tax expense	101	333
Net income	$ 3,718	$ 1,365
Earnings per share:		
Basic	$ .23	$ .08
Diluted	$ .23	$ .08
Weighted average number of common shares outstanding:		
Basic	16,168	16,096
Diluted	16,209	16,150

See accompanying Notes to Condensed Consolidated Financial Statements.

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LYDALL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands Except Per Share Data)

	Nine Months Ended September 30, 2006	2005
	(Unaudited)	
Net sales	$ 245,757	$ 228,994
Cost of sales	191,353	178,938
Gross margin	54,404	50,056
Selling, product development and administrative expenses	42,536	42,626
Operating income	11,868	7,430
Interest expense	1,138	1,297
Other (income) expense, net	(41)	175
Income before income taxes	10,771	5,958
Income tax expense	2,668	1,858
Net income	$ 8,103	$ 4,100
Earnings per share:		
Basic	$ .50	$ .26
Diluted	$ .50	$ .25
Weighted average number of common shares outstanding:		
Basic	16,148	16,075
Diluted	16,199	16,135

See accompanying Notes to Condensed Consolidated Financial Statements.

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LYDALL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands)

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,542	$ 2,162
Accounts receivable, net	53,635	52,295
Inventories, net	33,863	36,754
Prepaid expenses and other current assets, net	8,036	7,050
Total current assets	97,076	98,261
Property, plant and equipment, at cost	208,117	204,421
Accumulated depreciation	(106,407)	(100,963)
Net, property, plant and equipment	101,710	103,458
Goodwill	30,884	30,884
Other assets, net	16,149	15,646
Total assets	$ 245,819	$ 248,249
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 1,163	$ 3,185
Accounts payable	24,770	23,751
Accrued payroll and other compensation	7,931	5,681
Accrued taxes	3,965	1,696
Other accrued liabilities	5,793	6,243
Total current liabilities	43,622	40,556
Long-term debt	14,658	30,256
Deferred tax liabilities	20,625	17,332
Pension and other long-term liabilities	8,506	16,876
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock	2,256	2,255
Capital in excess of par value	46,361	46,186
Unearned compensation		(330)
Retained earnings	176,611	168,508
Accumulated other comprehensive loss	(2,839)	(9,409)
	222,389	207,210
Treasury stock, at cost	(63,981)	(63,981)

Total stockholders equity		158,408		143,229
Total liabilities and stockholders equity	$	245,819	$	248,249

See accompanying Notes to Condensed Consolidated Financial Statements.

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LYDALL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Nine Months Ended September 30, 2006	2005
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 8,103	$ 4,100
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	11,641	11,316
Accretion of asset retirement obligations	88	
Deferred income taxes	487	(149)
Stock based compensation	403	207
Loss on disposition of property, plant and equipment	744	51
Curtailment gain		(302)
Changes in operating assets and liabilities:		
Accounts receivable	(265)	(8,207)
Inventories	3,651	(3,564)
Accounts payable	611	474
Accrued payroll and other compensation	1,612	2,441
Other, net	(2,071)	2,476
Net cash provided by operating activities	25,004	8,843
Cash flows from investing activities:		
Capital expenditures	(7,496)	(11,809)
Net cash used for investing activities	(7,496)	(11,809)
Cash flows from financing activities:		
Debt proceeds	60,650	80,349
Debt repayments	(79,137)	(78,713)
Reimbursement of cash from leasing company		3,133
Common stock issued	103	195
Net cash (used) provided by financing activities	(18,384)	4,964
Effect of exchange rate changes on cash	256	(276)
(Decrease) increase in cash and cash equivalents	(620)	1,722
Cash and cash equivalents at beginning of period	2,162	1,580
Cash and cash equivalents at end of period	$ 1,542	$ 3,302

See accompanying Notes to Condensed Consolidated Financial Statements.

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LYDALL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Financial Statement Presentation

Lydall designs and manufactures specialty engineered automotive thermal and acoustical barriers, passive and active industrial thermal and insulating solutions, air and liquid filtration media, medical filtration media and devices and biopharmaceutical processing components for demanding thermal/acoustical and filtration/separation applications.

The accompanying condensed consolidated financial statements include the accounts of Lydall, Inc. and its subsidiaries (collectively, the Company or the Registrant). All financial information is unaudited for the interim periods reported. All significant intercompany transactions have been eliminated in the condensed consolidated financial statements. The condensed consolidated financial statements have been prepared, in all material respects, in accordance with the same accounting principles followed in the preparation of the Company s annual financial statements for the year ended December 31, 2005, except for the Company s adoption of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, on January 1, 2006 (See Note 5). The year-end condensed consolidated balance sheet was derived from the December 31, 2005 audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Management believes that all adjustments, which include only normal recurring adjustments necessary to fairly present the Company s consolidated financial position, results of operations and cash flows for the periods reported, have been included. For further information, refer to the consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. Certain prior year components of the condensed consolidated financial statements have been reclassified to be consistent with current year presentation.

The Company has expanded certain of its significant accounting policy disclosures, described in Note 1 of the Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, to provide additional information with respect to those policies, as described below:

Pre-production design and development costs The Company enters into contractual agreements with certain customers to design and develop molds, dies and tools (collectively, tooling). All such tooling contracts relate to products that the Company will supply to its customers under long-term supply agreements. The Company accounts for these pre-production design and development costs pursuant to Emerging Issues Task Force Issue No. 99-5, Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements (EITF 99-5). The majority of all tooling contracts are executed under sales terms where revenue is recognized upon acceptance of the tooling by the customer. For tooling sales arrangements, applicable costs are recorded in inventory as incurred and subsequently recognized, along with the related revenue, upon customer acceptance of the tooling.

Periodically, the Company enters into contractually guaranteed reimbursement arrangements related to the sale of tooling to customers. Under these arrangements, revenue is recognized upon acceptance of the tooling by the customer and amounts due under such arrangements are settled over the part supply arrangement, in accordance with the specific terms of the arrangement. The amounts due from the customer in such transactions are recorded in Prepaid expenses and other current assets or Other assets, net based upon the expected term of the reimbursement arrangement.

Occasionally, the Company incurs costs in excess of those contractually reimbursed. In those cases, the Company capitalizes these costs when the customer provides the Company the non-cancelable right to use the tooling during the part supply arrangement; otherwise, such non-reimbursed costs are expensed as incurred. These capitalized costs are then amortized over the expected life of the part supply arrangement. For such part supply arrangements, tooling costs are recorded in inventory as incurred and, upon customer acceptance of the tooling, the related revenue and costs are recorded, as applicable, and any non-reimbursed portion of the costs is reclassified to Other assets, net and amortized over the life of the part supply arrangement (typically not to exceed three years).

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The Company also may progress bill on certain tooling being constructed. These billings are recorded as progress billings (a reduction of the associated inventory) until the appropriate revenue recognition criteria have been met. Amounts included in Prepaid expenses and other current assets, net include the short-term portion of receivables due under reimbursement arrangements and amounts included in Other assets, net represent the long-term portion of those receivables in addition to customer owned tooling that was not reimbursed.

Revenue recognition The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin 104, Revenue Recognition (SAB 104). SAB 104 requires revenue to be recognized: (1) once evidence of an arrangement exists; (2) product delivery has occurred; (3) pricing is fixed or determinable; and (4) collection is reasonably assured. The four criteria required to recognize revenue by SAB 104 are considered to be met, and the passage of title to the customer occurs, at the respective FOB point and, therefore, revenue is recognized at that time. The Company s standard sales and shipping terms are FOB shipping point, therefore, substantially all revenue is recognized upon shipment. However, in limited circumstances, the Company conducts business with certain customers on FOB destination terms and in these instances revenue is recognized upon receipt by the customer. The Company generally does not provide specific customer inspection or acceptance provisions in its sales terms, with the exception of tooling sales discussed in Pre-production design and development costs above.

Sales returns and allowances are recorded as identified or communicated by the customer and internally approved. The Company does not provide customers with general rights of return for products sold; however, in limited circumstances, the Company will allow sales returns and allowances from customers if the products sold do not conform to specifications.

Shipping and handling costs consist primarily of costs incurred to deliver products to customers and internal costs related to preparing products for shipment and are recorded in cost of sales.

2. Accounting for Conditional Asset Retirement Obligations

In March 2005, the Financial Accounting Standards Board (FASB) issued Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 (FIN 47). This interpretation clarified the timing of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation are conditional on a future event. The Company adopted FIN 47 on October 1, 2005 and determined that conditional legal obligations existed for certain of the Company s owned and leased facilities related primarily to building materials and leasehold improvements. The Company recorded a liability for conditional asset retirement obligations of approximately $0.6 million as of December 31, 2005.

The following table illustrates the effect on net income and earnings per share as if FIN 47 had been applied during the quarter and nine months ended September 30, 2005:

In thousands except per share amounts	Quarter Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income as reported	$ 1,365	$ 4,100
Less: Total depreciation and interest accretion costs, net of tax	(8)	(25)
Net income pro forma	$ 1,357	$ 4,075
Basic earnings per common share:		
Net income as reported	$ .08	$ .26
Net income pro forma	$ .08	$ .25
Diluted earnings per common share:		
Net income as reported	$ .08	$ .25
Net income pro forma	$ .08	$ .25

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Accrued liabilities for conditional asset retirement obligations as of September 30, 2006 were as follows:

In thousands	Total
Balance as of December 31, 2005	$ 620
Accretion	88
Other	27
Balance as of September 30, 2006	$ 735

3. Inventories

Inventories, net of valuation reserves, as of September 30, 2006 and December 31, 2005 were as follows:

In thousands	September 30, 2006	December 31, 2005
Raw materials	$ 14,830	$ 14,295
Work in process	11,000	12,017
Finished goods	8,784	11,077
	34,614	37,389
Less: Progress billings	(751)	(635)
Total inventories	$ 33,863	$ 36,754

Raw materials, work in process and finished goods inventories were net of valuation reserves of $2.6 million and $3.2 million as of September 30, 2006 and December 31, 2005, respectively. Progress billings relate to tooling inventory, which is included in work in process inventory in the above table.

4. Earnings Per Share

Basic and diluted earnings per common share are calculated in accordance with the provisions of SFAS No. 128, Earnings per Share. Basic earnings per common share are equal to net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share are equal to net income divided by the weighted average number of common shares outstanding during the period, including the effect of stock options and stock awards, where such effect is dilutive.

	Quarter Ended September 30, 2006			Quarter Ended September 30, 2005		
In thousands except per share amounts	Net Income	Average Shares	Per Share Amount	Net Income	Average Shares	Per Share Amount
Basic earnings per share	$ 3,718	16,168	$ .23	$ 1,365	16,096	$ .08
Effect of dilutive options and awards		41			54	
Diluted earnings per share	$ 3,718	16,209	$ .23	$ 1,365	16,150	$ .08

	Nine Months Ended September 30, 2006			Nine Months Ended September 30, 2005		
	Net	Average	Per Share	Net	Average	Per Share
In thousands except per share amounts	**Income**	**Shares**	**Amount**	**Income**	**Shares**	**Amount**
Basic earnings per share	$ 8,103	16,148	$ .50	$ 4,100	16,075	$ .26
Effect of dilutive options and awards		51			60	(.01)
Diluted earnings per share	$ 8,103	16,199	$ .50	$ 4,100	16,135	$ .25

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Options to purchase approximately 0.8 million and 1.1 million shares of common stock were excluded from the quarter ended September 30, 2006 and 2005 computations of diluted earnings per share, respectively, and options to purchase approximately 0.8 million and 1.0 million shares of common stock were excluded from the nine months ended September 30, 2006 and 2005 computations of diluted earnings per share, respectively. These options were excluded because the assumed proceeds from the exercise were greater than the average market price of the Company s common stock.

5. Stock Based Compensation

The Company has stock-based compensation plans under which incentive and non-qualified stock options and restricted shares may be granted from common stock or treasury shares. Options issued by the Company under its stock option plans have a term of ten years and generally vest ratably over a period of four years. Restricted grants are expensed over the vesting period of the award. Stock options issued under the current plan must have an exercise price that may not be less than the fair market value of a share of the Company s common stock on the date of grant.

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment. SFAS No. 123(R) requires that companies account for awards of equity instruments under the fair value method of accounting and recognize such amounts in their statements of operations. The Company adopted SFAS No. 123(R) on January 1, 2006 using the modified prospective method, and in connection therewith compensation expense was recognized in its consolidated statement of operations for the quarter and nine months ended September 30, 2006. The financial statements of prior interim periods do not reflect any restated amounts. The Company recognizes expense on a straight-line basis over the vesting period of the entire award. Stock-based compensation expense includes the estimated effects of forfeitures, and such estimates of forfeitures will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ, from such estimates. The effect of changes in estimated forfeitures will be recognized in the period of change and will also impact the amount of expense to be recognized in future periods. The Company estimates the fair value of option grants based on the Black Scholes option-pricing model. Expected volatility and expected term are based on historical information. The Company determined that its future volatility and expected term are not likely to differ from the Company s historical stock price volatility and historical exercise data, respectively.

Prior to January 1, 2006, the Company recorded stock-based compensation in accordance with the provisions of APB Opinion 25. The Company estimated the fair value of stock option awards in accordance with SFAS No. 123, Accounting for Stock-Based Compensation, and disclosed the resulting estimated compensation effect on net income on a pro forma basis. Forfeitures of employee awards were provided in the pro forma effects as they occurred.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company s income before taxes and net income were both reduced by $0.1 million, for the three months ended September 30, 2006, with no impact per diluted share, and $0.3 million and $0.2 million, respectively, for the nine months ended September 30, 2006, or $0.01 per diluted share. During the quarter and nine months ended September 30, 2006, the Company incurred approximately $0.1 million and $0.4 million, respectively, in expense for all stock-based compensation plans, including restricted stock awards, which was primarily recorded in selling, product development and administrative expense. At September 30, 2006, the total unrecognized compensation cost related to non-vested awards was approximately $1.1 million, with a weighted average expected amortization period of 2.8 years.

Compensation for restricted stock is recorded based on the market value of the stock on the grant date and amortized to expense over the vesting period of the award. Prior to January 1, 2006, the Company capitalized the full amount of the restricted stock as unearned compensation with an offset to additional paid-in capital. Upon adoption of SFAS 123(R) on January 1, 2006, the Company eliminated the unamortized balance of $0.3 million against additional paid-in capital.

The following table illustrates the pro forma effect on net income and earnings per share for compensation cost for the quarter and nine months ended September 30, 2005 had compensation cost been recognized for the Company s stock based compensation based on the fair value of the options at the grant dates using the Black-Scholes fair value method for option pricing.

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In thousands except per share amounts	Quarter Ended September 30, 2005		Nine Months Ended September 30, 2005	
Net income as reported	$	1,365	$	4,100
Add: Stock-based employee compensation expense included in net income, net of related tax effects		32		132
Less: Total stock-based employee compensation expense under FAS 123, using the fair value method, net of related tax effects		(264)		(817)
Net income pro forma	$	1,133	$	3,415
Basic earnings per common share:				
Net income as reported	$	.08	$	.26
Net income pro forma	$	.07	$	.21
Diluted earnings per common share:				
Net income as reported	$	.08	$	.25
Net income pro forma	$	.07	$	.21

The amounts included in the table above have been adjusted to correct the amount of stock-based compensation expense previously reported under FAS 123. The amounts above have been adjusted in order to reflect the impact of forfeitures of stock options on the reported stock-based employee compensation expense.

The following table is a summary of option activity of the Company s plans during the nine months ended September 30, 2006:

In thousands

Fixed Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 31, 2005	**1,169**	**$ 10.47**		
Granted	**32**	**$ 9.35**		
Exercised	**(3)**	**$ 7.29**		
Forfeited/Cancelled	**(56)**	**$ 11.53**		
Outstanding at September 30, 2006	**1,142**	**$ 10.40**	**6.14**	**$ 397**
Options exercisable at September 30, 2006	**834**	**$ 11.25**	**5.05**	**$ 94**

There were 32,275 options and 19,950 options granted during the nine months ended September 30, 2006 and 2005, respectively. There were no options granted during the third quarter of 2006 or 2005. The total intrinsic value of options exercised during the nine months ended September 30, 2006 and 2005, was less than $0.1 million.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for the quarters ended:

	Nine Months Ended September 30, 2006	2005
Risk-free interest rate	**4.86%**	3.75%

Expected life	**7 years**	7 years
Expected volatility	**41%**	47%
Expected dividend yield	**0%**	0%

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The following is a summary of the Company s nonvested restricted shares as of September 30, 2006, and changes during the nine months ended September 30, 2006:

In thousands

Nonvested Restricted Shares	Shares		Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2005	**74**	**$**	**10.95**
Granted		**$**	
Vested	**(20)**	**$**	**11.21**
Forfeited	**(2)**	**$**	**10.70**
Nonvested at September 30, 2006	**52**	**$**	**10.86**

In August 2003, the Company s Board of Directors approved a Stock Repurchase Program (the Repurchase Program) to mitigate the potentially dilutive effects of stock options and shares of restricted and unrestricted stock granted by the Company. Under the Repurchase Program, shares may be purchased by the Company up to the quantity of shares underlying options and other equity-based awards granted after January 1, 2003 under shareholder approved plans. Under the current terms and conditions of its domestic revolving credit facility, the Company s stock repurchase activity is limited to no more than $1.8 million in any fiscal quarter and no more than $5.0 million during any fiscal year. As of September 30, 2006, there were approximately 0.7 million shares remaining available for purchase under the Repurchase Program. No shares were repurchased during the quarter and nine months ended September 30, 2006.

6. Employer Sponsored Benefit Plans

As of September 30, 2006, the Company maintained three defined benefit pension plans (pension plans) that cover the majority of domestic Lydall employees. The pension plans are noncontributory and benefits are based on either years of service or eligible compensation paid while a participant is in a 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.

Effective January 1, 2006, Lydall closed its domestic defined benefit pension plans to new employees hired after December 31, 2005, who are not covered under a collective bargaining agreement.

On April 27, 2006, the Board of Directors of the Company approved an amendment to certain of the Company s domestic defined benefit pension plans, effective June 30, 2006, which provided that benefits under these pension plans will stop accruing for all eligible employees not covered under a collective bargaining agreement. Concurrently, the Board of Directors approved an increase in the Company s matching cash contribution to the Company s 401(k) plan to 100 percent of employee pretax contributions up to 6 percent of compensation. The amendment resulted in a pension curtailment loss of $15,000 during the second quarter of 2006.

The measurement of pension plan liabilities at April 30, 2006, for the defined benefit pension plans impacted by the amendment, resulted in the reductions of: (i) additional minimum pension liabilities by $5.1 million, (ii) intangible assets by $0.1 million, (iii) deferred tax assets by $1.9 million and (iv) accumulated other comprehensive loss by $3.1 million, during the quarter ended June 30, 2006.

The Company expects to contribute up to $4.5 million in cash to its defined benefit pension plans in 2006. Contributions of $1.1 million and $3.5 million were made during the quarter ended and nine months ended September 30, 2006, respectively. Contributions of $0.1 million were made during the quarter and nine months ended September 30, 2005.

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The Company also maintained an unfunded Supplemental Executive Retirement Plan (SERP) that provides supplemental income payments after retirement to certain former senior executives. On December 7, 2005, the Company amended the SERP so that no additional participants will be eligible to participate in the SERP and no further benefits will accrue under the SERP after December 31, 2005.

The following is a summary of the components of net periodic benefit cost for the quarters and nine months ended September 30, 2006 and September 30, 2005:

In thousands	Quarter Ended September 30, 2006	Quarter Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Components of net periodic benefit cost:				
Service cost	$ 92	$ 453	$ 889	$ 1,359
Interest cost	616	616	1,878	1,848
Curtailment loss (gain)		(302)	15	(302)
Expected return on assets	(697)	(596)	(1,979)	(1,788)
Amortization of unrecognized actuarial loss	44	210	418	631
Net periodic benefit cost	$ 55	$ 381	$ 1,221	$ 1,748

7. Comprehensive Income

Comprehensive income (loss) for the periods ended September 30, 2006 and 2005 was as follows:

In thousands	Quarter Ended September 30, 2006	Quarter Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Net income	$ 3,718	$ 1,365	$ 8,103	$ 4,100
Changes in accumulated other comprehensive income (loss):				
Foreign currency translation	(479)	(319)	3,484	(5,262)
Minimum pension liability, net of tax			3,092	
Unrealized (loss) gain on derivative instruments, net of tax	11	(9)	(6)	103
Total comprehensive income (loss)	$ 3,250	$ 1,037	$ 14,673	$ (1,059)

8. Income Taxes

The effective tax rate for the quarter ended September 30, 2006 was 2.6 percent compared with 19.6 percent for the same period of 2005. The effective tax rate for the nine months ended September 30, 2006 was 24.8 percent compared with 31.2 percent for the same period of 2005. Income tax expense for the current quarter is net of a tax benefit of $1.2 million. The benefit related to the completion of certain tax audits during the quarter and additional tax benefits identified during the preparation of the Company s 2005 tax returns, primarily related to changes in estimates of certain export sales benefits. This third-quarter adjustment contributed to reducing the Company s effective tax rate to 24.8 percent for the nine months ended September 30, 2006 from 36.9 percent for the six months ended June 30, 2006.

9. Segment Information

Lydall s reportable segments are: Thermal/Acoustical and Filtration/Separation. All other businesses are aggregated in Other Products and Services. For a full description of each segment, refer to the Notes to Consolidated Financial Statements reported in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

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In thousands	Quarter Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Thermal/Acoustical:				
Automotive	$ 40,694	$ 40,055	$ 128,439	$ 121,709
Passive thermal	8,268	5,934	24,382	18,928
Active thermal	5,182	5,459	14,950	14,806
Thermal/Acoustical Segment net sales	$ 54,144	$ 51,448	$ 167,771	$ 155,443
Filtration/Separation:				
Filtration	$ 15,013	$ 13,995	$ 44,877	$ 44,973
Vital Fluids	3,857	3,038	10,874	7,749
Filtration/Separation Segment net sales	$ 18,870	$ 17,033	$ 55,751	$ 52,722
Other Products and Services:				
Transport, distribution and warehousing services	$ 5,607	$ 5,467	$ 17,124	$ 16,261
Specialty products	2,126	1,731	6,992	6,514
Other Products and Services net sales	$ 7,733	$ 7,198	$ 24,116	$ 22,775
Eliminations and Other	(623)	(680)	(1,881)	(1,946)
Consolidated Net Sales	$ 80,124	$ 74,999	$ 245,757	$ 228,994

Operating income by segment was as follows:

In thousands	Quarter Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Thermal/Acoustical	$ 4,874			