

Lydall Inc.

First Quarter 2015 Financial Results

Thursday, April 30, 2015, 10:00 A.M. Eastern

CORPORATE PARTICIPANTS

Dale Barnhart - *President, Chief Executive Officer*

Robert Julian - *Executive Vice President, Chief Financial Officer*

David Glenn - *Vice President, Business Development & Investor Relations*

James Laughlan - *Vice President, Chief Accounting Officer & Treasurer*

PRESENTATION

Operator

Good morning and welcome to the Lydall, Inc. first quarter 2015 financial results conference call. All participants will be in listen only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by the zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your telephone keypad; to withdraw your question, please press star (*) then two (2). Please note this event is being recorded. I would now like to turn the conference over to Mr. David Glenn, Vice President Business Development and Investor Relations. Please go ahead.

David Glenn

Thank you, Operator. Good morning, everyone, and welcome to Lydall's first quarter 2015 earnings conference call. Joining me on today's call are Dale Barnhart, President and Chief Executive Officer; Robert Julian, Executive Vice President and Chief Financial Officer; and Jim Laughlan, Vice President and Chief Accounting Officer and Treasurer. Dale will start the call with comments about the continued progress we are making in executing our long term strategy, as well as provide an overview of current business conditions. Robert and Jim will follow with a summary of our financial performance and discuss the key drivers by business segment. At the end of our remarks, we'll open up the line for questions.

As you may be aware, our quarterly earnings press release and 10-Q quarterly report were released earlier today. So you can follow along with today's call, please reference the PowerPoint presentation entitled "Q1 2015 Earnings Conference Call," which can be found at lydall.com in the investor relations section. As noted on Slide 2 of this presentation, any comments made on this conference call that may constitute forward-looking statements are made available pursuant to the Safe Harbor provision for forward-looking statements as defined in the Securities laws. Lydall's businesses are subject to a number of risk factors that may cause actual results to differ materially from those anticipated in forward-looking statements. For information identifying some of these important risk factors, please refer to Lydall's report on Form 10-K under cautionary note concerning forward-looking statements. In addition, during this conference call, we will be making reference to non-GAAP financial measures. A reconciliation to GAAP financials can be found in the appendix of the presentation I just referenced. With that, I'd now like to turn the call over to Dale.

Dale Barnhart

Thank you, David. Good morning to everyone and thanks for joining us today. I am pleased to report that we had a good start to the year and I believe we remain on the right path to achieve our 2018 long term vision for profitable growth. Slide 3 outlines our recently published financial results for net sales, operating margin and adjusted earnings per share. On adjusted earnings per share, we're \$0.42, up 5% versus the first quarter of 2014 adjusted earnings per share of \$0.40. On a GAAP basis, first quarter 2015's diluted earnings per share were \$1.11, which included a \$0.69 per share gain related to the sale of the vital fluids business, which we announced earlier this year. Net sales grew approximately 2% to \$127.3 million.

The majority of the top line growth came from the acquisition of our industrial filtration business, which increased sales by 12%. The growth excludes foreign currency translation and also reflects a full quarter of results in the first quarter of 2015, compared to a partial quarter in the first quarter of 2014. This gross was mostly offset by unfavorable foreign currency translation of 5.7%, primarily attributed to the declining euro, and 2.4% from the sale of the vital fluids

business. Excluding these impacts, as well as lower tooling revenue, the business grew .03% organically versus the same period last year.

With respect to the ongoing investigation related to the possible violations of German antitrust laws, we are in the process of actively working with the German Federal Cartel Office. Despite this continued communication, we are, unfortunately, still unable to estimate either the timing or the amount of the liability associated with this matter.

Turning to Slide 4, this is overview of our long term growth strategy, which includes four drivers: new product development, Lean Six Sigma, geographic expansion, and M&A. With respect to M&A, we completed the acquisition of industrial filtration in the first quarter of 2014. Operating margins in this segment reached 9.2% in the first quarter of 2015, which was ahead of the adjusted operating margin of 7.5% reported for this segment in the full year of 2014, despite the recent headwinds experienced in China for this business during the quarter. This demonstrates the earning power of the business under our lean initiatives. Longer term, we're on track to generate more than \$4 million of annual net cost savings by the end of 2016, as we originally communicated, and should continue to see incremental operating margins improvement annually.

Looking forward, as I have previously communicated, both from a financial and resource perspective, we have the means, the wherewithal, and the desire to execute additional deals, primarily in the filtration and specialty engineering material spaces. Naturally, we cannot predict the timing of these, but we hope to put our strong balance sheet to good use through selective M&A. With respect to Lean Six Sigma, we have already realized a significant improvement over the past few years and we continue to look at new ways to operate more efficiently to serve our customers. During the first quarter, we continued to execute on this strategy and realized continued operating margin expansion over the prior year in both our thermal acoustic metals and thermal acoustic fibers businesses. However, on a consolidated basis, adjusted margins declined by 110 basis points to 7.9% during the quarter, which was primarily the result of lost leverage on lower sales and performance materials segment, and lower operating margins associated with industrial filtration segment related to the mix of product sales, particularly in China.

Turning to Slide 5, with respect to business conditions, overall, we believe underlying fundamentals of our businesses remain solid and consistent with prior years and we anticipate our typical seasonality, in which the first half of the year is stronger than the second half. With our automotive business, the scheduled plant shutdowns for a key customer have been completed and these plants should be at full production rate in May, which will support increased demand for our products for the balance of the year. Looking forward, current visibilities suggest that the overall demand within the global automotive market remains stable. North America continues to remain strong and we continue to see an improving European market. In our industrial filtration business, we are seeing signs of continued strength in orders and backlog, as well as some stability in China, which, as I mentioned earlier, provided to be a challenging region for us in the first quarter. In our performance materials business, we expect some headwinds in North America filtration market and softness in demands for some of our insulation products to persist.

To wrap up my comments before turning it over to Robert, we are pleased with our performance in the first quarter. We continue to operate well and look forward to delivering solid financial performance in 2015. Before I hand things off, I would like to take a moment to thank Robert for his service and contribution to Lydall. His leadership and development of a deeply talented

finance team has been instrumental in our success and he will be leaving us in good hands. On that note, I would like to formally introduce Jim Laughlan. In addition to the current role of Chief Accounting Officer and Treasurer, Jim will be taking on the role and responsibility of the Company principle financial officer until the CFO position is filled. Jim has a successful history with Lydall, dating back to 2005 and will provide us with a seamless transition and continuity within the finance organization. With that, I now turn the call over to Robert.

Robert Julian

Thanks, Dale, for the kind words and good morning, everyone. Today, I'll briefly cover the results of the quarter and then Jim will give you an overview of the operating results for each of the operating segments. Turning to Slide 6, in the first quarter 2015, the Company achieved net sales of \$127.3 million, an increase of 1.7% over the prior year. There were several discrete items affecting this growth, which I will take you through. First, the acquisition of industrial filtration was completed on February 20, 2014. Due to the partial period of reported sales in Q1 2014 for this segment, our quarter on quarter net sales comparison benefited by 12.0%, net of foreign exchange. Conversely, the sale of our vital fluids business, which occurred on January 30, 2015, had an unfavorable impact on the quarter on quarter sales comparison of 2.4%.

Second, we achieved .03% of organic growth during the period. This was driven by strong growth in our thermal acoustical metals and fibers businesses, primarily offset by a reduction in demand for our cryogenic insulation products and, to a lesser extent, lower air filtration demand in North America in our performance materials segment. Third, foreign currency translation had a large impact on our top line in the quarter. Total sales decreased by 5.7% as a result of the sharp rise in value of the U.S. dollar. Finally, tooling revenue, which is dependent upon the timing of platform awards in new product launches, pressured our top line by 2.5% in Q1 2015.

Our adjusted operating margin for the quarter was 7.9%, compared to 9.0% in Q1 of 2014. This decline was mostly related to higher absorption of fixed costs in our performance materials segment and higher corporate office expenses, partially offset by a margin expansion from our lean initiatives in the thermal acoustical metals and fibers businesses. The effective tax rate for the quarter was 35.9%, compared to 49.5% in the first quarter of 2014. The tax rate in the current period was slightly higher than what we would consider to be normal for 2015, primarily due to the tax burden associated with the sale of our vital fluids business.

Looking at the full year, we anticipate that our effective rate, going forward, will fall somewhere in the range of mid to low 30's. Adjusted diluted earnings per share, excluding onetime items, were \$0.42, compared to adjusted earnings of \$0.40 in the prior year. GAAP diluted EPS was \$1.11 in the first quarter of 2015, which reflected the gain on the sale of vital fluids of \$0.69 per diluted share. EPS reported in the first quarter of 2014 was \$0.22, which included acquisition related expenses.

Moving to the balance sheet, our liquidity remains very strong. At the end of the quarter, cash was \$72.1 million and total debt was \$40.7 million. During the quarter, we used cash of \$7.1 million to purchase shares under our share repurchase program and, in April, we closed this initiative out by purchasing the remaining shares authorized under our approved share repurchase program. Cumulatively since 2012, we have purchased 1 million shares under this program for a total average price of \$18.20 per share. Additionally in the quarter, cash flow was positively impacted by the net proceeds received from the sale of the vital fluids business of \$28.4 million.

Finally, as it relates to capital expenditures, we spent approximately \$7.4 million through the first

three months of the year, compared to \$2.8 million in the prior year. For the full year in 2015, we expect total capital expenditures to be in the range of \$20 million to \$25 million. That concludes the financial review of our consolidated results for the first quarter and I'll now turn the call over to Jim.

James Laughlan

Thank you, Robert, and good morning, everyone. Turning to Slide 7, I'll start with the thermal acoustical metals business. This is our global automotive segment, which specializes in providing underhood and underbody engineered thermal solutions. Overall, this business performed well during the quarter, despite unfavorable foreign currency translation. Excluding this, parts sales increased \$2.2 million, or approximately 5% compared to the prior year. Tooling sales were lower in the first quarter of 2015 due to the timing of new product launches.

We continued our efforts to get our China facility back on track and to meet our expectations for business performance. We have solved our materials sourcing issues and expect the negative impact of this to disappear by the second half of 2015 as we work through our existing inventory. As we have communicated in the past, we expect this facility to be break even sometime in the second half of 2015. The drag from the China facility negatively impacted segment operating margin in the quarter by approximately 200 basis points. Even with this drag and headwinds from foreign currency translation, segment operating margin improved 80 basis points over the prior year to 9.4%.

Slide 8 refers to our thermal acoustical fibers business. This business also serves the automotive industry and provides molded polyester acoustical solutions primarily for underbody application for vehicles in North America. Segments sales were \$31.1 million in the quarter, which was a slight reduction from \$32.5 million in the prior year. Lower sales were attributed to reduced tooling of approximately \$1.5 million, partially offset by modest growth in parts sales. Operating margin in the quarter increased 20 basis points over the prior year to 22.8%, reflecting a continuation of our lean initiatives during the quarter.

Moving to Slide 9, I will cover our performance materials segment, which provides specialty filtration and insulation to a variety of end markets, globally. Net sales in the first quarter declined 13.2%, quarter on quarter, to \$25.1 million. This decline was primarily due to lower demand for cryogenic insulation products given the sharp decline in the price of oil and lower filtration product net sales, primarily as a result of foreign currency translation, which reduced net sales by 6.6%. Excluding the impact of foreign currency, increase in demand for filtration products in Europe was offset by softness in North America. The segment level operating margin also declined 130 basis points to 5.2% during the quarter as a result of lost leverage on lower sales volume.

Slide 10 covers the industrial filtration business acquired in February 2014. This business focuses on providing needle felt filtration solutions, primarily for the industrial air segment, globally. For the first quarter of 2015, sales were \$34.2 million and operating margin was 9.2%. On adjusted basis, the quarter on quarter operating margin decrease was due to timing and mix of product sales, particularly associated with our China operation. We continue to focus on achieving cost savings from our synergy programs and lean initiatives implemented in the segment, which we believe are on track to be achieved by 2016, as Dale mentioned earlier.

Turning to Slide 11, our vital fluid business was sold on January 30th. Given the sale and the partial period contribution to our financials, I won't spend any time going through the financials other than highlighting our after tax gain of \$11.8 million, or \$0.69 per diluted share. This

concludes my comments on the financial performance of our segments for the quarter. I will turn the call, again, back to Dale.

Dale Barnhart

Thank you, Jim. To summarize, we had another strong quarter. Our end markets are stable and we continue to remain focused on executing new product development, implementing Lydall Lean Six Sigma, and putting our very strong balance sheet to good use. With that, I will now turn the call back over to the Operator to begin our question and answer session.

QUESTIONS AND ANSWERS

Operator

We will now begin the question and answer session. To ask a question, you may press star (*) then one (1) on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please star (*) then two (2). At this time, we will pause momentarily to assemble our roster. The first question comes from Mr. Robert Majek from CJS Securities. Please go ahead.

Robert Majek

Good morning.

[multiple voices]

Robert Majek

Can you give me a more specific update on your 2018 financial goals and if your confidence level has changed?

Dale Barnhart

Not at all, we're on our trajectory to achieve that goal. The currency impact has had an impact on revenue, but as we continue to show in our automotive space, we continue to win new platforms, we continue to improve our operating margins through lean and a key will be putting that balance sheet to good use on organic growth and acquisitions, which we are clearly focused on.

Robert Majek

That sounds great and could you give us any more color on the headwinds you were seeing in the North American filtration market?

Dale Barnhart

Sure. A couple things are really behind that, it's not a customer specific issue. We have been looking at all of the revenue from our customers in the first quarter and it's really been across the board. Part of it, we believe, was attributed to we had announced pricing action in the fourth quarter that would go into effect January 1st and we probably had some pull ahead from the North American customers on that, and then just a general softness in the marketplace.

Robert Majek

Okay and you mentioned that you expect increased demand from a key customer in fibers, who I will assume is Ford. Can you quantify the impact or give us any more detail around that?

Dale Barnhart

Well, we won't quantify the actual impact, but by the end of May – they have two facilities that

produced that vehicle which we have significant content on – by the end of May, they will be at full production rates and that will have a significant increase in the parts volume that we will be supplying to those two facilities. So, as we mentioned in the call, as we go forward, we expect to see revenue rebound in that sector.

Robert Majek

Okay and how is the current acquisition environment? What kind of companies are you looking at?

Dale Barnhart

Well, again, we're focused on the specialty materials filtration area, especially insulation. We have a very robust pipeline that we are pursuing and, obviously, we can't disclose much more than that at this time

Robert Majek

Okay, appreciate it. Thank you.

Dale Barnhart

Thank you, Rob.

Operator

The next question is from Mr. Casey Vaught from Century Management. Please go ahead.

Casey Vaught

Hey, guys, just wanted to follow up on the prior question regarding the Ford product implementation. Wanted to see, on the top line, you guys had a negative impact of 2.5%, is that expected to fall off in 2Q?

Dale Barnhart

It'll improve. I mean, we don't, as you know, we don't give guidance and we don't give specific forecasts, but we will be expecting and are seeing an improvement in the Q2 order rate as it relates to that platform. And, all in all, the North American automotive market is still very robust and not, it is showing slight year over year increases in factory production, which we benefit from.

Casey Vaught

Okay, perfect. That's all I have, I'll turn it back.

Dale Barnhart

Thank you, Casey.

Operator

Again, if you have a question, please press star (*) then one (1), star (*) and one (1). Gentlemen, there are no more questions at this time.

CONCLUSION

Dale Barnhart

Okay, well, we appreciate your participation in the call and we look forward to sharing with you our second quarter results in July. Thank you.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.