ENPRO INDUSTRIES, INC
Form 10-Q
August 09, 2010

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

FORM 10-Q

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the securities exchange act of 1934**
For the quarterly period ended June 30, 2010

o **Transition report pursuant to section 13 or 15(d) of the securities exchange act of 1934**
Commission File Number 001-31225

ENPRO INDUSTRIES, INC.
(Exact name of registrant, as specified in its charter)

North Carolina	**01-0573945**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
5605 Carnegie Boulevard, Suite 500, Charlotte, North Carolina	**28209**
(Address of principal executive offices)	(Zip Code)

(704) 731-1500
(Registrant s telephone number, including area code)

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 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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of August 5, 2010, there were 20,560,290 shares of common stock of the registrant outstanding. There is only one class of common stock.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
Quarters and Six Months Ended June 30, 2010 and 2009
(in millions, except per share amounts)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net sales	$ 250.8	$ 205.3	$ 479.0	$ 390.4
Cost of sales	159.1	137.0	298.7	257.9
Gross profit	91.7	68.3	180.3	132.5
Operating expenses:				
Selling, general and administrative expenses	61.2	54.7	123.7	111.6
Asbestos-related expenses	8.8	14.3	23.3	27.9
Goodwill impairment charge		113.1		113.1
Other operating expense	1.0	5.1	1.5	7.0
	71.0	187.2	148.5	259.6
Operating income (loss)	20.7	(118.9)	31.8	(127.1)
Interest expense	(5.1)	(3.1)	(8.2)	(6.2)
Interest income	0.5	0.1	0.8	0.2
Gain on deconsolidation of GST	54.1		54.1	
Other income		19.5		19.1
Income (loss) from continuing operations before income taxes	70.2	(102.4)	78.5	(114.0)
Income tax benefit (expense)	(25.7)	(4.0)	(28.4)	8.7
Income (loss) from continuing operations	44.5	(106.4)	50.1	(105.3)
Income from discontinued operations, net of tax	0.7	0.7	94.1	2.8
Net income (loss)	$ 45.2	$ (105.7)	$ 144.2	$ (102.5)
Basic earnings (loss) per share:				
Continuing operations	$ 2.19	$ (5.33)	$ 2.47	$ (5.29)
Discontinued operations	0.03	0.03	4.63	0.14

Net income (loss) per share	$ 2.22	$ (5.30)	$ 7.10	$ (5.15)
Diluted earnings (loss) per share:				
Continuing operations	$ 2.17	$ (5.33)	$ 2.44	$ (5.29)
Discontinued operations	0.03	0.03	4.58	0.14
Net income (loss) per share	$ 2.20	$ (5.30)	$ 7.02	$ (5.15)

See notes to consolidated financial statements (unaudited).

ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
Six Months Ended June 30, 2010 and 2009
(in millions)

	2010	2009
OPERATING ACTIVITIES OF CONTINUING OPERATIONS		
Net income (loss)	$ 144.2	$ (102.5)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities of continuing operations:		
Income from discontinued operations, net of taxes	(94.1)	(2.8)
Taxes related to sale of discontinued operations	(50.0)	
Gain on deconsolidation of GST, net of taxes	(33.8)	
Depreciation	12.7	13.5
Amortization	8.4	6.3
Accretion of debt discount	2.8	2.6
Goodwill impairment charge		113.1
Deferred income taxes	7.3	(13.5)
Stock-based compensation	3.0	0.2
Change in assets and liabilities, net of effects of acquisitions and deconsolidation of businesses:		
Asbestos liabilities, net of insurance receivables	26.0	8.1
Accounts and notes receivable	(38.7)	14.2
Inventories	(1.6)	(9.4)
Accounts payable	(1.2)	(5.1)
Other current assets and liabilities	(2.1)	(6.6)
Other non-current assets and liabilities	0.9	(16.1)
Net cash provided by (used in) operating activities of continuing operations	(16.2)	2.0
INVESTING ACTIVITIES OF CONTINUING OPERATIONS		
Purchases of property, plant and equipment	(8.4)	(11.5)
Proceeds from liquidation of investments		2.7
Divestiture of business	182.4	
Deconsolidation of GST	(29.5)	
Acquisitions, net of cash acquired		(5.2)
Other		1.1
Net cash provided by (used in) investing activities of continuing operations	144.5	(12.9)
FINANCING ACTIVITIES OF CONTINUING OPERATIONS		
Repayments of short-term borrowings	(3.5)	
Repayments of debt	(0.1)	(9.6)
Proceeds from issuance of common stock	0.4	
Net cash used in financing activities of continuing operations	(3.2)	(9.6)
CASH FLOWS OF DISCONTINUED OPERATIONS		
Operating cash flows	1.9	2.3

Investing cash flows	(0.1)	(2.2)
Net cash provided by discontinued operations	1.8	0.1
Effect of exchange rate changes on cash and cash equivalents	(2.6)	2.1
Net increase (decrease) in cash and cash equivalents	124.3	(18.3)
Cash and cash equivalents at beginning of period	76.8	76.3
Cash and cash equivalents at end of period	$ 201.1	$ 58.0
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 3.4	$ 3.8
Income taxes	$ 49.2	$ 6.8
Asbestos-related claims and expenses, net of insurance recoveries	$ 3.8	$ 19.8

See notes to consolidated financial statements (unaudited).

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ENPRO INDUSTRIES, INC.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(in millions, except share amounts)

	June 30, 2010	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 201.1	$ 76.8
Accounts and notes receivable	136.8	112.7
Asbestos insurance receivable		67.2
Inventories	77.6	86.1
Other current assets	37.1	52.2
Assets of discontinued operations		57.5
Total current assets	452.6	452.5
Property, plant and equipment	131.3	185.4
Goodwill	103.4	125.7
Other intangible assets	106.9	116.0
Investment in GST	236.0	
Asbestos insurance receivable		171.4
Deferred income taxes	8.1	119.9
Other assets	43.8	50.3
Total assets	$ 1,082.1	$ 1,221.2
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Short-term borrowings from GST	$ 20.9	$
Current maturities of long-term debt		0.1
Accounts payable	51.9	56.5
Asbestos liability		85.4
Other accrued expenses	85.7	71.7
Liabilities of discontinued operations		16.2
Total current liabilities	158.5	229.9
Long-term debt	133.0	130.3
Notes payable to GST	227.2	
Asbestos liability		406.9
Pension liability	73.0	84.8
Other liabilities	42.3	57.7
Total liabilities	634.0	909.6
Commitments and contingencies		

Shareholders equity		
Common stock $.01 par value; 100,000,000 shares authorized; issued, 20,555,871 shares in 2010 and 20,365,596 in 2009	0.2	0.2
Additional paid-in capital	406.1	402.7
Retained earnings (accumulated deficit)	49.5	(94.7)
Accumulated other comprehensive income (loss)	(6.3)	4.8
Common stock held in treasury, at cost 210,328 shares in 2010 and 211,860 shares in 2009	(1.4)	(1.4)
Total shareholders equity	448.1	311.6
Total liabilities and shareholders equity	$ 1,082.1	$ 1,221.2

See notes to consolidated financial statements (unaudited).

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ENPRO INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Overview and Basis of Presentation

Overview

EnPro Industries, Inc. (EnPro or the Company) is a leader in the design, development, manufacturing and marketing of proprietary engineered industrial products that include sealing products, self-lubricating, non-rolling bearing products and heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The Consolidated Balance Sheet as of December 31, 2009, was derived from the audited financial statements included in the Company s annual report on Form 10-K for the year ended December 31, 2009. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair statement of results for the periods presented, have been included. Management believes that the assumptions underlying the consolidated financial statements are reasonable. These interim financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto that are included in its annual report on Form 10-K for the year ended December 31, 2009.

Revenues, expenses, cash flows, assets and liabilities can and do vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be indicative of those for a full year.

All significant intercompany accounts and transactions between the Company s consolidated operations have been eliminated.

2. Garlock Sealing Technologies LLC and Garrison Litigation Management Group, Ltd.

The historical business operations of certain subsidiaries of the Company s subsidiary, Coltec Industries Inc (Coltec), principally Garlock Sealing Technologies LLC (GST LLC) and The Anchor Packing Company (Anchor), have resulted in a substantial volume of asbestos litigation in which plaintiffs have alleged personal injury or death as a result of exposure to asbestos fibers. Those subsidiaries manufactured and/or sold industrial sealing products, predominately gaskets and packing, that contained encapsulated asbestos fibers. Anchor is an inactive and insolvent indirect subsidiary of Coltec. The Company s subsidiaries exposure to asbestos litigation and their relationships with insurance carriers are managed through another Coltec subsidiary, Garrison Litigation Management Group, Ltd. (Garrison). GST LLC, Anchor and Garrison are collectively referred to as the Filers. GST LLC and Garrison are collectively referred to as GST.

On June 5, 2010 (the Petition Date), GST LLC, Anchor and Garrison filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Western District of North Carolina in Charlotte (the Bankruptcy Court). The filings were the initial step in a claims resolution process. The goal of the process is an efficient and permanent resolution of all current and future asbestos claims through court approval of a plan of reorganization that will establish a trust to which all asbestos claims will be channeled for resolution. GST intends to seek an

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agreement with asbestos claimants and other creditors on the terms of a plan for the establishment of such a trust and repayment of other creditors in full, or in the absence of such an agreement an order of the Bankruptcy Court confirming such a plan.

GST s financial results are included in the Company s consolidated results through June 4, 2010, the day prior to the Petition Date. However, generally accepted accounting principles require that an entity whose financial statements were previously consolidated with those of its parent (as GST s were with EnPro s) that files for protection under the U.S. Bankruptcy Code, whether solvent or insolvent, generally must be prospectively deconsolidated from the parent and presented on the cost method. The cost method requires the Company to present the net assets of GST as an investment and not recognize any income or loss from GST in the Company s results of operations during the reorganization period. When GST emerges from the jurisdiction of the Bankruptcy Court, the subsequent accounting will be determined based upon the applicable circumstances and facts at such time, including the terms of any plan of reorganization.

As a result of the deconsolidation of GST, the Company conducted an analysis to compare the fair market value of GST to its book value. The excess of GST s fair value over its book value resulted in a gain on deconsolidation. To estimate the fair value, the Company considered many factors and used both discounted cash flow and market valuation approaches. In the discounted cash flow approach, the Company used cash flow projections to calculate the fair value of GST. The key assumptions used for the discounted cash flow approach include expected cash flows based on internal business plans, historical and projected growth rates, discount rates, estimated asbestos claim values and insurance collection projections. The Company did not adjust the assumption about asbestos claims values from the assumption reflected in the liability it recorded prior to the deconsolidation. The asbestos claims value will be determined in the claims resolution process, either through negotiations with claimant representatives or by the Bankruptcy Court. The Company reviewed a wide range of possible outcomes for that determination and the $473 million liability is within that range. The Company concluded that there is no better estimate of the value a third party might ascribe to the claims. The Company s estimates are based upon assumptions it believes to be reasonable but which by nature are uncertain and unpredictable. For the market approach, the Company used recent acquisition multiples for businesses of similar size to GST. Based on this analysis, the Company recognized a $54.1 million pre-tax gain on the deconsolidation of GST. The fair value of GST (net of taxes on the gain on deconsolidation) was $236.0 million and this investment in GST will be presented using the cost method during the reorganization period and is subject to periodic reviews for impairment.

Financial Results

The GST condensed combined financial statements are set forth below:

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GST
(Debtor-in-Possession)
Condensed Combined Statements of Operations (Unaudited)
(in millions, at historical cost)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Net sales	$ 51.3	$ 39.0	$ 99.3	$ 79.2
Cost of sales	31.1	24.6	61.8	48.9
Gross profit	20.2	14.4	37.5	30.3
Operating expenses:				
Selling, general and administrative expenses	10.5	9.0	21.3	20.0
Asbestos-related expenses	9.1	14.3	23.6	27.9
Other operating expense			0.1	0.8
	19.6	23.3	45.0	48.7
Operating income (loss)	0.6	(8.9)	(7.5)	(18.4)
Interest income	9.0	3.3	17.1	6.9
Income (loss) before income taxes	9.6	(5.6)	9.6	(11.5)
Income tax benefit (expense)	(3.3)	2.1	(3.3)	4.5
Net income (loss)	$ 6.3	$ (3.5)	$ 6.3	$ (7.0)

GST
(Debtor-in-Possession)
Condensed Combined Balance Sheet (Unaudited)
June 30, 2010
(in millions, at historical cost)

Assets:	
Current assets	$ 150.8
Property, plant and equipment	41.0
Asbestos insurance receivable	157.1
Deferred income taxes	120.1
Notes receivable from affiliate	227.2
Other assets	23.8
Total assets	$ 720.0

Liabilities and Shareholder s Equity:	
Current liabilities	$ 17.9
Other liabilities	1.1
Liabilities subject to compromise	509.0 (A)
Total liabilities	528.0
Shareholder s equity	192.0
Total liabilities and shareholder s equity	$ 720.0

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(A) Liabilities subject to compromise include pre-petition unsecured claims which may be settled at amounts which differ from those recorded in the condensed combined balance sheet. Liabilities subject to compromise consist of the following:

Accounts payable	$ 9.8
Accrued expenses	4.3
Asbestos liability	473.1
Other long-term liabilities	21.8
	$ 509.0

Related Party Transactions

The Company regularly transacts business with GST. Previously, these related party transactions had been eliminated in consolidation, but due to the deconsolidation of GST, they are now reflected on the Company s consolidated statement of operations. Sales to GST totaling $1.8 million and purchases from GST totaling $1.2 million during the period from June 5, 2010 to June 30, 2010 are reflected in sales and cost of sales, respectively, for the quarter and six months ended June 30, 2010. The Company also provides services for GST including information technology, supply chain, treasury, tax administration, legal and human relations under a support services agreement. In addition, GST LLC s board of managers and Garrison s board of directors have approved a tax sharing agreement, subject to approval of the Bankruptcy Court, pursuant to which GST would be responsible for its share of income taxes included in the Company s tax returns. Amounts due from GST resulting from their purchase of goods and services from the Company totaling $9.9 million are included in accounts and notes receivable and amounts due to GST resulting from the Company s purchase of goods from GST totaling $4.1 million are included in accounts payable on the June 30, 2010 consolidated balance sheet.

Additionally, the Company and GST had outstanding foreign exchange forward contracts involving the Australian Dollar, Canadian Dollar, Mexican Peso and U.S. Dollar with a notional amount of $10.1 million as of June 30, 2010. These related party contracts were eliminated in consolidation prior to the deconsolidation of GST.

As discussed more fully in Note 10, the deconsolidation of GST from the Company s results requires that $20.9 million of short-term borrowings from GST and $227.2 million of notes payable to GST that had previously been eliminated in consolidation be reflected on the Company s consolidated balance sheet as of June 30, 2010. Interest expense related to these borrowings for the period from June 5, 2010 to June 30, 2010 of $1.8 million is reflected in interest expense for the quarter and six months ended June 30, 2010 and accrued interest of $12.3 million is included in other accrued expenses on the June 30, 2010 consolidated balance sheet.

Debtor-in-Possession Financing

On June 8, 2010, GST entered into a Post-Petition Loan and Security Agreement with Bank of America, N.A. (the DIP Loan Agreement) to establish a secured revolving credit facility pursuant to which GST may from time to time obtain loans, letters of credit and bank products in an aggregate amount up to $10 million outstanding at any time (with a sublimit of $8 million for letters of credit). Actual borrowing availability at any date is determined by reference to a borrowing base of specified percentages of eligible accounts receivable and inventory, which borrowing base is reduced by loans and letters of credit outstanding and certain reserves. The obligations of GST under the DIP Loan Agreement are guaranteed by GST s two domestic subsidiaries and secured by certain assets of GST and such domestic subsidiaries. As a result of the deconsolidation of GST from the Company s financial results, any indebtedness incurred under the DIP Loan Agreement will not be reflected in the Company s consolidated balance sheets.

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3. Discontinued Operations

During the fourth quarter of 2009, the Company announced its plans to sell the Quincy Compressor business (Quincy) that had been reported within the Engineered Products segment. Accordingly, the Company has reported, for all periods presented, the financial condition, results of operations and cash flows of Quincy as a discontinued operation in the accompanying consolidated financial statements.

On March 1, 2010, the Company completed the sale of Quincy, other than the equity interests in Kunshan Q-Tech Air Systems Technologies Ltd., Quincy s operation in China (Q-Tech). The sale of the equity interests in Q-Tech was completed during the second quarter. The purchase price for the assets and equity interests sold included $182.4 million in cash and a receivable from the purchaser of $7.0 million. The Company also assumed certain liabilities of Quincy. The sale resulted in a gain of $148.0 million ($92.5 million, net of tax).

For the quarters and six months ended June 30, 2010 and 2009, results of operations from Quincy during the periods owned by EnPro were as follows:

	Quarters Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in millions)			
Sales	$ 2.4	$ 30.0	$ 23.3	$ 61.3
Income from discontinued operations	0.2	1.2	2.6	4.3
Income tax expense	(0.1)	(0.5)	(1.0)	(1.5)
Income from discontinued operations, net of taxes	0.1	0.7	1.6	2.8
Gain from disposal of discontinued operations, net of tax	0.6		92.5	
Net income from discontinued operations	$ 0.7	$ 0.7	$ 94.1	$ 2.8

The major classes of assets and liabilities for Quincy as of December 31, 2009 are shown below:

	December 31, 2009 (in millions)
Assets:	
Accounts and notes receivable	$ 18.0
Inventories	8.2
Other current assets	0.9
Property, plant and equipment	18.3
Goodwill	6.4
Other intangible assets	4.6
Other assets	1.1