ENPRO INDUSTRIES, INC
Form 10-Q
May 08, 2009

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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 March 31, 2009

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. (Check one):

Large accelerated filer þ   Accelerated filer o   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 April 30, 2009, there were 19,963,779 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 Ended March 31, 2009 and 2008
(in millions, except per share amounts)

	2009	2008 As Adjusted (Note 1)
Net sales	$ 216.4	$ 283.1
Cost of sales	143.5	179.6
Gross profit	72.9	103.5
Operating expenses:		
Selling, general and administrative expenses	62.9	65.5
Asbestos-related expenses	13.6	12.1
Other operating expense	1.9	1.2
	78.4	78.8
Operating income (loss)	(5.5)	24.7
Interest expense	(3.1)	(3.1)
Interest income	0.1	1.1
Other expense		(2.8)
Income (loss) before income taxes	(8.5)	19.9
Income tax benefit (expense)	11.7	(7.4)
Net income	$ 3.2	$ 12.5
Basic earnings per share	$ 0.16	$ 0.59
Diluted earnings per share	$ 0.16	$ 0.58

See notes to consolidated financial statements (unaudited).

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ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
Quarters Ended March 31, 2009 and 2008
(in millions)

	2009	2008 As Adjusted (Note 1)
OPERATING ACTIVITIES		
Net income	$ 3.2	$ 12.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	7.9	7.4
Amortization	3.3	3.4
Accretion of debt discount	1.3	1.1
Deferred income taxes	(15.3)	1.4
Stock-based compensation	(0.3)	0.7
Excess tax benefits from stock-based compensation		(0.1)
Change in assets and liabilities, net of effects of acquisitions of businesses:		
Asbestos liabilities, net of insurance receivables	5.5	4.6
Accounts and notes receivable	6.0	(21.5)
Inventories	(8.7)	(5.3)
Accounts payable	0.1	5.4
Other current assets and liabilities	(5.1)	(1.9)
Other non-current assets and liabilities	2.6	1.7
Net cash provided by operating activities	0.5	9.4
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(7.3)	(12.7)
Proceeds from liquidation of investments	2.0	0.3
Acquisitions, net of cash acquired	(5.3)	(27.2)
Other		0.2
Net cash used in investing activities	(10.6)	(39.4)
FINANCING ACTIVITIES		
Repayments of debt	(9.6)	(0.5)
Common stock repurchases		(50.2)
Excess tax benefits from stock-based compensation		0.1
Net cash used in financing activities	(9.6)	(50.6)
Effect of exchange rate changes on cash and cash equivalents	(0.3)	0.5
Net decrease in cash and cash equivalents	(20.0)	(80.1)
Cash and cash equivalents at beginning of year	76.3	129.2

Cash and cash equivalents at end of period	$	56.3	$	49.1
Supplemental disclosures of cash flow information:				
Cash paid during the period for:				
Interest	$	0.4	$	0.4
Income taxes	$	3.6	$	6.0
Asbestos-related claims and expenses, net of insurance recoveries	$	8.1	$	7.5

See notes to consolidated financial statements (unaudited).

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

	March 31, 2009	December 31, 2008 As Adjusted (Note 1)
ASSETS		
Current assets		
Cash and cash equivalents	$ 56.3	$ 76.3
Accounts and notes receivable	153.2	157.7
Asbestos insurance receivable	75.0	67.9
Inventories	93.3	84.8
Other current assets	54.4	40.9
Total current assets	432.2	427.6
Property, plant and equipment	203.8	206.1
Goodwill	218.7	218.1
Other intangible assets	100.7	103.4
Asbestos insurance receivable	227.2	239.5
Deferred income taxes	80.6	79.1
Other assets	58.1	60.0
Total assets	$ 1,321.3	$ 1,333.8
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Current maturities of long-term debt	$	$ 9.6
Accounts payable	66.9	66.4
Asbestos liability	96.4	85.3
Other accrued expenses	82.8	86.4
Total current liabilities	246.1	247.7
Long-term debt	126.1	124.9
Asbestos liability	369.4	380.2
Pension liability	82.2	80.3
Other liabilities	74.7	74.6
Total liabilities	898.5	907.7
Shareholders equity		
Common stock $.01 par value; 100,000,000 shares authorized; issued, 20,179,944 shares in 2009 and 20,031,709 in 2008	0.2	0.2
Additional paid-in capital	399.8	400.2
Retained earnings	47.8	44.6
Accumulated other comprehensive loss	(23.6)	(17.4)

Common stock held in treasury, at cost 215,560 shares in 2009 and 217,790 shares in 2008	(1.4)	(1.5)
Total shareholders equity	422.8	426.1
Total liabilities and shareholders equity	$ 1,321.3	$ 1,333.8

See notes to consolidated financial statements (unaudited).

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

1. Overview, Basis of Presentation and Recent Accounting Pronouncements

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, air compressors, 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, 2008, was derived from the audited financial statements included in the Company s annual report on Form 10-K for the year ended December 31, 2008. 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, 2008.

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 operations have been eliminated.

In May 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* (APB 14-1). APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash on conversion to separately account for the liability and equity components of the instrument in a manner that reflects the issuer s nonconvertible debt borrowing rate. APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application was not permitted; however, the transition guidance requires retrospective application to all periods presented. Prior periods presented in these consolidated financial statements and related notes have been recast to report as if APB 14-1 had been used and the effects of those changes are shown below.

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	For the Quarter Ended March 31, 2008	
	As Previously Reported	As Adjusted
	(in millions, except per share amounts)	
Consolidated Statement of Operations		
Interest expense	$ (2.0)	$ (3.1)
Income before income taxes	21.0	19.9
Income tax expense	(7.8)	(7.4)
Net income	13.2	12.5
Basic earnings per share	0.63	0.59
Diluted earnings per share	0.61	0.58
Consolidated Statement of Cash Flows		
Net income	13.2	12.5
Accretion of debt discount		1.1
Deferred income taxes	1.8	1.4

	As of December 31, 2008 (in millions)	
Deferred income taxes	$ 96.5	$ 79.1
Other assets	61.3	60.0
Total assets	1,352.5	1,333.8
Long-term debt	172.6	124.9
Total liabilities	955.4	907.7
Additional paid-in capital	363.0	400.2
Retained earnings	52.8	44.6
Total shareholders equity	397.1	426.1
Total liabilities and shareholders equity	1,352.5	1,333.8

Recent Accounting Pronouncements

In December 2008, the FASB issued FASB Staff Position No. 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* (FSP 132(R)-1). FSP 132(R)-1 amends FASB Statement No. 132(R), *Employers Disclosures about Pensions and Other Postretirement Benefits* to require additional disclosures about assets held in an employer s defined benefit pension or other postretirement plan. FSP 132(R)-1 is effective for fiscal years ending after December 15, 2009. Since FSP 132(R)-1 requires only additional disclosures, adoption of the standard will not affect the Company s financial condition, results of operations or cash flows.

2. Acquisition

In February 2009, the Company acquired PTM (UK) Limited, a full service provider of sealing solutions. The acquisition was paid for in cash and is included in the Company s Sealing Products segment. The purchase price allocations of PTM (UK) Limited and other recently acquired businesses are subject to the completion of the valuation of certain assets and liabilities.

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3. Other Expense

Included in other non-operating expense for the quarter ended March 31, 2008, were $2.4 million of incremental costs for legal, financial and strategic advice and proxy solicitation in connection with the contested election of directors initiated by one of the Company s shareholders. On April 11, 2008, an agreement with the shareholder was entered into that resolved the contested election.

4. Income Taxes

The Company s effective tax rate for the first quarter of 2009 was a 138.0% benefit compared to a 37.3% expense in 2008. The change in the rate is principally a result of the jurisdictional mix of earnings and losses. Reflected in the rate are pre-tax losses in high tax jurisdictions (primarily the U.S.) and earnings in lower tax jurisdictions (primarily Europe). The lower rate outside the U.S. is partially a result of recent structural and organizational changes the Company made in its European operations.

As of March 31, 2009 and December 31, 2008, the Company had $6.2 million and $5.6 million, respectively, of liabilities recorded for unrecognized tax benefits. The liabilities included interest of $0.5 million and $0.5 million, respectively. The unrecognized tax benefit balances as of March 31, 2009 and December 31, 2008, also included $2.2 million and $1.6 million, respectively, for tax positions for which the ultimate deductibility was highly certain but for which there was uncertainty about the timing of such deductibility. Included in the unrecognized tax benefits as of March 31, 2009 and December 31, 2008, were cumulative amounts of $4.0 million and $4.0 million, respectively, for uncertain tax positions that would affect the Company s effective tax rate if recognized. The Company records interest and penalties related to unrecognized tax benefits in income tax expense.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. Substantially all state, local and foreign income tax returns for the years 2003 through 2007 are open to examination. The U.S. federal income tax return for 2007 is also open to examination. Various foreign and state tax returns are currently under examination and may conclude within the next twelve months. The final outcomes of these audits are not yet determinable; however, management believes that any assessments that may arise will not be material to the Company s financial condition or results of operations.

5. Comprehensive Income (Loss)

Total comprehensive income (loss) consists of the following:

	Quarters Ended March 31, 2009	Quarters Ended March 31, 2008
	(in millions)	
Net income	$ 3.2	$ 12.5
Foreign currency translation adjustments	(6.9)	20.0
Pensions and postretirement benefits	1.1	0.1
Net unrealized gains (losses) from cash flow hedges	(0.4)	1.5
Total comprehensive income (loss)	$ (3.0)	$ 34.1

6. Earnings Per Share

The computation of basic and diluted earnings per share is as follows:

	Quarters Ended March 31, 2009	Quarters Ended March 31, 2008
	(in millions, except per share amounts)	
Numerator (basic and diluted):		
Net income	$ 3.2	$ 12.5
Denominator:		
Weighted-average shares basic	19.9	21.1
Share-based awards	0.2	0.3
Other		0.1
Weighted-average shares diluted	20.1	21.5
Earnings per share:		
Basic	$ 0.16	$ 0.59
Diluted	$ 0.16	$ 0.58

As discussed further in Note 9, the Company previously issued $172.5 million in aggregate principal amount of Convertible Senior Debentures (the Debentures). Under the terms of the Debentures, the Company would settle the par amount of its obligations in cash and the remaining obligations, if any, in common shares. Pursuant to applicable accounting guidelines, the Company includes the conversion option effect in diluted earnings per share during such periods when the Company s average stock price exceeds the conversion price of $33.79 per share.

7. Inventories

Inventories consist of the following:

	As of March 31, 2009	As of December 31, 2008
	(in millions)	
Finished products	$ 52.4	$ 53.5
Costs relating to long-term contracts and programs	53.0	41.5
Work in process	17.5	16.1
Raw materials and supplies	39.6	36.9
	162.5	148.0
Reserve to reduce certain inventories to LIFO basis	(16.8)	(16.9)
Progress payments	(52.4)	(46.3)
Total	$ 93.3	$ 84.8

The Company uses the last-in, first-out (LIFO) method of valuing certain of its inventories. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management s estimates of expected year-end inventory levels and costs, which are subject to change in the final year-end LIFO inventory valuation.

8. Intangible Assets

The changes in the net carrying value of goodwill by reportable segment for the quarter ended March 31, 2009, are as follows:

	Sealing Products	Engineered Products	Engine Products and Services	Total
		(in millions)		
Goodwill, net as of December 31, 2008	$ 66.4	$ 144.6	$ 7.1	$ 218.1
Acquisitions	3.3	0.4		3.7
Foreign currency translation	(0.3)	(2.8)		(3.1)
Goodwill, net as of March 31, 2009	$ 69.4	$ 142.2	$ 7.1	$ 218.7

Due to the impact of the continuing deterioration in the global economic environment and the Company s reduced enterprise value resulting from the decrease in its stock price, the Company is in the process of assessing whether any impairment of its goodwill has occurred. Although the exact amount of the non-cash charges, if any, related to an impairment of goodwill cannot be determined at this time, the indicators point to a potential impairment in the Company s GGB reporting unit which is included in the Company s Engineered Products segment and the Plastomer Technologies reporting unit which is included in the Company s Sealing Products segment. The goodwill associated with these reporting units as of March 31, 2009 was $110.2 million. The Company will complete the evaluation during the second quarter and will record the goodwill impairment charge at that time, if necessary.

The gross carrying amount and accumulated amortization of identifiable intangible assets is as follows:

	As of March 31, 2009		As of December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
		(in millions)		
Customer relationships	$ 77.2	$ 28.8	$ 77.3	$ 27.1
Existing technology	22.0	5.3	22.4	5.0
Trademarks	36.7	6.5	36.5	6.4
Other	14.0	8.6	14.1	8.4
	$ 149.9	$ 49.2	$ 150.3	$ 46.9

Amortization expense for the quarters ended March 31, 2009 and 2008, was $2.5 million and $2.6 million, respectively. The Company has trademarks with indefinite lives that are included in the table above with a carrying amount of approximately $23 million as of March 31, 2009 that are not amortized.

9. Long-Term Debt

In 2005, the Company issued $172.5 million in aggregate principal amount of Debentures. The Debentures bear interest at the annual rate of 3.9375%, with interest due on April 15 and October 15 of each year. The Debentures will mature on October 15, 2015 unless they are converted prior to that date. The Debentures are the Company s direct, unsecured and unsubordinated obligations and would rank equal in priority with all unsecured and unsubordinated indebtedness and senior in right of payment to all subordinated indebtedness. They would effectively rank junior to all secured indebtedness to the extent

of the value of the assets securing such indebtedness. The Debentures do not contain any financial covenants.

Holders may convert the Debentures into cash and shares of the Company s common stock, under certain circumstances. The initial conversion rate, which is subject to adjustment, is 29.5972 shares of common stock per $1,000 principal amount of Debentures. This is equal to an initial conversion price of $33.79 per share. The debentures may be converted under the following circumstances:

- during any fiscal quarter (and only during such fiscal quarter), if the closing price of the Company s common stock for at least 20 trading days in the 30 consecutive trading-day period ending on the last trading day of the preceding fiscal quarter was 130% or more of the then current conversion price per share of common stock on that 30th trading day;

- during the five business day period after any five consecutive trading-day period (which is referred to as the measurement period) in which the trading price per debenture for each day of the measurement period was less than 98% of the product of the closing price of the Company s common stock and the applicable conversion rate for the debentures;

- on or after September 15, 2015;

- upon the occurrence of specified corporate transactions; or

- in connection with a transaction or event constituting a change of control.

The conditions that permit conversion were not satisfied at March 31, 2009.

Upon conversion of any Debentures, the principal amount would be settled in cash. Specifically, in connection with any conversion, the Company will satisfy its obligations under the Debentures by delivering to holders, in respect of each $1,000 aggregate principal amount of Debentures being converted:

- cash equal to the lesser of $1,000 or the Conversion Value (defined below), and

- to the extent the Conversion Value exceeds $1,000, a number of shares equal to the sum of, for each day of the Cash Settlement Period, (1) 5% of the difference between (A) the product of the conversion rate (plus any additional shares as an adjustment upon a change of control) and the closing price of the Company s common stock for such date and (B) $1,000, divided by (2) the closing price of the Company s common stock for such day.

Conversion Value means the product of (1) the conversion rate in effect (plus any additional shares as an adjustment upon a change of control) and (2) the average of the closing prices of the Company s common stock for the 20 consecutive trading days beginning on the second trading day after the conversion date for those Debentures.

The Company used a portion of the net proceeds from the sale of the Debentures to enter into call options (hedge and warrant transactions), which entitle the Company to purchase shares of its stock from a financial institution at $33.79 per share and entitle the financial institution to purchase shares from the Company at $46.78 per share. This will reduce potential dilution to the Company s common stock from conversion of the Debentures by increasing the effective conversion price to $46.78 per share.

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APB 14-1 requires that the liability component of the Debentures be recorded at its fair value as of the issuance date. This resulted in the Company recording debt in the amount of $111.2 million with the $61.3 million offset to the debt discount being recorded in equity on a net of tax basis. The debt discount, $46.4 million as of March 31, 2009, is being amortized through interest expense until the maturity date of October 15, 2015, resulting in an effective interest rate of approximately 9.5% and a $126.1 million net carrying amount of the liability component at March 31, 2009. As of December 31, 2008, the unamortized debt discount was $47.7 million and the net carrying amount of the liability component was $124.8 million. Interest expense related to the Debentures for the quarters ended March 31, 2009 and 2008 includes $1.7 million of contractual interest coupon in both periods and $1.3 million and $1.1 million, respectively, of debt discount amortization.

10. Pensions and Postretirement Benefits

The components of net periodic benefit cost for the Company s U.S. and foreign defined benefit pension and other postretirement plans for the quarters ended March 31, 2009 and 2008, are as follows:

	Quarters Ended March 31,			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
	(in millions)			
Service cost	$ 1.7	$ 1.8	$ 0.3	$ 0.2
Interest cost	3.1	2.9	0.3	0.3
Expected return on plan assets	(2.7)	(3.5)		
Prior service cost component	0.2	0.2		0.1
Net loss component	1.6	0.1		
	$ 3.9	$ 1.5	$ 0.6	$ 0.6

The Company anticipates there will be a required funding of $6.4 million in 2009 for its U.S. defined benefit pension plans. However, the Company may utilize credit balances, which were received in prior years for making discretionary contributions to the plans to offset the majority of the U.S. required contribution. The Company expects to make total contributions of approximately $0.9 million in 2009 to its foreign pension plans.

11. Derivative Instruments

The Company uses derivative financial instruments to manage its exposure to various risks. The use of these financial instruments modifies the exposure with the intent of reducing the risk to the Company. The Company does not use financial instruments for trading purposes, nor does it use leveraged financial instruments. The counterparties to these contractual arrangements are major financial institutions. The Company uses several different financial institutions for derivative contracts to minimize the concentration of credit risk. Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), as amended, requires that all derivative instruments be reported in the Consolidated Balance Sheets at fair value and that changes in a derivative s fair value be recognized currently in earnings unless specific hedge criteria are met.

The Company is exposed to foreign currency risks that arise from normal business operations. These risks include the translation of local currency balances on its foreign subsidiaries balance sheets, intercompany loans with foreign subsidiaries and transactions denominated in foreign currencies. The Company strives to control its exposure to these risks through its normal operating activities and, where appropriate, through derivative instruments. The Company has entered into contracts to hedge forecasted transactions occurring at various dates through December 2010 that are denominated in foreign currencies. The notional amount of foreign exchange contracts hedging foreign currency transactions was $94.4 million and $130.3 million at March 31, 2009 and December 31, 2008, respectively. These contracts are accounted for as cash flow hedges. As cash flow hedges, the effective po