ENPRO INDUSTRIES, INC
Form 10-Q
August 05, 2015

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

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

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 ý No ¨

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 ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of July 30, 2015, there were 21,956,295 shares of common stock of the registrant outstanding, which does not include 197,842 shares of common stock held by a subsidiary of the registrant and accordingly are not entitled to be voted. There is only one class of common stock.

PART I
FINANCIAL INFORMATION
Item 1. Financial Statements
ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
Quarters and Six Months Ended June 30, 2015 and 2014
(in millions, except per share amounts)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net sales	$298.4	$313.1	$575.9	$600.3
Cost of sales	197.1	205.0	384.8	395.7
Gross profit	101.3	108.1	191.1	204.6
Operating expenses:				
Selling, general and administrative	74.1	83.5	151.4	162.4
Goodwill and other intangible asset impairment	47.0	—	47.0	—
Other	0.5	0.5	1.6	0.7
Total operating expenses	121.6	84.0	200.0	163.1
Operating income (loss)	(20.3)	24.1	(8.9)	41.5
Interest expense	(13.1)	(10.4)	(26.1)	(21.5)
Interest income	0.2	0.3	0.3	0.5
Other expense	(0.2)	(2.5)	(4.3)	(6.7)
Income (loss) before income taxes	(33.4)	11.5	(39.0)	13.8
Income tax benefit (expense)	(3.9)	(3.2)	0.1	(4.2)
Net income (loss)	$(37.3)	$8.3	$(38.9)	$9.6
Comprehensive income (loss)	$(29.2)	$10.3	$(47.0)	$10.6
Basic earnings (loss) per share	$(1.66)	$0.36	$(1.68)	$0.43
Diluted earnings (loss) per share	$(1.66)	$0.32	$(1.68)	$0.38

See notes to consolidated financial statements (unaudited).

ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
Six Months Ended June 30, 2015 and 2014
(in millions)

	2015	2014
OPERATING ACTIVITIES		
Net income (loss)	$(38.9)	$9.6
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation	14.8	14.9
Amortization	14.1	14.0
Loss on exchange and repurchase of convertible debentures	2.8	6.0
Goodwill and other intangible asset impairment	47.0	—
Deferred income taxes	(5.6)	(13.3)
Stock-based compensation	1.4	4.9
Other non-cash adjustments	0.8	2.6
Change in assets and liabilities, net of effects of acquisitions of businesses:		
Accounts receivable, net	(5.1)	(40.5)
Inventories	(12.2)	(13.3)
Accounts payable	(5.7)	6.0
Other current assets and liabilities	(10.9)	(0.6)
Other non-current assets and liabilities	(4.9)	(4.1)
Net cash used in operating activities	(2.4)	(13.8)
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(16.2)	(14.2)
Payments for capitalized internal-use software	(2.3)	(4.8)
Acquisitions, net of cash acquired	(30.6)	(4.3)
Other	0.1	0.1
Net cash used in investing activities	(49.0)	(23.2)
FINANCING ACTIVITIES		
Net proceeds from short-term borrowings	2.3	—
Proceeds from debt	110.9	128.0
Repayments of debt	(66.0)	(87.0)
Repurchase of common stock	(80.0)	—
Dividends paid	(9.4)	—
Repurchase of convertible debentures conversion option	(21.6)	—
Other	(2.1)	(4.6)
Net cash provided by (used in) financing activities	(65.9)	36.4
Effect of exchange rate changes on cash and cash equivalents	0.6	1.1
Net increase (decrease) in cash and cash equivalents	(116.7)	0.5
Cash and cash equivalents at beginning of period	194.2	64.4
Cash and cash equivalents at end of period	$77.5	$64.9
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$27.6	$21.1
Income taxes, net	$11.4	$17.5

See notes to consolidated financial statements (unaudited).

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

	June 30, 2015	December 31, 2014
ASSETS		
Current assets		
Cash and cash equivalents	$77.5	$194.2
Accounts receivable, net	212.2	205.2
Inventories	170.5	159.7
Prepaid expenses and other current assets	41.0	44.0
Total current assets	501.2	603.1
Property, plant and equipment, net	202.2	199.3
Goodwill	192.8	232.4
Other intangible assets	205.0	202.8
Investment in GST	236.9	236.9
Deferred income taxes and income tax receivable	100.3	80.3
Other assets	44.9	49.2
Total assets	$1,483.3	$1,604.0
LIABILITIES AND EQUITY		
Current liabilities		
Short-term borrowings from GST	$24.9	$23.6
Notes payable to GST	12.2	11.7
Current maturities of long-term debt	2.3	22.5
Accounts payable	87.5	87.8
Accrued expenses	109.1	131.6
Total current liabilities	236.0	277.2
Long-term debt	367.0	298.6
Notes payable to GST	271.0	259.3
Other liabilities	128.8	130.5
Total liabilities	1,002.8	965.6
Commitments and contingencies		
Temporary equity	—	1.0
Shareholders’ equity		
Common stock – $.01 par value; 100,000,000 shares authorized; issued, 22,154,137 shares in 2015 and 24,172,716 shares in 2014	0.2	0.2
Additional paid-in capital	376.8	477.3
Retained earnings	147.0	195.3
Accumulated other comprehensive loss	(42.2)	(34.1)
Common stock held in treasury, at cost – 198,754 shares in 2015 and 200,022 shares in 2014	(1.3)	(1.3)
Total shareholders’ equity	480.5	637.4
Total liabilities and equity	$1,483.3	$1,604.0

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 Recently Issued Authoritative Accounting Guidance

Overview

EnPro Industries, Inc. (“we,” “us,” “our,” “EnPro” or the “Company”) is a leader in the design, development, manufacture and marketing of proprietary engineered industrial products that primarily include: sealing products; heavy-duty truck wheel-end component systems; self-lubricating non-rolling bearing products; precision engineered components and lubrication systems for reciprocating compressors; and heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines, including parts and services.

Basis of Presentation

The accompanying interim consolidated financial statements are unaudited, and certain related information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted in accordance with Rule 10-01 of Regulation S-X. They were prepared following the same policies and procedures used in the preparation of our annual financial statements and reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of results for the periods presented. The Consolidated Balance Sheet as of December 31, 2014 was derived from the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2014. The results of operations for the interim periods are not necessarily indicative of the results for the fiscal year. These consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2014 included within our annual report on Form 10-K.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amount of assets and liabilities and the disclosures regarding contingent assets and liabilities at period end and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

All intercompany accounts and transactions between our consolidated operations have been eliminated.

As of June 30, 2015, we had purchased $5.9 million of property, plant and equipment for which cash payments had not yet been made. This is considered a noncash investing activity.

Recently Issued Authoritative Accounting Guidance

In July 2015, a standard was issued that simplifies the measurement of inventory by requiring certain inventory to be measured at the lower of cost or net realizable value. This will not apply to the portion of our inventory that is measured using the last-in, first-out method. The amendments in this guidance are effective for fiscal years beginning after December 15, 2016 and for interim periods therein, but early application is permitted. This standard is not expected to have a significant impact on our consolidated financial statements or disclosures.

In April 2015, a standard was issued that amends existing guidance to require the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred charge. It is effective for annual reporting periods beginning after December 15, 2015, but early adoption is permitted. This standard is not expected to have a significant impact on our consolidated financial statements or disclosures.

In May 2014, a comprehensive new revenue recognition standard was issued that will supersede nearly all existing revenue recognition guidance. The new guidance introduces a five-step model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The new standard will become effective for us beginning with the first quarter 2018. We are currently evaluating the new guidance, including possible transition alternatives, to determine the impact it will have on our consolidated financial statements.

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2. Acquisitions

In February 2015, we acquired the stock of ATDynamics, Inc. ("ATDynamics"), a privately-held company offering innovative aerodynamic products to the commercial trucking industry. ATDynamics is managed as part of our Stemco division within the Sealing Products segment. ATDynamics, headquartered in Hayward, California, is a leading designer and manufacturer of a suite of aerodynamic products engineered to reduce fuel consumption in the global freight transportation industry.

We paid $30.6 million, net of cash acquired, for the business. The acquisition of ATDynamics includes an agreement that could require us to pay additional consideration based on the future gross profit of ATDynamics during the twelve months subsequent to the acquisition. The range of undiscounted amounts we could pay under the contingent consideration agreement is between $0 and $5.0 million. The fair value of the contingent consideration recognized on the acquisition date was $0.5 million, which is included in accrued expenses in the accompanying Consolidated Balance Sheet as of June 30, 2015.

Because the assets, liabilities and results of operations for this acquisition are not significant to our consolidated financial position or results of operations, pro forma financial information and additional disclosures are not presented.

Subsequent to the second quarter of 2015 (July 1, 2015), we purchased the Veyance North-American air spring business (the "Air Spring Business") for $18.1 million in cash. The Air Spring Business is a manufacturer of air springs that are used in the suspension systems of commercial vehicles. Following the acquisition, it became part of EnPro's Stemco division within the Sealing Products segment. The Air Spring Business manufactures products in its facility in San Luis Potosi, Mexico with a commercial organization in the U.S., Canada and Mexico, and engineering, testing and administrative resources in Fairlawn, Ohio. The addition of the Air Spring Business significantly expands Stemco's presence and scale in the commercial vehicle suspension market.

3. Earnings Per Share

	Quarters Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in millions, except per share amounts)			
Numerator (basic and diluted):				
Net income (loss)	$(37.3)	$8.3	$(38.9)	$9.6
Denominator:				
Weighted-average shares – basic	22.5	22.9	23.1	22.1
Share-based awards	—	0.1	—	0.1
Convertible debentures and related warrants	—	3.0	—	3.4
Weighted-average shares – diluted	22.5	26.0	23.1	25.6
Earnings (loss) per share:				
Basic	$(1.66)	$0.36	$(1.68)	$0.43
Diluted	$(1.66)	$0.32	$(1.68)	$0.38

As discussed further in Note 9, "Long-Term Debt - Convertible Debentures", we previously issued Convertible Senior Debentures (the “Convertible Debentures”). Under the terms of the Convertible Debentures, upon conversion, we will settle the par amount of our obligations in cash and the remaining obligations, if any, in common shares. Pursuant to applicable accounting guidelines, we include the conversion option effect in diluted earnings per share during such periods when our average stock price exceeds the adjusted conversion price ($33.58 per share at June 30, 2015 and $33.79 per share at June 30, 2014) and when inclusion of the conversion option effect is not antidilutive. As discussed further in Note 9, "Long-Term Debt - Convertible Debentures", we repurchased a significant portion of our outstanding Convertible Debentures in March 2015.

We used a portion of the net proceeds from the original sale of the Convertible Debentures to enter into call options, consisting of hedge and warrant transactions, which would entitle us to purchase shares of our stock from a financial institution at an adjusted price of $33.68 per share and entitle the financial institution to purchase shares of our stock from us at an adjusted price of $46.64 per share. The warrant transactions had a dilutive effect during such periods that the average price per share of our common stock exceeded the per share strike price of the warrants. During the second quarter of 2015, we completed a previously announced agreement with this financial institution to effectively accelerate and offset settlement

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obligations of the parties under the call options which resulted in a net-share settlement of approximately 0.9 million shares being delivered to us. These shares were immediately retired and are no longer considered outstanding.

In the quarter and six months ended June 30, 2015, there was a loss attributable to common shares. There were 1.1 million and 1.4 million, respectively, of potentially dilutive shares excluded from the calculation of diluted earnings per share during those periods since they were antidilutive.

4. Inventories

	June 30, 2015	December 31, 2014
	(in millions)	
Finished products	$108.1	$ 101.2
Work in process	25.8	22.1
Raw materials and supplies	45.2	45.7
	179.1	169.0
Reserve to reduce certain inventories to LIFO basis	(12.8)	(12.8)
Manufacturing inventories	166.3	156.2
Incurred costs relating to long-term contracts	10.3	9.1
Progress payments related to long-term contracts	(6.1)	(5.6)
Net balance associated with completed-contract inventories	4.2	3.5
Total inventories	$170.5	$ 159.7

We use the last-in, first-out ("LIFO") method of valuing certain of our 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 until the final year-end LIFO inventory valuation.

Refer to Note 5, "Long-Term Contracts" for additional information about incurred costs and progress payments related to long-term contracts.