

ENPRO INDUSTRIES, INC

Form 10-Q

November 06, 2007

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

**Quarterly report pursuant to Section 13 or 15(d) of the securities exchange act of 1934**

**For the quarterly period ended September 30, 2007**

**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  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  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

As of November 1, 2007, there were 21,614,476 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 Nine Months Ended September 30, 2007 and 2006  
(in millions, except per share amounts)**

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Sales	\$ 252.7	\$ 228.6	\$ 754.4	\$ 683.6
Cost of sales	163.2	156.7	485.0	455.9
Gross profit	89.5	71.9	269.4	227.7
Operating expenses:				
Selling, general and administrative expenses	57.8	47.7	168.0	145.9
Asbestos-related expenses	11.5	28.7	37.5	54.3
Other	0.8	1.3	3.1	2.1
	70.1	77.7	208.6	202.3
Operating income (loss)	19.4	(5.8)	60.8	25.4
Interest expense	(2.1)	(2.1)	(6.1)	(6.1)
Interest income	2.0	1.2	6.1	3.6
Other income	0.6		0.6	0.3
Income (loss) before income taxes	19.9	(6.7)	61.4	23.2
Income tax benefit (expense)	(7.6)	2.4	(23.0)	(8.5)
Net income (loss)	\$ 12.3	\$ (4.3)	\$ 38.4	\$ 14.7
Basic earnings per share	\$ 0.58	\$ (0.20)	\$ 1.81	\$ 0.71
Diluted earnings per share	\$ 0.54	\$ (0.20)	\$ 1.71	\$ 0.68

See notes to consolidated financial statements (unaudited).

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**ENPRO INDUSTRIES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**Nine Months Ended September 30, 2007 and 2006**  
**(in millions)**

	2007	2006
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 38.4	\$ 14.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	21.6	19.7
Amortization	8.0	6.2
Deferred income taxes	5.7	0.4
Stock-based compensation	2.4	4.0
Excess tax benefits from stock-based compensation	(3.9)	(0.8)
Change in assets and liabilities, net of effects of acquisitions of businesses:		
Asbestos liabilities, net of receivables	23.4	18.6
Receivables	(14.3)	(11.1)
Inventories	9.8	(13.2)
Accounts payable	5.7	4.9
Other current assets and liabilities	(5.9)	2.0
Other non-current assets and liabilities	(15.9)	(2.9)
Net cash provided by operating activities	75.0	42.5
<b>INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(30.1)	(30.3)
Receipts from restricted cash accounts	0.2	39.8
Acquisitions, net of cash acquired	(72.1)	(27.3)
Other	0.5	1.2
Net cash used in investing activities	(101.5)	(16.6)
<b>FINANCING ACTIVITIES</b>		
Repayments of debt	(1.7)	
Proceeds from issuance of common stock	0.8	0.6
Excess tax benefits from stock-based compensation	3.9	0.8
Other		(0.7)
Net cash provided by financing activities	3.0	0.7
Effect of exchange rate changes on cash and cash equivalents	3.0	1.9
Net increase (decrease) in cash and cash equivalents	(20.5)	28.5
Cash and cash equivalents at beginning of year	161.0	109.5

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Cash and cash equivalents at end of period	\$ 140.5	\$ 138.0
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest expense	\$ 4.5	\$ 4.3
Income taxes	\$ 17.3	\$ 8.1
Payments for asbestos-related claims and expenses, net of insurance recoveries	\$ 14.1	\$ 35.7
See notes to consolidated financial statements (unaudited).		

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

	September 30, 2007	December 31, 2006
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 140.5	\$ 161.0
Accounts and notes receivable	166.2	138.3
Asbestos insurance receivable	64.8	71.3
Inventories	77.0	79.3
Other current assets	29.9	22.4
Total current assets	478.4	472.3
Property, plant and equipment	182.3	166.3
Goodwill	198.2	161.6
Other intangible assets	104.5	70.1
Asbestos insurance receivable	328.6	396.7
Deferred income taxes	98.3	80.2
Other assets	63.2	59.4
Total assets	\$ 1,453.5	\$ 1,406.6
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities		
Current maturities of long-term debt	\$ 0.5	\$
Accounts payable	72.6	62.2
Asbestos liability	86.4	88.8
Other accrued expenses	96.8	74.1
Total current liabilities	256.3	225.1
Long-term debt	185.6	185.7
Retained liabilities of previously owned businesses	28.2	27.7
Environmental liabilities	19.4	25.1
Asbestos liability	430.3	479.1
Other liabilities	66.1	60.0
Total liabilities	985.9	1,002.7
Shareholders equity		
Common stock \$.01 par value; 100,000,000 shares authorized; issued, 21,589,288 shares in 2007 and 21,211,044 in 2006	0.2	0.2
Additional paid-in capital	426.0	418.9
Accumulated deficit	(2.5)	(41.0)
Accumulated other comprehensive income	45.4	27.3
	(1.5)	(1.5)

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Common stock held in treasury, at cost 223,987 shares in 2007 and 228,126 shares in 2006

Total shareholders' equity	467.6	403.9
Total liabilities and shareholders' equity	\$ 1,453.5	\$ 1,406.6

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 well recognized, proprietary engineered industrial products that include sealing products, metal and metal polymer bearings and filament wound 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 generally accepted accounting principles 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 generally accepted accounting principles for complete financial statements. The Consolidated Balance Sheet as of December 31, 2006, was derived from the audited financial statements included in the Company s annual report on Form 10-K. 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, 2006.

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.

Certain amounts in the accompanying 2006 financial statements have been reclassified to conform to the current year presentation.

**2. Acquisitions**

In July 2007, the Company acquired Compressor Products International Limited, a privately-held manufacturer of critical sealing components for reciprocating compressors, gas engines and related equipment. The acquisition was paid for in cash and is included in the Company s Engineered Products segment.

In June 2007, the Company acquired Texflo Machining Ltd., a privately-held company that services and repairs reciprocating compressors, primarily for the natural gas market in western Canada. The acquisition was paid for in cash and is included in the Company s Engineered Products segment.

The purchase price allocation of these acquired businesses is subject to the completion of the valuation of certain assets and liabilities.

**Table of Contents****3. Comprehensive Income (Loss)**

Total comprehensive income (loss) consists of the following:

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in millions)			
Net income (loss)	\$ 12.3	\$ (4.3)	\$ 38.4	\$ 14.7
Unrealized translation adjustments	11.2	4.2	18.0	12.6
Prior service cost and net actuarial loss	0.1		0.5	
Net unrealized losses from cash flow hedges	(0.1)	(0.1)	(0.4)	(0.4)
Total comprehensive income (loss)	23.5	(0.2)	\$ 56.5	\$ 26.9

**4. Earnings Per Share**

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

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in millions, except per share amounts)			
Numerator (basic and diluted):				
Net income (loss)	\$ 12.3	\$ (4.3)	\$ 38.4	\$ 14.7
Denominator:				
Weighted-average shares basic	21.3	20.9	21.2	20.9
Share-based awards	0.5		0.5	0.6
Convertible debentures	0.9		0.7	0.1
Weighted-average shares diluted	22.7	20.9	22.4	21.6
Earnings per share:				
Basic	\$ 0.58	\$ (0.20)	\$ 1.81	\$ 0.71
Diluted	\$ 0.54	\$ (0.20)	\$ 1.71	\$ 0.68

As discussed further in Note 8, the Company has issued 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. In accordance with the current applicable accounting guidelines, the Company includes the conversion option effect in diluted earnings per share during such periods when the Company's stock price exceeds the conversion price of \$33.79 per share.

In the quarter ended September 30, 2006, there was a loss attributable to common shares. Potentially dilutive share-based awards of 0.7 million shares were excluded from the calculation of diluted earnings per share as they were antidilutive.

**5. Income Taxes**

The Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes on January 1, 2007. Accordingly, the Company recorded a \$0.1 million decrease in liabilities for unrecognized tax benefits with a corresponding reduction in the accumulated deficit. At January 1, 2007, the Company had recorded a liability of approximately \$21.8 million for unrecognized tax benefits of which \$4.9 million, if recognized, would affect the

effective tax rate. The Company records interest and

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penalties related to unrecognized tax benefits in income tax expense. At January 1, 2007, the Company had accrued \$1.1 million for the potential payment of interest. At September 30, 2007, the Company had a \$17.0 million liability recorded for unrecognized tax benefits, which includes interest of \$1.9 million. The total amount of unrecognized benefits that, if recognized, would have affected the effective tax rate was \$5.7 million.

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 federal, state and local, and foreign income tax returns for the years 2003 through 2006 are open to examination. The U.S. federal income tax returns for 2003 to 2005 and various foreign and state tax returns are currently under examination. 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.

**6. Inventories**

Inventories consist of the following:

	<b>As of September 30, 2007</b>	<b>As of December 31, 2006</b>
	<b>(in millions)</b>	
Finished products	\$ 43.8	\$ 40.0
Costs relating to long-term contracts and programs	33.6	32.1
Work in process	21.5	20.8
Raw materials and supplies	31.8	24.6
	130.7	117.5
Reserve to reduce certain inventories to LIFO basis	(17.2)	(16.6)
Progress payments	(36.5)	(21.6)
Total	\$ 77.0	\$ 79.3

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 and are subject to the final year-end LIFO inventory valuation.

**7. Intangible Assets**

The changes in the net carrying value of goodwill by reportable segment for the nine months ended September 30, 2007, are as follows:

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	<b>Sealing Products</b>	<b>Engineered Products</b>	<b>Engine Products and Services</b>	<b>Total</b>
	(in millions)			
Goodwill, net as of December 31, 2006	\$ 48.6	\$ 105.9	\$ 7.1	\$ 161.6
Acquisitions		29.0		29.0
Foreign currency translation	0.8	6.8		7.6
Goodwill, net as of September 30, 2007	\$ 49.4	\$ 141.7	\$ 7.1	\$ 198.2

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

	<b>As of September 30, 2007</b>		<b>As of December 31, 2006</b>	
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
	(in millions)			
Customer relationships	\$ 43.7	\$ 19.2	\$ 42.9	\$ 16.1
Existing technology	16.5	3.4	16.5	2.9
Trademarks	35.5	5.7	29.8	4.7
Other	44.0	6.9	10.1	5.5
	\$ 139.7	\$ 35.2	\$ 99.3	\$ 29.2

Amortization expense for the nine months ended September 30, 2007 and 2006, was \$5.6 million and \$4.3 million, respectively. The Company has trademarks with indefinite lives valued at approximately \$16 million that are not being amortized as of September 30, 2007, and December 31, 2006, and that are included in the table above.

Goodwill and the identifiable intangible assets are subject to the completion of the valuation of certain assets and liabilities for the acquisitions described in Note 2 to these Consolidated Financial Statements. As of September 30, 2007, the \$39.1 million estimate for identifiable intangible assets for the acquisitions was included above in trademarks and other identifiable intangible assets.

**8. Long-Term Debt**

In 2005, the Company issued \$172.5 million in aggregate principal amount of Debentures that may be converted only under certain circumstances. The conditions that permit conversion were not satisfied at September 30, 2007. In the event the conversion conditions become satisfied, the Company will be required to immediately expense all unamortized debt issue costs, which amounted to \$4.7 million at September 30, 2007, and reclassify the aggregate principal amount from long-term to current.

**9. 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 and nine months ended September 30, 2007 and 2006, are as follows:

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	<b>Quarters Ended September 30,</b>			
	<b>Pension Benefits</b>		<b>Other Benefits</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(in millions)			
Service cost	\$ 1.7	\$ 2.3	\$ 0.3	\$ 0.3
Interest cost	2.7	2.6	0.2	0.2
Expected return on plan assets	(3.3)	(2.9)		
Prior service cost component	0.3	0.7	0.1	
Net loss component	(0.6)	0.4		
	\$ 0.8	\$ 3.1	\$ 0.6	\$ 0.5

	<b>Nine Months Ended September 30,</b>			
	<b>Pension Benefits</b>		<b>Other Benefits</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(in millions)			
Service cost	\$ 4.9	\$ 6.9	\$ 0.9	\$ 0.9
Interest cost	8.0	7.8	0.5	0.6
Expected return on plan assets	(10.0)	(8.7)		
Prior service cost component	0.9	2.1	0.2	
Net loss component	0.6	1.2	0.1	
	\$ 4.4	\$ 9.3	\$ 1.7	\$ 1.5

The Company implemented amendments to the U.S. salaried defined benefit pension plan effective January 1, 2007, that resulted in the reduction of the pension benefit service cost.

In 2007 and 2006, the Company made discretionary contributions of \$10.0 million in each year to its U.S. defined benefit pension plans. The Company expects to make total contributions of approximately \$1.2 million in 2007 to its foreign pension plans.

**10. Business Segment Information**

The Company has three reportable segments. The Sealing Products segment manufactures sealing and polytetrafluoroethylene ( PTFE ) products. The Engineered Products segment manufactures metal and metal polymer bearings and filament wound products, air compressor systems and vacuum pumps, and reciprocating compressor components. The Engine Products and Services segment manufactures and services heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines. The Company's reportable segments are managed separately based on differences in their products and services and their end-customers. Segment profit is total segment revenue reduced by operating expenses and restructuring and other costs identifiable with the segment. Corporate expenses include general corporate administrative costs. Expenses not directly attributable to the segments, corporate expenses, net interest expense, asbestos-related expenses, gains/losses or impairments related to the sale of assets and income taxes are not included in the computation of segment profit. The accounting policies of the reportable segments are the same as those for the Company.

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	<b>Quarters Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Sales				
Sealing Products	\$ 112.6	\$		

(in millions)