

ENPRO INDUSTRIES, INC  
Form 10-Q  
August 08, 2012

**UNITED STATES**  
**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 June 30, 2012**

**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)

01-0573945  
(I.R.S. Employer)

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of incorporation)

Identification No.)

5605 Carnegie Boulevard, Suite 500, Charlotte,

North Carolina  
(Address of principal executive offices)

(704) 731-1500

28209  
(Zip Code)

(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 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  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

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

As of July 26, 2012, there were 20,710,869 shares of common stock of the registrant outstanding. 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, 2012 and 2011

(in millions, except per share amounts)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net sales	\$ 301.7	\$ 263.7	\$ 613.2	\$ 533.3
Cost of sales	198.7	164.4	403.0	340.0
Gross profit	103.0	99.3	210.2	193.3
Operating expenses:				
Selling, general and administrative expenses	75.8	71.2	149.3	133.5
Other operating expense	0.8	0.2	2.3	0.5
	76.6	71.4	151.6	134.0
Operating income	26.4	27.9	58.6	59.3
Interest expense	(10.9)	(10.0)	(21.6)	(19.9)
Interest income	0.1	0.4	0.2	0.8
Other expense	(0.5)		(0.5)	
Income before income taxes	15.1	18.3	36.7	40.2
Income tax expense	(4.9)	(6.1)	(12.7)	(12.8)
Net income	\$ 10.2	\$ 12.2	\$ 24.0	\$ 27.4
Basic earnings per share	\$ 0.50	\$ 0.59	\$ 1.16	\$ 1.34
Diluted earnings per share	\$ 0.47	\$ 0.56	\$ 1.11	\$ 1.26

See notes to consolidated financial statements (unaudited).

## ENPRO INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

Quarters and Six Months Ended June 30, 2012 and 2011

(in millions)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	\$ 10.2	\$ 12.2	\$ 24.0	\$ 27.4
Other comprehensive income (loss):				
Foreign currency translation adjustments	(13.1)	4.8	(7.1)	14.6
Amortization of pension and post-retirement benefits included in net income	2.4	1.3	4.7	2.5
Change in fair value of cash flow hedges		0.1	0.5	1.1
Realized (gain) loss from settled cash flow hedges included in net income	0.3	(0.1)		1.0
Other comprehensive income (loss), before tax	(10.4)	6.1	(1.9)	19.2
Income tax expense related to items of other comprehensive income (loss)	(0.9)	(0.6)	(1.9)	(1.8)
Other comprehensive income (loss), net of tax	(11.3)	5.5	(3.8)	17.4
Comprehensive income (loss)	\$ (1.1)	\$ 17.7	\$ 20.2	\$ 44.8

See notes to consolidated financial statements (unaudited).

## ENPRO INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Six Months Ended June 30, 2012 and 2011

(in millions)

	2012	2011
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 24.0	\$ 27.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	13.7	11.7
Amortization	12.7	10.4
Accretion of debt discount	3.4	3.1
Deferred income taxes	0.2	(7.1)
Stock-based compensation	2.7	2.2
Change in assets and liabilities, net of effects of acquisitions of businesses:		
Accounts receivable	(24.1)	(23.6)
Inventories	(12.6)	(16.9)
Accounts payable	(1.2)	6.8
Other current assets and liabilities	(12.0)	0.8
Other non-current assets and liabilities	(2.0)	(2.2)
Net cash provided by operating activities	4.8	12.6
<b>INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(13.1)	(11.6)
Acquisitions, net of cash acquired	(85.3)	(155.3)
Other		1.0
Net cash used in investing activities	(98.4)	(165.9)
<b>FINANCING ACTIVITIES</b>		
Repayments of short-term borrowings	(0.3)	(11.9)
Proceeds from debt	191.2	
Repayments of debt	(96.6)	
Other	0.2	(0.7)
Net cash provided by (used in) financing activities	94.5	(12.6)
Effect of exchange rate changes on cash and cash equivalents	(0.4)	1.4
Net increase (decrease) in cash and cash equivalents	0.5	(164.5)
Cash and cash equivalents at beginning of period	30.7	219.2
Cash and cash equivalents at end of period	\$ 31.2	\$ 54.7
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 19.9	\$ 18.5
Income taxes (net of refunds of \$3.4 in 2012)	\$ 12.5	\$ 19.9
See notes to consolidated financial statements (unaudited).		



## ENPRO INDUSTRIES, INC.

## CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in millions, except share amounts)

	June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 31.2	\$ 30.7
Accounts receivable	223.9	195.3
Inventories	128.8	112.6
Prepaid expenses and other current assets	48.9	44.1
<b>Total current assets</b>	<b>432.8</b>	<b>382.7</b>
Property, plant and equipment	175.6	164.2
Goodwill	217.3	201.2
Other intangible assets	233.4	195.7
Investment in GST	236.9	236.9
Other assets	68.8	71.4
<b>Total assets</b>	<b>\$ 1,364.8</b>	<b>\$ 1,252.1</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities		
Short-term borrowings	\$ 9.8	\$ 9.9
Notes payable to GST	10.7	10.2
Current maturities of long-term debt	1.0	1.6
Accounts payable	86.2	83.9
Accrued expenses	100.8	119.5
<b>Total current liabilities</b>	<b>208.5</b>	<b>225.1</b>
Long-term debt	247.4	148.6
Notes payable to GST	237.4	227.2
Pension liability	106.8	108.7
Other liabilities	47.5	48.4
<b>Total liabilities</b>	<b>847.6</b>	<b>758.0</b>
Commitments and contingencies		
Shareholders' equity		
Common stock - \$.01 par value; 100,000,000 shares authorized; issued, 20,903,844 shares in 2012 and 20,779,237 shares in 2011	0.2	0.2
Additional paid-in capital	421.0	418.1
Retained earnings	128.9	104.9
Accumulated other comprehensive loss	(31.5)	(27.7)
Common stock held in treasury, at cost - 205,125 shares in 2012 and 206,306 shares in 2011	(1.4)	(1.4)
<b>Total shareholders' equity</b>	<b>517.2</b>	<b>494.1</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,364.8</b>	<b>\$ 1,252.1</b>

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 Adopted Accounting Pronouncement**

*Overview*

EnPro Industries, Inc. ( EnPro or the Company ) is a leader in the design, development, manufacturing and marketing of proprietary engineered industrial products that primarily include sealing products, 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 for 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, 2011, was derived from the audited financial statements included in the Company s annual report on Form 10-K for the year ended December 31, 2011. 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 included in its annual report on Form 10-K for the year ended December 31, 2011.

Revenues, expenses, cash flows, assets and liabilities can and do vary 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.

*Recently Adopted Accounting Pronouncement*

In June 2011, accounting guidance was amended to change the presentation of comprehensive income. These changes give an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. These changes became effective retrospectively for fiscal years beginning after December 15, 2011. Other than the change in presentation, there was no effect on the consolidated financial statements.

**2. Acquisitions**

In April 2012, the Company acquired Motorwheel Commercial Vehicle Systems, Inc. ( Motorwheel ). Motorwheel is a leading U.S. manufacturer of lightweight brake drums for heavy-duty trucks and other commercial vehicles. Motorwheel also sells wheel-end component assemblies for the heavy-duty market, sells fasteners for wheel-end applications and provides a full suite of services to its customers, including product development, testing and certification. The business operates

manufacturing facilities in Chattanooga, Tennessee and Berea, Kentucky. Motorwheel is managed as part of the Stemco operations in the Sealing Products segment.

The acquisition was paid for with approximately \$85 million of cash, which was funded by additional borrowings from the Company's revolving credit facility. The following table represents the preliminary purchase price allocation:

	(in millions)
Accounts receivable	\$ 7.0
Inventories	5.2
Property, plant and equipment	14.9
Goodwill	16.8
Other intangible assets	49.6
Other assets	0.1
Liabilities assumed	(8.3)
	\$ 85.3

The purchase price allocation is subject to the completion of the valuation of certain assets and liabilities as well as purchase price adjustments pursuant to the acquisition agreement. Because the assets, liabilities and results of operations for this acquisition are not significant to the Company's consolidated financial position or results of operations, pro forma financial information and additional disclosures are not presented.

In January 2011, the Company acquired certain assets and assumed certain liabilities of Rome Tool & Die, Inc., a leading supplier of steel brake shoes to the North American heavy-duty truck market. In February 2011, the Company acquired the business of Pipeline Seal and Insulator, Inc. and its affiliates (PSI), a privately-owned group of companies that manufacture products for the safe flow of fluids through pipeline transmission and distribution systems worldwide. In February 2011, the Company acquired the Mid Western group of companies, a privately-owned business primarily serving the oil and gas drilling, production and processing industries of Western Canada. In July 2011, the Company acquired Tara Technologies Corporation (Tara), a privately-held company that offers highly engineered products and solutions to the semiconductor, aerospace, energy and medical markets. In August 2011, the Company acquired certain assets and assumed certain liabilities of PI Bearing Technologies, a privately-held manufacturer of bearing blocks and other bearing products used in fluid power applications.

The following pro forma condensed consolidated financial results of operations for the Company for the quarter and six months ended June 30, 2011, are presented as if the 2011 acquisitions had been completed prior to 2011:

	Quarter Ended June 30, 2011	Six Months Ended June 30, 2011
	(in millions)	
Pro forma net sales	\$ 284.0	\$ 583.1
Pro forma net income	13.7	32.3

The 2011 supplemental pro forma net income was adjusted to exclude \$1.5 million of pre-tax acquisition-related costs and \$1.7 million of pre-tax nonrecurring expenses related to the fair value adjustment to acquisition date inventory. These pro forma financial results have been prepared for comparative purposes only and do not reflect the effect of synergies that would have been expected to result from the integration of these acquisitions. The pro forma information does not purport to be

indicative of the results of operations that actually would have resulted had the combinations occurred prior to 2011, or of future results of the consolidated entities.

### 3. Earnings Per Share

	Quarters Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
(in millions, except per share amounts)				
Numerator (basic and diluted):				
Net income	\$ 10.2	\$ 12.2	\$ 24.0	\$ 27.4
Denominator:				
Weighted-average shares basic	20.7	20.5	20.6	20.5
Share-based awards	0.4	0.3	0.4	0.3
Convertible debentures	0.7	1.1	0.6	0.9
Weighted-average shares diluted	21.8	21.9	21.6	21.7
Earnings per share:				
Basic	\$ 0.50	\$ 0.59	\$ 1.16	\$ 1.34
Diluted	\$ 0.47	\$ 0.56	\$ 1.11	\$ 1.26

As discussed further in Note 8, the Company previously issued Convertible Senior Debentures (the Debentures). Under the terms of the Debentures, upon conversion, 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 stated conversion price.

### 4. Inventories

	June 30, 2012	December 31, 2011
(in millions)		
Finished products	\$ 71.4	\$ 64.5
Deferred costs relating to long-term contracts	27.9	28.6
Work in process	23.4	18.9
Raw materials and supplies	41.0	42.3
	163.7	154.3
Reserve to reduce certain inventories to LIFO basis	(12.2)	(12.0)
Progress payments	(22.7)	(29.7)
Total	\$ 128.8	\$ 112.6

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 until the final year-end LIFO inventory valuation.



**5. Goodwill and Other Intangible Assets**

The changes in the net carrying value of goodwill by reportable segment for the six months ended June 30, 2012, are as follows:

	Sealing Products	Engineered Products	Engine Products and Services	Total
	(in millions)			
Gross goodwill as of December 31, 2011	\$ 164.1	\$ 166.5	\$ 7.1	\$ 337.7
Accumulated impairment losses	(27.8)	(108.7)		(136.5)
Goodwill as of December 31, 2011	136.3	57.8	7.1	201.2
Foreign currency translation	(0.7)			(0.7)
Acquisitions	15.4	1.4		16.8
Gross goodwill as of June 30, 2012	178.8	167.9	7.1	353.8
Accumulated impairment losses	(27.8)	(108.7)		(136.5)
Goodwill as of June 30, 2012	\$ 151.0	\$ 59.2	\$ 7.1	\$ 217.3

Identifiable intangible assets are as follows:

	As of June 30, 2012		As of December 31, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in millions)			
<b>Amortized:</b>				
Customer relationships	\$ 187.0	\$ 61.1	\$ 166.9	\$ 54.4
Existing technology	54.2	11.6	34.7	10.6
Trademarks	32.8	13.0	33.1	12.2
Other	23.8	14.8	24.3	12.2
	297.8	100.5	259.0	89.4
<b>Indefinite-Lived:</b>				
Trademarks	36.1		26.1	
<b>Total</b>	<b>\$ 333.9</b>	<b>\$ 100.5</b>	<b>\$ 285.1</b>	<b>\$ 89.4</b>

Amortization expense for the quarters ended June 30, 2012 and 2011, was \$6.1 million and \$4.9 million, respectively. Amortization expense for the six months ended June 30, 2012 and 2011, was \$11.5 million and \$8.9 million, respectively.

**6. Accrued Expenses**

June 30, 2012	December 31, 2011
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	(in millions)	
Salaries, wages and employee benefits	\$ 46.2	\$ 52.9
Interest	15.1	27.6
Other	39.5	39.0
	\$ 100.8	\$ 119.5

## 7. Related Party Transactions

The historical business operations of 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 Industries Inc ( Coltec ). The Company s subsidiaries exposure to asbestos litigation and their relationships with insurance carriers have been managed through another Coltec subsidiary, Garrison Litigation Management Group, Ltd. ( Garrison ). GST LLC, Anchor and Garrison are collectively referred to as GST.

On June 5, 2010, GST commenced an asbestos claims resolution process under Chapter 11 of the United States Bankruptcy Code. The resulting deconsolidation of GST from the Company s financial results, discussed more fully in Note 13, required certain intercompany indebtedness described below to be reflected on the Company s Consolidated Balance Sheets.

As of June 30, 2012 and December 31, 2011, Coltec Finance Company Ltd., a wholly-owned subsidiary of Coltec, had aggregate, short-term borrowings of \$9.8 million and \$9.9 million, respectively, from GST s subsidiaries in Mexico and Australia. The unsecured obligations were denominated in the currency of the lending party, and bear interest based on the applicable one-month interbank offered rate for each foreign currency involved.

Effective as of January 1, 2010, Coltec entered into a \$73.4 million Amended and Restated Promissory Note due January 1, 2017 (the Coltec Note ) in favor of GST LLC, and the Company s subsidiary Stemco LP entered into a \$153.8 million Amended and Restated Promissory Note due January 1, 2017, in favor of GST LLC (the Stemco Note , and together with the Coltec Note, the Intercompany Notes ). The Intercompany Notes refinanced intercompany notes issued in 2005.

The Intercompany Notes bear interest at 11% per annum, of which 6.5% is payable in cash and 4.5% is added to the principal amount of the Intercompany Notes as payment-in-kind ( PIK ) interest, with interest due on January 31 of each year. In 2012 and 2011, \$10.7 million and \$10.2 million, respectively, of the PIK interest were added to the principal balance of the Intercompany Notes. If GST LLC is unable to pay ordinary course operating expenses, under certain conditions, GST LLC can require Coltec and Stemco to pay in cash the accrued PIK interest necessary to meet such ordinary course operating expenses, subject to certain restrictions described more fully in the Company s most recent Form 10-K.

The Coltec Note is secured by Coltec s pledge of certain of its equity ownership in specified U.S. subsidiaries. The Stemco Note is guaranteed by Coltec and secured by Coltec s pledge of its interest in Stemco. The Intercompany Notes are subordinated to any obligations under the Company s senior secured revolving credit facility described in Note 8.

Interest expense related to the Intercompany Notes of \$6.9 million and \$6.7 million was reflected in interest expense for the quarters ended June 30, 2012 and 2011, respectively. Interest expense related to the Intercompany Notes of \$13.8 million and \$13.3 million was reflected in interest expense for the six months ended June 30, 2012 and 2011, respectively. Accrued interest of \$13.6 million and \$26.1 million was included in accrued expenses at June 30, 2012 and December 31, 2011, respectively.

The Company regularly transacts business with GST. Sales to GST totaling \$7.5 million and \$7.3 million were reflected in net sales and purchases from GST totaling \$5.2 million and \$6.0 million were reflected in cost of sales for the quarters ended June 30, 2012 and 2011, respectively. Sales to GST

totaling \$12.1 million and \$13.1 million were reflected in net sales and purchases from GST totaling \$9.9 million and \$11.2 million were reflected in cost of sales for the six months ended June 30, 2012 and 2011, respectively. The Company also provides services for GST including information technology, supply chain, treasury, tax administration, legal, and human resources under a support services agreement. Amounts due from GST totaling \$13.3 million and \$18.5 million resulting from the purchase of goods and services from the Company were included in accounts receivable at June 30, 2012 and December 31, 2011, respectively. Amounts due to GST totaling \$6.0 million and \$4.9 million resulting from the Company's purchase of goods from GST were included in accounts payable as of June 30, 2012 and December 31, 2011, respectively. Amounts due from GST totaling \$2.3 million for taxes paid on their behalf were included in other current assets at June 30, 2012 and December 31, 2011. Amounts due from GST totaling \$27.2 million and \$21.8 million for taxes paid on their behalf were included in other noncurrent assets at June 30, 2012 and December 31, 2011, respectively.

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 \$20.6 million as of June 30, 2012. These related party contracts were eliminated in consolidation prior to the deconsolidation of GST.

## **8. Long-Term Debt**

### ***Debentures***

The Company has \$172.5 million outstanding in aggregate principal amount of Debentures, originally recorded net of a discount of \$61.3 million. The Debentures bear interest at the annual rate of 3.9375%, with interest due on April 15 and October 15 of each year, and 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 rank equal in priority with all unsecured and unsubordinated indebtedness and senior in right of payment to all subordinated indebtedness. They 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 described more fully in the Company's most recent Form 10-K. None of the conditions that permit conversion were satisfied as of June 30, 2012.

The debt discount, \$27.0 million and \$30.4 million as of June 30, 2012 and December 31, 2011, respectively, is being amortized through interest expense until the maturity date of October 15, 2015, resulting in an effective interest rate of approximately 9.5%. Interest expense related to the Debentures for the quarters ended June 30, 2012 and 2011 includes \$1.7 million of contractual interest coupon in both periods and \$1.7 million and \$1.6 million, respectively, of debt discount amortization. Interest expense related to the Debentures for the six months ended June 30, 2012 and 2011 includes \$3.4 million of contractual interest coupon in both periods and \$3.4 million and \$3.1 million, respectively, of debt discount amortization.

### ***Credit Facility***

The Company's primary U.S. operating subsidiaries, other than GST LLC, have a senior secured revolving credit facility with a maximum availability of \$175 million. Actual borrowing availability under the credit facility is determined by reference to a borrowing base of specified percentages of eligible accounts receivable, inventory, equipment and real property elected to be pledged, and is reduced by usage of the facility, including outstanding letters of credit, and any reserves. Under certain conditions, the Company may request an increase to the facility maximum availability to \$225 million in



total. Any increase is dependent on obtaining future lender commitments for those amounts, and no current lender has any obligation to provide such commitment. The credit facility matures on July 17, 2015 unless, prior to that date, the Debentures are paid in full, refinanced on certain terms or defeased, in which case the facility will mature on March 30, 2016. The terms of the facility, including fees and customary covenants and restrictions, are described more fully in the Company's most recent Form 10-K.

The borrowing availability at June 30, 2012, under the Company's senior secured revolving credit facility was \$42.2 million after giving consideration to \$4.1 million of letters of credit outstanding and \$99.4 million of revolver borrowings.

### 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 six months ended June 30, 2012 and 2011, are as follows:

	Quarters Ended June 30,			
	Pension Benefits		Other Benefits	
	2012	2011	2012	2011
	(in millions)			
Service cost	\$ 1.1	\$ 0.9	\$ 0.2	\$ 0.2
Interest cost	2.6	2.0	0.1	0.1
Expected return on plan assets	(2.3)	(1.4)		
Amortization of prior service cost	0.1			
Net loss component	2.3	0.8		
Deconsolidation of GST	(0.5)	(0.3)		
	\$ 3.3	\$ 2.0	\$ 0.3	\$ 0.3

	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2012	2011	2012	2011
	(in millions)			
Service cost	\$ 2.3	\$ 2.2	\$ 0.4	\$ 0.4
Interest cost	5.1	4.8	0.2	0.2
Expected return on plan assets	(4.5)	(3.4)		
Amortization of prior service cost	0.2			
Net loss component	4.5	2.0		
Deconsolidation of GST	(1.1)	(0.8)		
	\$ 6.5	\$ 4.8	\$ 0.6	\$ 0.6

The Company estimates it will be required to contribute \$13.4 million to its U.S. defined benefit pension plans and approximately \$0.4 million to its foreign pension plans in 2012.

### 10. 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 and GST as described in Note 7. The Company uses multiple financial institutions for derivative contracts to minimize the concentration of credit risk. The current accounting rules require derivative instruments, excluding certain contracts that are issued and held by a reporting entity that are both indexed to its own stock and classified in shareholders' equity, be reported in the Consolidated Balance Sheets at fair value and 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 entered into contracts to hedge forecasted transactions denominated in foreign currencies occurring at various dates through June 2013. The notional amount of foreign exchange contracts hedging foreign currency transactions was \$112.3 million and \$125.5 million at June 30, 2012 and December 31, 2011, respectively. At June 30, 2012, foreign exchange contracts with notional amounts totaling \$49.7 million were accounted for as cash flow hedges. As cash flow hedges, the effective portion of the gain or loss on the contracts was reported in accumulated other comprehensive loss and the ineffective portion was reported in income. Amounts in accumulated other comprehensive loss are reclassified into income, primarily cost of sales, in the period the hedged transactions affect earnings. The balances of derivative assets are generally recorded in other current assets and the balances of derivative liabilities are generally recorded in accrued expenses in the Consolidated Balance Sheets. The remaining notional amounts of \$62.6 million of foreign exchange contracts, most of which have a maturity date of a month or less, were recorded at their fair market value with changes in market value recorded in income.

#### **11. Business Segment Information**

The Company has three reportable segments. The Sealing Products segment manufactures and sells sealing products, including metallic, non-metallic and composite material gaskets; dynamic seals; compression packing; resilient metal seals; elastomeric seals; hydraulic components; expansion joints; heavy-duty truck wheel-end component systems, including brake products; flange sealing and isolation products; pipeline casing spacers/isolators; casing end seals; modular sealing systems for sealing pipeline penetrations; hole forming products; manhole infiltration sealing systems; safety-related signage for pipelines; bellows and bellows assemblies; pedestals for semiconductor manufacturing; polytetrafluoroethylene (PTFE) products; conveyor belting; and sheeted rubber products.

The Engineered Products segment manufactures self-lubricating, non-rolling bearing products, aluminum blocks for hydraulic applications, and precision engineered components and lubrication systems for reciprocating compressors.

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, gains and losses related to the sale of assets, impairments, 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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Segment operating results and other financial data for the quarters and six months ended June 30, 2012 and 2011, were as follows:

	Quarters Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
	(in millions)			
<b>Sales</b>				
Sealing Products	\$ 165.1	\$ 135.6	\$ 314.6	\$ 251.3
Engineered Products	95.1	102.1	195.7	196.4
Engine Products and Services	42.1	26.5	104.1	86.7
	302.3	264.2	614.4	534.4
Intersegment sales	(0.6)	(0.5)	(1.2)	(1.1)
<b>Total sales</b>	<b>\$ 301.7</b>	<b>\$ 263.7</b>	<b>\$ 613.2</b>	<b>\$ 533.3</b>
<b>Segment Profit</b>				
Sealing Products	\$ 22.8	\$ 24.2	\$ 45.3	\$ 43.8
Engineered Products	6.8	9.6	15.8	19.7
Engine Products and Services	7.8	5.6	19.6	16.8
<b>Total segment profit</b>	<b>37.4</b>	<b>39.4</b>	<b>80.7</b>	<b>80.3</b>
Corporate expenses	(9.1)	(10.0)	(18.2)	(17.9)
Interest expense, net	(10.8)	(9.6)	(21.4)	(19.1)
Other expense	(2.4)	(1.5)	(4.4)	(3.1)
<b>Income before income taxes</b>	<b>\$ 15.1</b>	<b>\$ 18.3</b>	<b>\$ 36.7</b>	<b>\$ 40.2</b>

Segment assets are as follows:

	June 30, 2012	December 31, 2011
Sealing Products	\$ 555.4	\$ 474.8
Engineered Products	328.7	324.3
Engine Products and Services	126.7	99.1
Corporate	354.0	353.9
	\$ 1,364.8	\$ 1,252.1

## 12. Fair Value Measurements

The Company utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.

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Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.  
Assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	Fair Value Measurements as of			
	Total	June 30, 2012		Level 3
Level 1		Level 2	Level 3	
(in millions)				
<b>Assets</b>				
Cash equivalents:				
European government money market	\$ 9.7	\$ 9.7	\$	\$
Time deposits	6.6	6.6		
	16.3	16.3		
Guaranteed investment contract	2.5		2.5	
Foreign currency derivatives	1.0		1.0	
Deferred compensation assets	4.1	4.1		
	\$ 23.9	\$ 20.4	\$ 3.5	\$
<b>Liabilities</b>				
Deferred compensation liabilities	\$ 6.1	\$ 6.1	\$	\$
Foreign currency derivatives	0.7		0.7	
	\$ 6.8	\$ 6.1	\$ 0.7	\$

	Fair Value Measurements as of			
	Total	December 31, 2011		Level 3
Level 1		Level 2	Level 3	
(in millions)				
<b>Assets</b>				
Cash equivalents:				
European government money market	\$ 13.0	\$ 13.0	\$	\$
	13.0	13.0		
Guaranteed investment contract	2.5		2.5	
Foreign currency derivatives	1.2		1.2	
Deferred compensation assets	3.3	3.3		
	\$ 20.0	\$ 16.3	\$ 3.7	\$
<b>Liabilities</b>				
Deferred compensation liabilities	\$ 5.2	\$ 5.2	\$	\$
Foreign currency derivatives	2.1		2.1	
	\$ 7.3	\$ 5.2	\$ 2.1	\$

The Company's cash equivalents and deferred compensation assets and liabilities are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The fair value for the guaranteed investment contract is based on quoted market prices for outstanding bonds of the insurance company issuing the contract. The fair values for foreign currency derivatives are based on quoted market prices from various banks for similar instruments.

The carrying values of the Company's significant financial instruments reflected in the Consolidated Balance Sheets approximate their respective fair values at June 30, 2012 and December 31, 2011, except for the following instruments:



	June 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt	\$ 248.4	\$ 321.0	\$ 150.2	\$ 217.4
Notes payable to GST	248.1	259.0	237.4	239.8
	\$ 496.5	\$ 580.0	\$ 387.6	\$ 457.2

The fair values for long-term debt are based on quoted market prices, so this is considered a Level 1 computation. The computations related to the notes payable to GST are considered Level 2 since they are based on rates available to the Company for debt with similar terms and maturities.

The fair value of intangible assets associated with acquisitions was determined using a discounted cash flow analysis. Projecting discounted future cash flows required the Company to make significant estimates regarding future revenues and expenses, projected capital expenditures, changes in working capital and the appropriate discount rate. This non-recurring fair value measurement would be classified as Level 3 due to the absence of quoted market prices or observable inputs for assets of a similar nature.

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

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, which is ongoing. 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, which is expected to establish a trust to which all asbestos claims will be channeled for resolution. GST intends to seek an 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 were included in the Company's consolidated results through June 4, 2010, the day prior to the Petition Date. However, GAAP requires that an entity that files for protection under the U.S. Bankruptcy Code, whether solvent or insolvent, whose financial statements were previously consolidated with those of its parent, as GST and its subsidiaries were with EnPro, generally must be prospectively deconsolidated from the parent and the investment accounted for using the cost method. At deconsolidation, the Company's investment was recorded at its estimated fair value on June 4, 2010. The cost method requires the Company to present its ownership interests in the net assets of GST at the Petition Date as an investment and to not recognize any income or loss from GST and subsidiaries in the Company's results of operations during the reorganization period. This investment is subject to periodic reviews for impairment. When GST emerges from the jurisdiction of the Bankruptcy Court, the subsequent accounting will be determined based upon the applicable facts and circumstances at such time, including the terms of any plan of reorganization.

In November 2011, GST filed a proposed plan of reorganization with the Bankruptcy Court. The proposed plan calls for a trust to be formed, to which GST and affiliates would contribute \$200 million and which would be the exclusive remedy for future asbestos personal injury claimants whose claims arise after confirmation of the plan. The proposed plan provides that each present asbestos personal injury claim i.e. any pending claim or one that arises between the Petition Date and plan confirmation, will be assumed by reorganized GST and resolved either by settlement (pursuant to a matrix contained in the



proposed plan or as otherwise agreed), or by payment in full of any final judgment entered after trial in federal court. Based on a preliminary estimate provided prior to the time that GST filed its proposed plan by Bates White, the estimation expert retained by counsel to GST, GST estimates that the indemnity costs to resolve all present claims pursuant to the settlement matrix in the plan would cost reorganized GST approximately \$70 million. Under the proposed plan, all non-asbestos claimants would be paid the full value of their claims.

GST's proposed plan is opposed by the Official Committee of Asbestos Personal Injury Claimants (the Claimants Committee) and Future Claimants Representative (the FCR) and is unlikely to be approved in its current form. The Claimants Committee and FCR have announced their intention to file a competing proposed plan of reorganization.

On April 13, 2012, the Bankruptcy Court granted a motion by GST for the Bankruptcy Court to estimate the allowed amount of present and future asbestos claims against GST for mesothelioma, a rare cancer attributed to asbestos exposure, for purposes of determining the feasibility of a potential proposed plan of reorganization. The estimation trial is scheduled to occur in the second quarter of 2013.

From the Petition Date through June 30, 2012, GST has recorded reorganization costs, including fees and expenses, in the Chapter 11 case totaling \$39.6 million. The total includes \$19.2 million for fees and expenses of GST's counsel and experts; \$16.5 million for fees and expenses of counsel and experts for the asbestos claimants committee, and \$3.9 million for the fees and expenses of the future claims representative and his counsel and experts. GST recorded \$15.4 million of those case-related fees and expenses in the first half of 2012 and \$8.1 million in the second quarter of 2012, compared to \$7.6 million and \$4.0 million, respectively, in the first half and second quarter of 2011.

### Financial Results

Condensed combined financial information for GST is set forth below, presented on a historical cost basis.

#### GST

#### (Debtor-in-Possession)

#### Condensed Combined Statements of Comprehensive Income (Unaudited)

(in millions)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net sales	\$ 62.0	\$ 61.2	\$ 124.4	\$ 118.9
Cost of sales	36.1	36.7	74.0	71.9
Gross profit	25.9	24.5	50.4	47.0
Operating expenses:				
Selling, general and administrative expenses	11.8	11.0	23.9	22.8
Asbestos-related	0.7	0.7	(2.4)	1.4
Other operating expense	0.7		1.3	
	13.2	11.7	22.8	24.2
Operating income	12.7	12.8	27.6	22.8
Interest income, net	6.9	6.8	13.8	13.4
Income before reorganization expenses and income taxes	19.6	19.6	41.4	36.2
Reorganization expenses	(8.1)	(4.0)	(15.4)	(7.6)

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Income before income taxes	11.5	15.6	26.0	28.6
Income tax expense	(3.7)	(5.2)	(9.2)	(10.4)
Net income	\$ 7.8	\$ 10.4	\$ 16.8	\$ 18.2
Comprehensive income	\$ 6.1	\$ 10.6	\$ 17.1	\$ 19.6

**GST**

**(Debtor-in-Possession)**

**Condensed Combined Statements of Cash Flows (Unaudited)**

**Six Months Ended June 30, 2012 and 2011**

**(in millions)**

	<b>2012</b>	<b>2011</b>
Net cash provided by operating activities	\$ 13.4	\$ 17.3
Investing activities:		
Purchases of property, plant and equipment	(3.4)	(1.6)
Net receipts from loans to affiliates	0.3	12.1
Other	1.4	0.3
Net cash provided by (used in) investing activities	(1.7)	10.8
Effect of exchange rate changes on cash and cash equivalents	(0.2)	0.3
Net increase in cash and cash equivalents	11.5	28.4
Cash and cash equivalents at beginning of period	126.3	87.1
Cash and cash equivalents at end of period	\$ 137.8	\$ 115.5

**GST**

**(Debtor-in-Possession)**

**Condensed Combined Balance Sheets (Unaudited)**

**(in millions)**

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
<u>Assets:</u>		
Current assets	\$ 249.6	\$ 237.0
Asbestos insurance receivable	123.6	142.3
Deferred income taxes	127.1	131.0
Notes receivable from affiliate	237.4	227.2
Other assets	73.2	74.1
Total assets	\$ 810.9	\$ 811.6
<u>Liabilities and Shareholder's Equity:</u>		
Current liabilities	\$ 68.1	\$ 65.9
Other liabilities	7.9	27.6
Liabilities subject to compromise (A)	468.4	469.2

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Total liabilities	544.4	562.7
Shareholder's equity	266.5	248.9
Total liabilities and shareholder's equity	\$ 810.9	\$ 811.6

- (A) Liabilities subject to compromise include pre-petition unsecured claims which may be resolved at amounts different from those recorded in the condensed combined balance sheets. Liabilities subject to compromise consist principally of asbestos-related claims. GST has undertaken to project the number and ultimate cost of all present and future bodily injury claims expected to be asserted, based on actuarial principles, and to measure probable and estimable liabilities under generally accepted accounting principles. GST has accrued \$466.8 million as of June 30, 2012. The estimate indicated for those asbestos-related claims reflects the point in a wide range of possible outcomes determined based on historical facts and circumstances prior to the Petition Date as the Company's estimate of the cost to resolve asbestos-related personal injury cases and claims against GST as they would have been resolved in the state courts or by settlements over a ten-year period from April 1, 2010 through March 31, 2020. GST adjusts this estimate to reflect payments of previously accrued but unpaid legal fees and to reflect the results of appeals. Otherwise, GST does not expect to adjust the estimate unless developments in the Chapter 11 proceeding provide a

reasonable basis for a revised estimate. GST intends to use the claims resolution process in Chapter 11 to determine the validity and ultimate amount of its aggregate liability for asbestos-related claims. Due to the uncertainties of asbestos-related litigation and the Chapter 11 process, GST's ultimate liability could differ materially from the recorded liability. See Note 14, Commitments and Contingencies Asbestos.

#### **14. Commitments and Contingencies**

##### ***General***

A description of environmental, asbestos and other legal matters against certain of the Company's subsidiaries is included in this section in more detail. In addition to the matters noted herein, the Company is from time to time subject to, and is presently involved in, other litigation and legal proceedings arising in the ordinary course of business. While the outcome of litigation is by its nature uncertain, the Company believes that the outcome of such other litigation and legal proceedings will not have a material adverse affect on its financial condition, results of operations and cash flows. Expenses for legal and administrative proceedings are recorded when incurred.

##### ***Environmental***

The Company's facilities and operations are subject to federal, state and local environmental and occupational health and safety requirements of the U.S. and foreign countries. The Company takes a proactive approach in its efforts to comply with environmental, health and safety laws as they relate to its manufacturing operations and in proposing and implementing any remedial plans that may be necessary. The Company also conducts comprehensive compliance and management system audits at its facilities to maintain compliance and improve operational efficiency.

Although the Company believes past operations were in substantial compliance with the then applicable regulations, the Company or one of its subsidiaries has been named as a potentially responsible party or is otherwise involved at 16 sites at each of which the costs to the Company or its subsidiary are expected to exceed \$100 thousand. Investigations have been completed for 13 sites and are in progress at the other three sites. The majority of these sites relate to remediation projects at former operating facilities that were sold or closed and primarily deal with soil and groundwater contamination. The laws governing investigation and remediation of these sites can impose joint and several liability for the associated costs. Liability for these costs can be imposed on present and former owners or operators of the properties or on parties that generated the wastes that contributed to the contamination.

The Company's policy is to accrue environmental investigation and remediation costs when it is probable that a liability has been incurred and the amount can be reasonably estimated. The measurement of the liability is based on an evaluation of currently available facts with respect to each individual situation and takes into consideration factors such as existing technology, presently enacted laws and regulations and prior experience in remediation of contaminated sites. Liabilities are established for all sites based on these factors. As assessments and remediation progress at individual sites, these liabilities are reviewed periodically and adjusted to reflect additional technical data and legal information. As of June 30, 2012 and December 31, 2011, EnPro had accrued liabilities of \$12.1 million and \$12.6 million, respectively, for estimated future expenditures relating to environmental contingencies. These amounts have been recorded on an undiscounted basis in the Consolidated Financial Statements.

The Company believes that its accruals for environmental liabilities are adequate based on currently available information. Actual costs to be incurred for identified situations in future periods may vary from estimates because of the inherent uncertainties in evaluating environmental exposures due to unknown and changing conditions, changing government regulations and legal standards regarding liability.

See the section entitled *Crucible Materials Corporation* in this footnote for additional information.

***Colt Firearms and Central Moloney***

The Company has contingent liabilities related to divested businesses for which certain of its subsidiaries retained liability or are obligated under indemnity agreements. These contingent liabilities include, but are not limited to, potential product liability and associated claims related to firearms manufactured prior to 1990 by Colt Firearms, a former operation of Coltec, and for electrical transformers manufactured prior to 1994 by Central Moloney, another former Coltec operation. The Company believes that the reasonably possible range of loss on these contingent liabilities will not be material to its financial condition or results of operations, either individually or in the aggregate. The Company also has ongoing obligations, which are included in other liabilities in the Consolidated Balance Sheets, with regard to workers' compensation, retiree medical and other retiree benefit matters that relate to the Company's periods of ownership of these operations.

***Crucible Materials Corporation***

Crucible, which was engaged primarily in the manufacture and distribution of high technology specialty metal products, was a wholly owned subsidiary of Coltec until 1985 when a majority of the outstanding shares were sold. Coltec divested its remaining minority interest in 2004. Crucible filed for Chapter 11 bankruptcy protection in May 2009 and is no longer conducting operations.

In conjunction with the closure of a Crucible plant in the early 1980s, Coltec was required to fund a trust for retiree medical benefits for certain employees at the plant. This trust (the *Benefits Trust*) pays for these retiree medical benefits on an ongoing basis. Coltec has no ownership interest in the Benefits Trust, and thus the assets and liabilities of this trust are not included in the Company's Consolidated Balance Sheets. Under the terms of the Benefits Trust agreement, the trustees retained an actuary to assess the adequacy of the assets in the Benefits Trust in 1995 and 2005. A third and final actuarial report will be required in 2015. The actuarial reports in 1995 and 2005 determined that the Benefits Trust has sufficient assets to fund the payment of future benefits. The Company owns a guaranteed investment contract with a current value of \$2.5 million, which is being held in a special account in case of a shortfall in the Benefits Trust.

The Company also has certain ongoing obligations, which are included in other liabilities in the Consolidated Balance Sheets, including workers' compensation, retiree medical and other retiree benefit matters, in addition to those mentioned previously, related to the Company's period of ownership of Crucible. Based on the Company's prior ownership of Crucible, the Company may have certain additional contingent liabilities, including liabilities as a potentially responsible party in one or more significant environmental matters. The Company is investigating these matters. Except with respect to those matters for which the Company has an accrued liability as discussed in *Environmental* above, the Company is unable to estimate a reasonably possible range of loss related to these contingent liabilities.

***Warranties***

The Company provides warranties on many of its products. The specific terms and conditions of these warranties vary depending on the product and the market in which the product is sold. The Company records a liability based upon estimates of the costs it may incur under its warranties after a review of historical warranty experience and information about specific warranty claims. Adjustments are made to the liability as claims data and historical experience warrant.

Changes in the carrying amount of the product warranty liability for the six-months ended June 30, 2012 and 2011 are as follows:

	2012	2011
	(in millions)	
Balance at beginning of year	\$ 3.5	\$ 3.5
Charges to expense	0.6	1.4
Settlements made (primarily payments)	(1.0)	(1.8)
Balance at end of period	\$ 3.1	\$ 3.1

### *Asbestos*

**Background on Asbestos-Related Litigation.** The historical business operations of GST LLC and Anchor resulted in a substantial volume of asbestos litigation in which plaintiffs alleged that exposure to asbestos fibers in products produced or sold by GST LLC or Anchor, together with products produced and sold by numerous other companies, contributed to the bodily injuries or deaths of such plaintiffs. GST LLC and Anchor manufactured and/or sold industrial sealing products that contained encapsulated asbestos fibers. Other subsidiaries of the company that manufactured or sold equipment that may have at various times in the past contained asbestos-containing components have also been named in a number of asbestos lawsuits, but neither the Company nor any of its subsidiaries other than GST LLC and Anchor has ever paid an asbestos claim.

Since the first asbestos-related lawsuits were filed against GST LLC in 1975, GST LLC and Anchor have processed more than 900,000 claims to conclusion, and, together with insurers, have paid over \$1.4 billion in settlements and judgments and over \$400 million in fees and expenses. The Company's subsidiaries' exposure to asbestos litigation and their relationships with insurance carriers have been managed through Garrison.

**Subsidiary Chapter 11 Filing and Effect.** On the Petition Date, GST LLC, Garrison and Anchor filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the Bankruptcy Court. The filings were the initial step in a claims resolution process. See Note 13 for additional information about this process and its impact on the Company.

During the pendency of the Chapter 11 proceedings, certain actions proposed to be taken by GST not in the ordinary course of business will be subject to approval by the Bankruptcy Court. As a result, during the pendency of these proceedings, the Company will not have exclusive control over these companies. Accordingly, as required by GAAP, GST was deconsolidated beginning on the Petition Date.

As a result of the initiation of the Chapter 11 proceedings, the resolution of asbestos claims is subject to the jurisdiction of the Bankruptcy Court. The filing of the Chapter 11 cases automatically stayed the prosecution of pending asbestos bodily injury and wrongful death lawsuits, and initiation of new such lawsuits, against GST. Further, the Bankruptcy Court issued an order enjoining plaintiffs from bringing or further prosecuting asbestos products liability actions against affiliates of GST, including EnPro, Coltec and all their subsidiaries, during the pendency of the Chapter 11 proceedings, subject to further order. As a result, the numbers of new claims filed against the Company's subsidiaries and, except as a result of the resolution of appeals from verdicts rendered prior to the Petition Date, the numbers of claims pending against them have not changed since the Petition Date, and those numbers continue to be as reported in the Company's 2009 Form 10-K and its quarterly reports for the first and second quarters of 2010.

**Pending Claims.** On the Petition Date, according to Garrison, there were more than 90,000 total claims pending against GST LLC, and approximately 5,800 claims alleging the disease mesothelioma. Mesothelioma is a rare cancer of the protective lining of many of the body's internal organs, principally the lungs. The primary cause of mesothelioma is believed to be exposure to asbestos. As a result of asbestos tort reform during the 2000s, most active asbestos-related lawsuits, and a large majority of the

amount of payments made by the Company's subsidiaries, have been as a result of claims alleging mesothelioma. In total, GST LLC has paid \$563.2 million to resolve a total of 15,300 mesothelioma claims, and another 5,700 mesothelioma claims have been dismissed without payment.

In order to estimate the allowed amount for mesothelioma claims against GST, the Bankruptcy Court approved a process whereby all current GST LLC mesothelioma claimants were required to respond to a questionnaire about their claims. Questionnaires were distributed to the mesothelioma claimants identified in Garrison's claims database. Many of the 5,800 claimants (over 700) have not responded to the questionnaire at all, many others (more than 1,700) have acknowledged that they do not have mesothelioma, or that they cannot establish exposure to GST products, or that their claims were dismissed, settled or withdrawn. Still others have responded to the questionnaire but their responses are deficient in some material respect. As a result of this process, GST LLC and Garrison believe that less than 3,500 claimants now assert that they had mesothelioma claims against GST LLC as of the Petition Date.

Since the Petition Date, many asbestos-related lawsuits have been filed by claimants against other companies in state and federal courts, and many of those claimants might also have included GST LLC as a defendant but for the bankruptcy injunction. Many of those claimants likely will make claims against GST in the bankruptcy proceeding.

Product Defenses. The Company has consistently asserted that the asbestos-containing products manufactured or sold by GST could not have been a substantial contributing cause of any asbestos-related disease. The asbestos in the products was encapsulated, which means the asbestos fibers incorporated into the products during the manufacturing process were sealed in binders. The products were also nonfriable, which means they could not be crumbled by hand pressure. The U.S. Occupational Safety and Health Administration, which began generally requiring warnings on asbestos-containing products in 1972, has never required that a warning be placed on products such as GST LLC's gaskets. Even though no warning label was required, GST LLC included one on all of its asbestos-containing products beginning in 1978. Further, gaskets such as those previously manufactured and sold by GST LLC are one of the few asbestos-containing products still permitted to be manufactured under regulations of the U.S. Environmental Protection Agency. Nevertheless, GST LLC discontinued all manufacture and distribution of asbestos-containing products in the U.S. during 2000 and worldwide in mid-2001.

Appeals. GST LLC has had a record of success in trials of asbestos cases, especially before the bankruptcies of many of the historically significant asbestos defendants, those who manufactured raw asbestos, asbestos insulation, refractory products or other dangerous friable asbestos products. However, it has on occasion lost jury verdicts at trial. GST has consistently appealed when it has received an adverse verdict and has enjoyed success in a majority of those appeals. The Company believes that GST LLC will continue to be successful in the appellate process, although there can be no assurance of success in any particular appeal. GST LLC won reversals of adverse verdicts in one of two recent appellate decisions. In September 2011, the United States Court of Appeals for the Sixth Circuit overturned a \$500 thousand verdict against GST LLC that was handed down in 2009 by a Kentucky federal court jury. The federal appellate court found that GST LLC's motion for judgment as a matter of law should have been granted because the evidence was not sufficient to support a determination of liability. The Sixth Circuit's chief judge wrote that, "On the basis of this record, saying that exposure to Garlock gaskets was a substantial cause of [claimant's] mesothelioma would be akin to saying that one who pours a bucket of water into the ocean has substantially contributed to the ocean's volume." In May 2011, a three-judge panel of the Kentucky Court of Appeals upheld GST LLC's \$700 thousand share of a jury verdict, which included punitive damages, in a lung cancer case against GST LLC in Kentucky state court. This verdict, which was secured by a bond pending the appeal, was paid in June 2012. At June 30, 2012, three additional GST LLC appeals are pending from adverse decisions totaling \$2.4 million.



**Insurance Coverage.** At June 30, 2012, the Company had \$147.3 million of insurance coverage the Company believes is available to cover current and future asbestos claims payments and certain expense payments. GST has collected insurance payments totaling \$47.3 million since the Petition Date, including \$10 million collected in the second quarter of 2012. Of the \$147.3 million of available insurance coverage remaining, the Company considers \$144.6 million (98%) to be of high quality because the insurance policies are written or guaranteed by U.S.-based carriers whose credit rating by S&P is investment grade (BBB-) or better, and whose AM Best rating is excellent (A-) or better. The Company considers \$2.7 million (2%) to be of moderate quality because the insurance policies are written with various London market carriers. Of the \$147.3 million, \$111.3 million is allocated to claims that were paid by GST LLC prior to the initiation of the Chapter 11 proceedings and submitted to insurance companies for reimbursement, and the remainder is allocated to pending and estimated future claims. There are specific agreements in place with carriers covering \$109.6 million of the remaining available coverage. Based on those agreements and the terms of the policies in place and prior decisions concerning coverage, the Company is of the view that substantially all of the \$147.3 million of insurance proceeds will ultimately be collected, although there can be no assurance that the insurance companies will make the payments as and when due. The \$147.3 million is in addition to the \$14.6 million collected in the first half of 2012. Based on those agreements and policies, some of which define specific annual amounts to be paid and others of which limit the amount that can be recovered in any one year, the Company anticipates that \$36.9 million will become collectible at the conclusion of GST's Chapter 11 proceeding and that the following amounts will be collected in the years set out regardless of when the case concludes:

2012	\$5.7 million (in the second half of the year)
2013	\$22.7 million
2014	\$20 million
2015	\$20 million
2016	\$18 million
2017	\$13 million
2018	\$11 million.

In addition, GST LLC has received \$6.7 million of insurance recoveries from insolvent carriers since 2007 (including \$3.9 million in the first six months of 2012) and may receive additional payments from insolvent carriers in the future. No anticipated insolvent carrier collections are included in the \$147.3 million of anticipated collections. The insurance available to cover current and future asbestos claims is from comprehensive general liability policies that cover Coltec and certain of its other subsidiaries in addition to GST LLC for periods prior to 1985 and therefore could be subject to potential competing claims of other covered subsidiaries and their assignees.

**Liability Estimate.** The Company's recorded asbestos liability as of the Petition Date was \$472.1 million. The Company based that recorded liability on an estimate of probable and estimable asbestos personal injury claims under generally accepted accounting principles, made by the Company, with the assistance of Garrison and an estimation expert, Bates White, retained by GST LLC's counsel. The estimate was an estimate of the most likely point in a broad range of potential amounts that GST LLC might have to pay to resolve asbestos claims (by settlement in the majority of the cases except those dismissed or tried) over the following ten-year period in the state court system, plus accrued but unpaid legal fees. The estimate, which was not discounted to present value, did not reflect GST LLC's views of its actual legal liability; GST LLC has continuously maintained that its products could not have been a substantial contributing cause of any asbestos disease. Instead, the liability estimate reflected GST LLC's recognition of the fact that most claims would be resolved more efficiently and at a significantly lower cost through settlements without any actual liability determination.

Neither the Company nor GST has endeavored to update the estimate since the Petition Date except as necessary to reflect payments of accrued fees and the disposition of cases on appeal. As a result of those necessary updates, the liability estimate at June 30, 2012 was \$466.8 million. In each asbestos-driven Chapter 11 case that has been resolved previously, the amount of the debtor's

liability has been determined as part of a consensual plan of reorganization agreed to by the debtor and its creditors, including asbestos claimants and a representative of potential future claimants. GST does not believe that there is a reliable process by which an estimate of such a resolution can be made and therefore believes that there is no basis upon which it can revise the estimate last updated prior to the Petition Date.

In a proposed plan of reorganization filed by GST and opposed by claimant representatives, GST has proposed to resolve all pending and future claims. GST has estimated that the amounts to be paid into the Trust created by the plan for payments to future claimants plus the indemnity costs incurred under the plan to pay present claimants would be approximately \$270 million. Claimant representatives, on the other hand, have asserted that GST's liability exceeds the value of GST.

The Company has offered to fund \$30 million of the proposed settlement in order to resolve any and all derivative claims against it, and to guarantee the obligations of GST under the proposed plan. That offer is incorporated into the terms of the proposed plan and is only offered in the context of that plan, which would result in the equity interests of GST being retained by GST's equity holder and the reconsolidation of GST into the Company, and an injunction protecting the Company from future GST claims.

The Company cannot predict when a plan of reorganization for GST LLC might be approved and effective; however, an estimation trial for the purpose of determining the number and value of allowed mesothelioma claims for plan feasibility purposes has been tentatively scheduled for April 2013. The Company believes that GST will present compelling defenses at the estimation trial that, among other things, GST's products could not have been a substantial contributing cause of any asbestos-related disease and that therefore the amounts that will be paid under its proposed plan would be far more than sufficient to fully fund its actual legal liability. There are many potential hurdles to plan confirmation, including appeals, that could arise during and after the estimation trial.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following is management's discussion and analysis of certain significant factors that have affected our financial condition, cash flows and operating results during the periods included in the accompanying unaudited consolidated financial statements and the related notes. You should read this in conjunction with those financial statements and the audited consolidated financial statements and related notes included in our annual report on Form 10-K for the fiscal year ended December 31, 2011.*

### **Forward-Looking Information**

This quarterly report on Form 10-Q includes statements that reflect projections or expectations of the future financial condition, results of operations and business of EnPro that are subject to risk and uncertainty. We believe those statements to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this report, the words may, hope, will, should, expect, plan, anticipate, intend, believe, estimate, predict, potential, continue, likely, generally identify forward-looking statements.

We cannot guarantee actual results or events will not differ materially from those projected, estimated, assigned or anticipated in any of the forward-looking statements contained in this report. In addition to those factors specifically noted in the forward-looking statements and those identified in the Company's annual report on Form 10-K for the year ended December 31, 2011, other important factors that could result in those differences include:

the value of pending claims and the number and value of future asbestos claims against our subsidiaries;

risks inherent and potential adverse developments that may occur in the Chapter 11 reorganization proceeding involving Garlock Sealing Technologies LLC ( GST LLC ), The

Anchor Packing Company ( Anchor ) and Garrison Litigation Management Group, Ltd. ( Garrison ), including risks presented by efforts of asbestos claimant representatives to assert claims against us based on various theories of derivative corporate responsibility, including veil piercing and alter ego;

general economic conditions in the markets served by our businesses, some of which are cyclical and experience periodic downturns;

prices and availability of raw materials; and

the amount of any payments required to satisfy contingent liabilities related to discontinued operations of our predecessors, including liabilities for certain products, environmental matters, guaranteed debt payments, employee benefit obligations and other matters.

We caution our shareholders not to place undue reliance on these statements, which speak only as of the date on which such statements were made.

Whenever you read or hear any subsequent written or oral forward-looking statements attributed to us or any person acting on our behalf, you should keep in mind the cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

## **Overview and Outlook**

Overview. We are a leader in the design, development, manufacturing and marketing of proprietary engineered industrial products. We have 59 primary manufacturing facilities located in 11 countries, including the United States.

We manage our business as three segments: a Sealing Products segment, an Engineered Products segment, and an Engine Products and Services segment.

Our Sealing Products segment designs, manufactures and sells sealing products, including: metallic, non-metallic and composite material gaskets; dynamic seals; compression packing; resilient metal seals; elastomeric seals; hydraulic components; expansion joints; heavy-duty truck wheel-end component systems, including brake products; flange sealing and isolation products; pipeline casing spacers/isolators; casing end seals; modular sealing systems for sealing pipeline penetrations; hole forming products; manhole infiltration sealing systems; safety-related signage for pipelines; bellows and bellows assemblies; pedestals for semiconductor manufacturing; PTFE products; conveyor belting; and sheeted rubber products. These products are used in a variety of industries, including chemical and petrochemical processing, petroleum extraction and refining, pulp and paper processing, heavy-duty trucking, power generation, food and pharmaceutical processing, primary metal manufacturing, mining, water and waste treatment, aerospace, medical, filtration and semiconductor fabrication. In many of these industries, performance and durability are vital for safety and environmental protection. Many of our products are used in highly demanding applications, e.g., where extreme temperatures, extreme pressures, corrosive environments, strict tolerances, and/or worn equipment make product performance difficult.

Our Engineered Products segment includes operations that design, manufacture and sell self-lubricating, non-rolling, metal-polymer, solid polymer and filament wound bearing products, aluminum blocks for hydraulic applications, and precision engineered components and lubrication systems for reciprocating compressors. These products are used in a wide range of applications, including the

automotive, pharmaceutical, pulp and paper, natural gas, health, power generation, machine tools, air treatment, refining, petrochemical and general industrial markets.

Our Engine Products and Services segment designs, manufactures, sells and services heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines. The United States government and the general markets for marine propulsion, power generation, and pump and compressor applications use these products and services.

The historical business operations of certain subsidiaries of the Company's subsidiary, Coltec Industries Inc ( Coltec ), principally GST LLC and 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. Information about GST LLC's asbestos litigation is contained in this Management's Discussion and Analysis of Financial Condition and Results of Operation in the Asbestos subsection of the Contingencies section and in Note 14 to our Consolidated Financial Statements.

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 ). GST LLC, Anchor and Garrison are sometimes referred to jointly as GST in this report. The filings were the initial step in a claims resolution process. GST LLC is one of the businesses in our broader Garlock group in our Sealing Products segment. GST LLC and its subsidiaries operate five primary manufacturing facilities, including operations in Palmyra, New York and Houston, Texas. The filings did not include EnPro Industries, Inc. or any other EnPro Industries, Inc. operating subsidiary.

GST LLC now operates in the ordinary course under court protection from asbestos claims. All pending litigation against GST is stayed during the process. We address our actions to permanently resolve GST LLC's asbestos litigation, and provide an update on its claims resolution process, in this Management's Discussion and Analysis of Financial Condition and Results of Operation in the Garlock Sealing Technologies LLC and Garrison Litigation Management Group, Ltd. and Contingencies Subsidiary Bankruptcy sections.

The financial results of GST and subsidiaries were included in our consolidated results through June 4, 2010, the day prior to the Petition Date. However, U.S. generally accepted accounting principles require an entity that files for protection under the U.S. Bankruptcy Code, whether solvent or insolvent, whose financial statements were previously consolidated with those of its parent, as GST's and its subsidiaries were with ours, generally must be prospectively deconsolidated from the parent and the investment accounted for using the cost method. At deconsolidation, our investment was recorded at its estimated fair value as of June 4, 2010, resulting in a gain for reporting purposes. The cost method requires us to present our ownership interests in the net assets of GST at the Petition Date as an investment and not recognize any income or loss from GST and subsidiaries in our results of operations during the reorganization period. Our investment of \$236.9 million as of June 30, 2012, is subject to periodic reviews for impairment. When GST emerges from the jurisdiction of the Bankruptcy Court, the subsequent accounting will be determined based upon the applicable facts and circumstances at such time, including the terms of any plan of reorganization. See Note 13 to our Consolidated Financial Statements for condensed financial information for GST and subsidiaries.

In April 2012, the Company acquired Motorwheel Commercial Vehicle Systems, Inc. ( Motorwheel ). Motorwheel is a leading U.S. manufacturer of lightweight brake drums for heavy-duty trucks and other com