ENPRO INDUSTRIES, INC
Form 10-Q
May 02, 2019

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-31225

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, $0.01 par value	NPO	New York Stock Exchange

As of April 29, 2019, there were 20,739,223 shares of common stock of the registrant outstanding, which does not include 188,027 shares of common stock held by a subsidiary of the registrant and accordingly are not entitled to be voted. There is only one class of common stock.

PART I
FINANCIAL INFORMATION
Item 1. Financial Statements
ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
Three Months Ended March 31, 2019 and 2018
(in millions, except per share amounts)

	2019	2018
Net sales	$360.3	$368.8
Cost of sales	247.2	243.7
Gross profit	113.1	125.1
Operating expenses:		
Selling, general and administrative	87.8	92.1
Other	1.4	1.0
Total operating expenses	89.2	93.1
Operating income	23.9	32.0
Interest expense	(5.2)	(8.2)
Interest income	0.7	0.4
Other expense	(1.5)	0.6
Income before income taxes	17.9	24.8
Income tax expense	(4.8)	(12.2)
Net income	$13.1	$12.6
Comprehensive income	$19.9	$22.4
Basic earnings per share	$0.63	$0.59
Diluted earnings per share	$0.63	$0.58
Cash dividends per share	$0.25	$0.24

See notes to consolidated financial statements (unaudited).

ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
Three Months Ended March 31, 2019 and 2018
(in millions)

	2019	2018
OPERATING ACTIVITIES		
Net income	$13.1	$12.6
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	9.2	9.3
Amortization	8.2	9.0
Deferred income taxes	(1.7)	(0.9)
Stock-based compensation	1.7	1.8
Other non-cash adjustments	1.5	1.1
Change in assets and liabilities:		
Accounts receivable, net	(5.6)	(20.1)
Inventories	(16.1)	(9.8)
Accounts payable	(13.4)	(6.8)
Other current assets and liabilities	14.6	(11.5)
Other non-current assets and liabilities	(1.6)	(4.7)
Net cash provided by (used in) operating activities	9.9	(20.0)
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(10.3)	(14.9)
Payments for capitalized internal-use software	(0.4)	(0.7)
Proceeds from sale of property, plant, and equipment	0.3	0.4
Net cash used in investing activities	(10.4)	(15.2)
FINANCING ACTIVITIES		
Proceeds from debt	120.8	256.1
Repayments of debt	(111.6)	(268.1)
Repurchase of common stock	(2.0)	(15.4)
Dividends paid	(5.4)	(5.3)
Other	(3.4)	(4.2)
Net cash used in financing activities	(1.6)	(36.9)
Effect of exchange rate changes on cash and cash equivalents	3.4	0.9
Net increase (decrease) in cash and cash equivalents	1.3	(71.2)
Cash and cash equivalents at beginning of period	129.6	189.3
Cash and cash equivalents at end of period	$130.9	$118.1
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest, net	$(1.6)	$14.5
Income taxes, net	$(12.3)	$(1.4)
Non-cash investing and financing activities:		
Non-cash acquisitions of property, plant, and equipment	$3.0	$3.2

See notes to consolidated financial statements (unaudited).

2

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

	March 31, 2019	December 31, 2018
ASSETS		
Current assets		
Cash and cash equivalents	$130.9	$ 129.6
Accounts receivable, net	292.1	286.6
Inventories	249.3	233.1
Income tax receivable	32.7	49.5
Prepaid expenses and other current assets	33.9	33.2
Total current assets	738.9	732.0
Property, plant and equipment, net	294.0	301.2
Goodwill	334.6	333.7
Other intangible assets, net	291.6	297.3
Other assets	88.0	54.9
Total assets	$1,747.1	$ 1,719.1
LIABILITIES AND EQUITY		
Current liabilities		
Current maturities of long-term debt	$0.4	$ 2.4
Accounts payable	119.3	139.2
Accrued expenses	158.8	145.5
Total current liabilities	278.5	287.1
Long-term debt	472.8	462.5
Other liabilities	119.7	106.8
Total liabilities	871.0	856.4
Commitments and contingencies		
Shareholders’ equity		
Common stock – $.01 par value; 100,000,000 shares authorized; issued, 20,975,221 shares in 2019 and 20,929,218 shares in 2018	0.2	0.2
Additional paid-in capital	299.8	301.0
Retained earnings	627.6	608.3
Accumulated other comprehensive loss	(50.2)	(45.5)
Common stock held in treasury, at cost – 188,761 shares in 2019 and 189,514 shares in 2018	(1.3)	(1.3)
Total shareholders’ equity	876.1	862.7
Total liabilities and equity	$1,747.1	$ 1,719.1

See notes to consolidated financial statements (unaudited).

ENPRO INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
1. Overview, Basis of Presentation and Recently Issued Authoritative Accounting Guidance
Overview
EnPro Industries, Inc. (“we,” “us,” “our,” “EnPro” or the “Company”) is a leader in the design, development, manufacture, and marketing of proprietary engineered industrial products that primarily include: sealing products; heavy-duty truck wheel-end component systems; self-lubricating non-rolling bearing products; precision engineered components and lubrication systems for reciprocating compressors; hoses and fittings for the hygienic process industries; bellows and bellow assemblies; pedestals for semiconductor manufacturing; PTFE products; and heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines, including parts and services.
Basis of Presentation
The accompanying interim consolidated financial statements are unaudited, and certain related information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted in accordance with Rule 10-01 of Regulation S-X. They were prepared following the same policies and procedures used in the preparation of our annual financial statements except as disclosed below and reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of results for the periods presented. The Consolidated Balance Sheet as of December 31, 2018 was derived from the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2018. The results of operations for the interim periods are not necessarily indicative of the results for the fiscal year. These consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2018 included within our annual report on Form 10-K.
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amount of assets and liabilities and the disclosures regarding contingent assets and liabilities at period end and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.
All intercompany accounts and transactions between our consolidated operations have been eliminated.
In the first quarter of 2019, we adopted a standard that establishes principles to report transparent and economically neutral information about the assets and liabilities that arise from leases. The standard requires lessees to recognize the lease assets and lease liabilities that arise from all leases in the statement of financial position and to disclose qualitative and quantitative information about lease transactions, such as information about variable lease payments and options to renew and terminate leases. The standard retains a distinction between finance leases and operating leases. As a result, the effect of leases in the Consolidated Statements of Operations and the Consolidated Statement of Cash Flows is largely unchanged. Additionally, the guidance provides clarification on the definition of a lease, including alignment of the concept of control of an asset with principles in other authoritative guidance around revenue recognition and consolidation. We adopted the new standard using the allowable option to apply the transition provisions of the new guidance at its adoption date without adjusting the comparative periods presented.

We evaluated the impact of applying practical expedients, and upon adoption we elected the package of practical expedients which permits us to not reassess prior conclusions related to contracts containing leases, lease classification, and initial direct costs. Additionally, we elected to not separate lease and non-lease components, we will not recognize an asset for leases with a term of twelve months or less, and we will apply a portfolio approach in determining discount rates.

Upon adoption of this standard, we recognized a right-of-use asset and a corresponding lease liability of approximately $30 million for our operating leases. The adoption of the standard did not have a material impact to our Consolidated Statements of Operations or Consolidated Statements of Cash Flows.

Additionally, in the first quarter of 2019, we adopted a standard that allows for the reclassification of disproportionate income tax effects ("stranded tax effects") resulting from the Tax Cuts and Jobs Act ("the Tax Act") from accumulated other comprehensive loss to retained earnings. As a result of the Tax Act, we remeasured our deferred taxes related to pensions and other postretirement benefits using the new U.S. federal tax rate. Our adoption of the standard resulted in the reclassification of a net tax benefit of $11.5 million from accumulated other comprehensive loss to opening retained earnings in our Consolidated Balance Sheet. Adoption of the standard had no impact to our Consolidated Statements of Operations or Consolidated Statements of Cash Flows.

Recently Issued Authoritative Accounting Guidance

In January 2017, a standard was issued to simplify annual and interim goodwill impairment testing for public business entities. Under the standard, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The standard is effective for any interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and is to be applied prospectively. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The standard is not currently expected to have a significant impact on our consolidated financial statements or disclosures.

In June 2016, a standard was issued that significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income, including trade receivables. The standard requires an entity to estimate its lifetime "expected credit loss" for such assets at inception, and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The standard is effective for annual periods beginning after December 15, 2019, and interim periods therein. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods therein. We are currently evaluating the new guidance to determine the impact it will have on our consolidated financial statements. Based upon our current population of receivables and associated historical credit loss experience, we do not expect that this standard will have a significant impact on our consolidated financial statements. This conclusion could be impacted by any significant future financing arrangements that we may choose to enter with customers.

2. Revenue from Contracts with Customers

Information regarding long-term engine contracts where revenue is recognized over time using an input method is as follows:

	March 31, 2019	December 31, 2018
	(in millions)	
Cumulative revenues recognized on uncompleted contracts	$404.1	$ 452.5
Cumulative billings on uncompleted contracts	358.6	393.9
	$45.5	$ 58.6

These amounts were included in the accompanying Consolidated Balance Sheets under the following captions:

	March 31, 2019	December 31, 2018
	(in millions)	
Accounts receivable, net (contract revenue recognized in excess of billings)	$60.5	$ 63.9
Accrued expenses (billings in excess of revenue recognized)	(15.0)	(5.3)
	$45.5	$ 58.6

The changes in our contract deferred revenue (billings in excess of revenue recognized) for the three months ended March 31, 2019 are as follows:

	2019
Balance at beginning of period	$5.5
Additional billings in excess of revenue recognized	15.2
Revenue recognized	(5.7)
Balance at end of period	$15.0

We make deposits and progress payments to certain vendors for long-lead-time manufactured components associated with engine projects. At March 31, 2019 and December 31, 2018, deposits and progress payments for long-lead-time components in our Power Systems segment totaled $2.0 million and $1.0 million, respectively. These deposits and progress

5

payments are classified in prepaid expenses and other current assets in the accompanying Consolidated Balance Sheets. Assets and liabilities for long-term service contracts recognized over time were immaterial as of March 31, 2019 and December 31, 2018.
As of March 31, 2019, the aggregate amount of transaction price of remaining performance obligations, or backlog, for the full company was $410.0 million. Approximately 86% of these obligations are expected to be satisfied within one year. The amount expected to be satisfied beyond March 31, 2020 is mainly attributable to our Power Systems segment and pertains to the contracts discussed above. Remaining performance obligations include those related to the contracts discussed above as well as orders across all of our businesses that we believe to be firm. However, there is no certainty these orders will result in actual sales at the times or in the amounts ordered. In addition, for most of our business, this total is not particularly predictive of future performance because of our short lead times and some seasonality.

3. Income Taxes

Our income tax expense and resulting effective tax rate are based upon the estimated annual effective tax rates applicable for the respective periods adjusted for the effect of items required to be treated as discrete in the interim periods, including losses generated in countries where we are projecting annual losses for which a deferred tax asset is not anticipated to be recognized. This estimated annual effective tax rate is affected by the relative proportions of revenue and income before taxes in the jurisdictions in which we operate. Based on the current geographical mix of earnings and the reduction in the U.S. corporate income tax rate as a result of the Tax Act, our global annual effective tax rate typically approximates the blended domestic statutory rate and fluctuates based on the portion of our profits earned in each jurisdiction.

The effective tax rates for the three months ended March 31, 2019 and 2018 were 26.8% and 49.2%, respectively. The effective tax rates for the three months ended March 31, 2019 and 2018 reflect the impact of the reduction in the U.S. federal statutory income tax rate to 21.0%, partially offset by the minimum tax on certain non-U.S. earnings, and higher tax rates in foreign jurisdictions. The effective tax rate for the three months ended March 31, 2018 was also impacted by a $5.4 million discrete tax charge to prior benefits recognized for domestic production activities as a result of interpretive guidance issued by the IRS.

In June 2017, the IRS began an examination of our 2014 U.S. federal income tax return. Although this examination is part of a routine and recurring cycle, we cannot predict the final outcome or expected conclusion date of the audit. Various foreign and state tax returns are also currently under examination and some of these exams may conclude within the next twelve months. The final outcomes of these audits are not yet determinable; however, management believes that any assessments that may arise will not have a material effect on our financial results.

4. Earnings Per Share

	Three months ended March 31,	
	2019	2018
Numerator (basic and diluted):		
Net income	$13.1	$12.6
Denominator:		
Weighted-average shares – basic	20.8	21.3
Share-based awards	0.1	0.3
Weighted-average shares – diluted	20.9	21.6
Earnings per share:		

Basic	$0.63	$0.59
Diluted	$0.63	$0.58

5. Inventories

	March 31, 2019	December 31, 2018
	(in millions)	
Finished products	$152.3	$ 142.9
Work in process	39.1	33.6
Raw materials and supplies	69.0	67.7
	260.4	244.2
Reserve to reduce certain inventories to LIFO basis	(11.1)	(11.1)
Total inventories	$249.3	$ 233.1

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

6. Goodwill and Other Intangible Assets

The changes in the net carrying value of goodwill by reportable segment for the three months ended March 31, 2019, are as follows:

	Sealing Products	Engineered Products	Power Systems	Total
	(in millions)			
Goodwill as of December 31, 2018	$311.3	$ 10.8	$ 11.6	$333.7
Change due to foreign currency translation	0.8	—	0.1	0.9
Goodwill as of March 31, 2019	$312.1	$ 10.8	$ 11.7	$334.6

The goodwill balances reflected above are net of accumulated impairment losses of $27.8 million for the Sealing Products segment and $154.8 million for the Engineered Products segment as of March 31, 2019 and December 31, 2018.

Identifiable intangible assets are as follows:

	As of March 31, 2019		As of December 31, 2018	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in millions)			
Amortized:				
Customer relationships	$285.2	$ 154.7	$284.5	$ 150.2
Existing technology	112.8	47.2	112.3	45.1
Trademarks	35.1	23.3	35.3	23.1
Other	28.5			