

ENPRO INDUSTRIES, INC
Form 10-Q
November 06, 2009

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 September 30, 2009

☐ Transition report pursuant to section 13 or 15(d) of the securities exchange act of 1934

Commission File Number 001-31225

ENPRO INDUSTRIES, INC.

(Exact name of registrant, as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation)

01-0573945

(I.R.S. Employer Identification No.)

5605 Carnegie Boulevard, Suite 500, Charlotte,
North Carolina

(Address of principal executive offices)

28209

(Zip Code)

(704) 731-1500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant 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 ☐

Smaller reporting
company ☐

(Do not check if a 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 November 2, 2009, there were 19,996,129 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 Nine Months Ended September 30, 2009 and 2008
(in millions, except per share amounts)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
		As Adjusted (Note 1)		As Adjusted (Note 1)
Net sales	\$ 219.7	\$ 278.6	\$ 671.4	\$ 878.5
Cost of sales	146.6	179.7	450.9	561.1
Gross profit	73.1	98.9	220.5	317.4
Operating expenses:				
Selling, general and administrative expenses	57.0	65.3	179.2	203.1
Asbestos-related expenses	13.7	13.0	41.6	37.3
Goodwill impairment charge			113.1	
Other operating expense (income), net	0.7	0.6	7.7	(2.1)
	71.4	78.9	341.6	238.3
Operating income (loss)	1.7	20.0	(121.1)	79.1
Interest expense	(3.1)	(3.2)	(9.3)	(9.5)
Interest income	0.4	0.4	0.6	2.3
Other income (expense), net		(0.2)	19.1	(4.0)
Income (loss) before income taxes	(1.0)	17.0	(110.7)	67.9
Income tax benefit (expense)	2.8	(4.6)	10.0	(22.6)
Net income (loss)	\$ 1.8	\$ 12.4	\$ (100.7)	\$ 45.3
Basic earnings (loss) per share	\$ 0.09	\$ 0.62	\$ (5.05)	\$ 2.22
Diluted earnings (loss) per share	\$ 0.09	\$ 0.59	\$ (5.05)	\$ 2.12

See notes to consolidated financial statements (unaudited).

ENPRO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
Nine Months Ended September 30, 2009 and 2008
(in millions)

	2009	2008 As Adjusted (Note 1)
OPERATING ACTIVITIES		
Net income (loss)	\$ (100.7)	\$ 45.3
Adjustments to reconcile net income (loss) to net cash provided by (used by) operating activities:		
Depreciation	23.5	23.1
Amortization	10.2	10.4
Accretion of debt discount	3.9	3.5
Goodwill impairment charge	113.1	
Gain on sale of assets		(2.2)
Deferred income taxes	(20.3)	(7.9)
Stock-based compensation	0.7	4.4
Excess tax benefits from stock-based compensation		(0.8)
Change in assets and liabilities, net of effects of acquisitions of businesses:		
Asbestos liabilities, net of insurance receivables	10.7	17.2
Accounts and notes receivable	10.3	(16.0)
Inventories	(1.2)	(12.5)
Accounts payable	(5.1)	(9.9)
Other current assets and liabilities	(4.0)	13.3
Other non-current assets and liabilities	(6.3)	0.9
Net cash provided by operating activities	34.8	68.8
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(18.8)	(36.4)
Proceeds from sales of assets	0.4	3.2
Proceeds from liquidation of investments	3.6	7.5
Acquisitions, net of cash acquired	(6.2)	(37.4)
Other	1.0	3.1
Net cash used in investing activities	(20.0)	(60.0)
FINANCING ACTIVITIES		
Repayments of debt	(9.9)	(4.0)
Common stock repurchases		(62.1)
Proceeds from issuance of common stock	0.1	0.3
Excess tax benefits from stock-based compensation		0.8
Net cash used in financing activities	(9.8)	(65.0)

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Effect of exchange rate changes on cash and cash equivalents	2.2	(1.2)
Net increase (decrease) in cash and cash equivalents	7.2	(57.4)
Cash and cash equivalents at beginning of year	76.3	129.2

Cash and cash equivalents at end of period	\$ 83.5	\$ 71.8
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Supplemental disclosures of cash flow information:

Cash paid during the period for:

Interest	\$ 3.9	\$ 4.5
Income taxes	\$ 10.3	\$ 30.6
Asbestos-related claims and expenses, net of insurance recoveries	\$ 30.9	\$ 20.1

See notes to consolidated financial statements (unaudited).

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

	September 30, 2009	December 31, 2008 As Adjusted (Note 1)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 83.5	\$ 76.3
Accounts and notes receivable	155.3	157.7
Asbestos insurance receivable	66.3	67.9
Inventories	90.2	84.8
Other current assets	52.5	40.9
Total current assets	447.8	427.6
Property, plant and equipment	205.3	206.1
Goodwill	113.7	218.1
Other intangible assets	102.1	103.4
Asbestos insurance receivable	186.4	239.5
Deferred income taxes	85.1	79.1
Other assets	48.4	60.0
Total assets	\$ 1,188.8	\$ 1,333.8
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current maturities of long-term debt	\$ 0.1	\$ 9.6
Accounts payable	64.8	66.4
Asbestos liability	85.2	85.3
Other accrued expenses	84.1	86.4
Total current liabilities	234.2	247.7
Long-term debt	128.9	124.9
Asbestos liability	336.3	380.2
Pension liability	86.9	80.3
Other liabilities	54.3	74.6
Total liabilities	840.6	907.7
Shareholders' equity		
Common stock \$.01 par value; 100,000,000 shares authorized; issued and outstanding, 20,195,363 shares in 2009 and 20,031,709 in 2008	0.2	0.2
Additional paid-in capital	400.9	400.2
Retained earnings (accumulated deficit)	(56.1)	44.6
Accumulated other comprehensive income (loss)	4.6	(17.4)

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Common stock held in treasury, at cost 212,885 shares in 2009 and 217,790 shares in 2008	(1.4)	(1.5)
Total shareholders' equity	348.2	426.1
Total liabilities and shareholders' equity	\$ 1,188.8	\$ 1,333.8

See notes to consolidated financial statements (unaudited).

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ENPRO INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Overview, Basis of Presentation and Recent Accounting 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 include sealing products, self-lubricating, non-rolling bearing products, air compressors, and heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The Consolidated Balance Sheet as of December 31, 2008, was derived from the audited financial statements included in the Company s annual report on Form 10-K for the year ended December 31, 2008. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair statement of results for the periods presented, have been included. Management believes that the assumptions underlying the consolidated financial statements are reasonable. The Company has evaluated events and transactions that have occurred through November 6, 2009 (the issuance date of these consolidated financial statements) in the preparation of these consolidated financial statements. These interim financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto that are included in its annual report on Form 10-K for the year ended December 31, 2008.

Revenues, expenses, cash flows, assets and liabilities can and do vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be indicative of those for a full year.

All significant intercompany accounts and transactions between the Company s operations have been eliminated.

In May 2008, the Financial Accounting Standards Board (FASB) issued a staff position that requires the issuer of certain convertible debt instruments that may be settled in cash on conversion to separately account for the liability and equity components of the instrument in a manner that reflects the issuer s nonconvertible debt borrowing rate. The staff position is effective for the Company s 2009 financial statements including interim periods. Early application was not permitted; however, the transition guidance requires retrospective application to all periods presented. Prior periods presented in these consolidated financial statements and related notes have been recast to report as if the staff position had been used and the effects of those changes are shown below.

	For the Quarter Ended September 30, 2008		For the Nine Months Ended September 30, 2008	
	As Previously Reported	As Adjusted	As Previously Reported	As Adjusted
(in millions, except per share amounts)				
Consolidated Statements of Operations				
Selling, general and administrative expenses	\$65.3	\$65.3	\$203.2	\$203.1
Total operating expenses	78.9	78.9	238.4	238.3
Operating income	20.0	20.0	79.0	79.1
Interest expense	(2.0)	(3.2)	(6.0)	(9.5)
Income before income taxes	18.2	17.0	71.3	67.9
Income tax expense	(5.1)	(4.6)	(23.9)	(22.6)
Net income	13.1	12.4	47.4	45.3
Basic earnings per share	0.66	0.62	2.33	2.22
Diluted earnings per share	0.62	0.59	2.22	2.12

Consolidated Statement of Cash Flows

Net income	47.4	45.3
Accretion of debt discount		3.5
Deferred income taxes	(6.6)	(7.9)
Change in other non-current assets and liabilities	1.0	0.9

As of December 31, 2008
(in millions)

	As Previously Reported	As Adjusted
Consolidated Balance Sheet		
Deferred income taxes	\$ 96.5	\$ 79.1
Other assets	61.3	60.0
Total assets	1,352.5	1,333.8
Long-term debt	172.6	124.9
Total liabilities	955.4	907.7
Additional paid-in capital	363.0	400.2
Retained earnings	52.8	44.6
Total shareholders' equity	397.1	426.1
Total liabilities and shareholders' equity	1,352.5	1,333.8

In May 2009, the FASB established general standards of accounting for, and require disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Company adopted the provisions of the standard for the quarter ended June 30, 2009. The adoption of these provisions did not have an effect on its financial condition, results of operations or cash flows.

In March 2008, the FASB issued a standard that requires entities to provide enhanced disclosure about how and why the entity uses derivative instruments, how the instruments and related hedged items are accounted for, and how the instruments and related hedged items affect the financial position, results of operations, and cash flows of the entity. The Company adopted the standard during the quarter ended March 31, 2009. The adoption of these provisions did not have an effect on its financial condition, results of operations or cash flows.

In December 2007, the FASB modified the rules regarding business combinations. The new standard retains the underlying concepts of the previously existing guidance in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting, but changes the method of applying the acquisition method in a number of aspects. The Company adopted the standard for any business combinations for which the acquisition date is on or after January 1, 2009. This new standard did not change the financial accounting and reporting for business combinations completed prior to the effective date of the new standard.

In April 2009, the FASB issued rules to require disclosures about fair value of financial instruments in interim reporting periods. Such disclosures were previously required only in annual financial statements. The Company adopted the provisions for the quarter ended June 30, 2009. Because it applies only to financial statement disclosures, the adoption did not have any impact on the Company's financial condition, results of operations or cash flows.

Recent Accounting Pronouncement

In December 2008, the FASB issued a staff position that requires additional disclosures about assets held in an employer's defined benefit pension or other postretirement plan. The staff position is effective for fiscal years ending after December 15, 2009. Since it requires only additional disclosures, adoption of the standard will not affect the Company's financial condition, results of operations or cash flows.

2. Acquisitions

In February 2009, the Company acquired PTM (UK) Limited, a full service provider of sealing solutions, which is included in the Company's Sealing Products segment. In the third quarter of 2009, the Company completed two small acquisitions, both of which are included in the Company's Engineered Products segment. The acquisitions completed during 2009 were paid for with \$6.2 million in cash. The purchase price allocations of PTM (UK) Limited and other recently acquired businesses are subject to the completion of purchase price adjustments pursuant to the acquisition agreements.

3. Other Operating Expense (Income), Net

The Company incurred \$0.7 million and \$7.7 million of restructuring costs during the quarter and nine months ended September 30, 2009, and \$0.6 million and \$2.6 million during the quarter and nine months ended September 30, 2008. Of the 2009 costs, \$6.9 million relates to workforce reductions announced at a number of locations due to the current economic conditions and the remainder is related to facility consolidation and equipment relocation. Workforce reductions announced during the year, which relate to these restructuring costs, total 427 employees of which 378 had actually been terminated as of September 30, 2009.

Restructuring reserve activity is summarized as follows:

(in millions)

Balance at December 31, 2008	\$ 1.2
Provision	7.7
Cash payments and other	(4.3)
Balance at September 30, 2009	\$ 4.6

Restructuring costs by reportable segment are as follows:

	Nine Months Ended September 30,	
	2009	2008
	(in millions)	
Sealing Products	\$ 1.6	\$ 2.3
Engineered Products	6.1	0.3
	\$ 7.7	\$ 2.6

Included in other operating expense (income), net for the nine months ended September 30, 2008, was \$2.5 million received related to the favorable settlement of a warranty claim against a supplier. Also during 2008, the Company sold a building for \$3.0 million, resulting in a pre-tax gain of \$2.2 million. This related to the relocation and consolidation of facilities for an operation in the Sealing Products segment.

4. Other Income (Expense), Net

In conjunction with the closure of a plant in the early 1980s, the Company's Coltec Industries Inc (Coltec) subsidiary was required to fund two trusts for retiree medical benefits for union employees at the plant. The first 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.

Because of the possibility that Coltec would be required to make contributions to the Benefits Trust, Coltec was required to establish a second trust (the Back-Up Trust) to cover potential shortfalls in the Benefits Trust. A liability for potential payments to be made from the Back-Up Trust is recorded in the Company's Consolidated Balance Sheets in other liabilities. In the quarter ended June 30, 2009, the Company recorded income of \$19.2 million related to the reduction of this estimated liability based upon a recent actuarial analysis that determined the potential liability was significantly less than the amount accrued. This is discussed further in Note 15, Commitments and Contingencies Crucible Materials Corporation.

Included in other income (expense), net for the nine months ended September 30, 2008, were \$3.4 million of incremental costs for legal, financial and strategic advice and proxy solicitation in connection with the contested election of directors initiated by one of the Company's shareholders. On April 11, 2008, an agreement with the shareholder was entered into that resolved the contested election.

5. Income Taxes

The Company recorded an income tax benefit of \$2.8 million on a loss before income taxes of \$1.0 million in the third quarter of 2009. During the third quarter of 2008, the Company recorded income tax expense of \$4.6 million on income before income taxes of \$17.0 million. The income tax rate in the third quarter of 2009 was impacted by the jurisdictional mix of earnings and losses as well as adjustments of prior year accruals based on return to accrual adjustments.

As of September 30, 2009 and December 31, 2008, the Company had \$7.5 million and \$5.6 million, respectively, of liabilities recorded for unrecognized tax benefits. The unrecognized tax benefit balances as of September 30, 2009 and December 31, 2008, included \$3.3 million and \$1.6 million, respectively, for tax positions for which the ultimate deductibility was highly certain but for which there was uncertainty about the timing of such deductibility and \$4.2 million and \$4.0 million at September 30, 2009 and December 31, 2008, respectively, for uncertain tax positions that would affect the Company's effective tax rate if recognized. These amounts include interest of \$0.6 million and \$0.5 million,

respectively. The Company records interest and penalties related to unrecognized tax benefits in income tax expense.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. Many state, local and foreign income tax returns for the years 2003 through 2008 are open to examination. The U.S. federal income tax returns for 2007 and 2008 are also open to examination. Various foreign and state tax returns are currently under examination and may conclude within the next twelve months. The final outcomes of these audits are not yet determinable; however, management believes that any assessments that may arise will not be material to the Company's financial condition or results of operations.

6. Comprehensive Income (Loss)

Total comprehensive income (loss) consists of the following:

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in millions)			
Net income (loss)	\$ 1.8	\$ 12.4	\$ (100.7)	\$ 45.3
Unrealized translation adjustments	12.1	(22.2)	18.3	(5.0)
Pensions and postretirement benefits	1.1	0.3	3.4	1.0
Net unrealized gains (losses) from cash flow hedges	0.4	(0.7)	0.3	1.0
Total comprehensive income (loss)	\$ 15.4	\$ (10.2)	\$ (78.7)	\$ 42.3

7. Earnings (Loss) Per Share

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

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in millions, except per share amounts)			
Numerator (basic and diluted):				
Net income (loss)	\$ 1.8	\$ 12.4	\$ (100.7)	\$ 45.3
Denominator:				
Weighted-average shares basic	20.0	20.0	19.9	20.4
Share-based awards	0.3	0.5		0.4
Convertible debentures		0.6		0.4
Other				0.1
Weighted-average shares diluted	20.3	21.1	19.9	21.3
Earnings (loss) per share:				
Basic	\$ 0.09	\$ 0.62	\$ (5.05)	\$ 2.22
Diluted	\$ 0.09	\$ 0.59	\$ (5.05)	\$ 2.12

As discussed further in Note 10, the Company previously issued \$172.5 million in aggregate principal amount of Convertible Senior Debentures (the "Debentures"). Under the terms of the Debentures, the Company would settle the par amount of its obligations in cash and the remaining obligations, if any, in common shares. Pursuant to applicable

accounting guidelines, the Company

includes the conversion option effect in diluted earnings per share during such periods when the Company's average stock price exceeds the conversion price of \$33.79 per share.

For the nine months ended September 30, 2009, there was a loss attributable to common shares. Potentially dilutive share-based awards of 0.3 million were excluded from the calculation of diluted earnings per share for this period, as they were antidilutive. There were no antidilutive shares in 2008.

8. Inventories

Inventories consist of the following:

	As of September 30, 2009	As of December 31, 2008
	(in millions)	
Finished products	\$ 54.9	\$ 53.5
Costs relating to long-term contracts and programs	53.3	41.5
Work in process	14.9	16.1
Raw materials and supplies	34.1	36.9
	157.2	148.0
Reserve to reduce certain inventories to LIFO basis	(16.8)	(16.9)
Progress payments	(50.2)	(46.3)
Total	\$ 90.2	\$ 84.8

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

9. Goodwill and Other Intangible Assets

The changes in the net carrying value of goodwill by reportable segment for the nine months ended September 30, 2009, are as follows:

	Sealing Products	Engineered Products	Engine Products and Services	Total
	(in millions)			
Goodwill as of December 31, 2008	\$ 66.4	\$ 144.6	\$ 7.1	\$ 218.1
Impairment	(4.4)	(108.7)		(113.1)
Acquisitions	3.3			3.3
Foreign currency translation	1.8	3.6		5.4
Goodwill as of September 30, 2009	\$ 67.1	\$ 39.5	\$ 7.1	\$ 113.7

Goodwill is tested for impairment annually on October 1, or more frequently when events or circumstances indicate that it is more likely than not that impairment might have occurred. Due to the impact on the Company's businesses from the continuing deterioration in the global economic environment and the Company's reduced enterprise value resulting from the decrease in its stock price,

the Company determined during the first quarter of 2009 that an interim test for impairment of goodwill was appropriate.

In evaluating goodwill for impairment, if the fair value of the reporting unit is less than its carrying value, the Company is then required to proceed to the second step of the impairment test. The second step involves estimating the fair value of all of the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. The implied value of the goodwill resulting from this process is then compared to the carrying value of the goodwill to determine the amount of impairment.

The Company uses a discounted cash flow model and a market value approach to estimate its reporting units' fair values in evaluating goodwill for impairment. The significant assumptions include projected cash flows, weighted average cost of capital, residual growth rates and market multiples. The Company also considers a control premium that represents the estimated amount an investor would pay for its equity securities to obtain a controlling interest and other factors.

The Company's analysis, completed for the second quarter of 2009, resulted in an implied fair value of goodwill of zero for two of its reporting units. As a result, the Company recognized a non-cash, pre-tax impairment charge of \$113.1 million related to the Company's GGB reporting unit included in the Engineered Products segment and the Plastomer Technologies reporting unit included in the Sealing Products segment during the second quarter of 2009. No impairment of any other long-lived asset was indicated.

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

	As of September 30, 2009		As of December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in millions)			
Customer relationships	\$ 81.7	\$ 32.8	\$ 77.3	\$ 27.1
Existing technology	22.4	6.1	22.4	5.0
Trademarks	38.3	7.6	36.5	6.4
Other	15.4	9.2	14.1	8.4
	\$ 157.8	\$ 55.7	\$ 150.3	\$ 46.9

Amortization expense for the quarter and nine months ended September 30, 2009, was \$2.6 million and \$7.7 million, respectively. Amortization expense for the quarter and nine months ended September 30, 2008, was \$2.8 million and \$8.2 million, respectively. The Company has trademarks with indefinite lives that are included in the table above with a carrying amount of approximately \$23 million as of September 30, 2009 that are not amortized.

10. Long-Term Debt

In 2005, the Company issued \$172.5 million in aggregate principal amount of Debentures. The Debentures bear interest at the annual rate of 3.9375%, with interest due on April 15 and October 15 of each year 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 would rank equal in priority with all unsecured and unsubordinated indebtedness and senior in right of payment to all subordinated indebtedness. They would effectively rank junior to all secured indebtedness to the extent

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

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

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

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

on or after September 15, 2015;

upon the occurrence of specified corporate transactions; or

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

None of the conditions that permit conversion were satisfied at September 30, 2009.

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

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

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

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

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

The current accounting rules require that the liability component of the Debentures be recorded at its fair value as of the issuance date. This resulted in the Company recording debt in the amount of

\$111.2 million with the \$61.3 million offset to the debt discount being recorded in equity on a net of tax basis. The debt discount, \$43.8 million as of September 30, 2009, is being amortized through interest expense until the maturity date of October 15, 2015, resulting in an effective interest rate of approximately 9.5% and a \$128.7 million net carrying amount of the liability component at September 30, 2009. As of December 31, 2008, the unamortized debt discount was \$47.7 million and the net carrying amount of the liability component was \$124.8 million. Interest expense related to the Debentures for the quarters ended September 30, 2009 and 2008 includes \$1.7 million of contractual interest coupon in both periods and \$1.3 million and \$1.2 million, respectively, of debt discount amortization. Interest expense related to the Debentures for the nine months ended September 30, 2009 and 2008 includes \$5.1 million of contractual interest coupon in both periods and \$3.9 million and \$3.5 million, respectively, of debt discount amortization.

11. Pensions and Postretirement Benefits

The components of net periodic benefit cost for the Company's U.S. and foreign defined benefit pension and other postretirement plans for the quarters and nine months ended September 30, 2009 and 2008, are as follows:

	Quarters Ended September 30,			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
	(in millions)			
Service cost	\$ 1.6	\$ 1.6	\$ 0.2	\$ 0.3
Interest cost	2.9	2.9	0.2	0.2
Expected return on plan assets	(2.2)	(3.4)		
Prior service cost component	0.2	0.2		
Net loss component	1.5	0.1	0.1	0.1
	\$ 4.0	\$ 1.4	\$ 0.5	\$ 0.6

	Nine Months Ended September 30,			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
	(in millions)			
Service cost	\$ 5.0	\$ 5.0	\$ 0.7	\$ 0.7
Interest cost	9.1	8.7	0.7	0.7
Expected return on plan assets	(7.2)	(10.3)		
Prior service cost component	0.6	0.7	0.1	0.2
Net loss component	4.7	0.3	0.2	0.2
	\$ 12.2	\$ 4.4	\$ 1.7	\$ 1.8

The Company will not be required to make any cash contributions to its U.S. defined benefit plans in 2009 as a result of credit balances available from previous discretionary contributions. The Company expects to make total contributions of approximately \$0.9 million in 2009 to its foreign pension plans.

12. Derivative Instruments

The Company uses derivative financial instruments to manage its exposure to various risks. The use of these financial instruments modifies the exposure with the intent of reducing the risk to the Company. The Company does not use financial instruments for trading purposes, nor does it use

leveraged financial instruments. The counterparties to these contractual arrangements are major financial institutions. The Company uses multiple financial institutions for derivative contracts to minimize the concentration of credit risk. The current accounting rules require that all derivative instruments be reported in the Consolidated Balance Sheets at fair value and that changes in a derivative's fair value be recognized currently in earnings unless specific hedge criteria are met.

The Company is exposed to foreign currency risks that arise from normal business operations. These risks include the translation of local currency balances on its foreign subsidiaries' balance sheets, intercompany loans with foreign subsidiaries and transactions denominated in foreign currencies. The Company strives to control its exposure to these risks through its normal operating activities and, where appropriate, through derivative instruments. The Company has entered into contracts to hedge forecasted transactions occurring at various dates through December 2010 that are denominated in foreign currencies. The notional amount of foreign exchange contracts hedging foreign currency transactions was \$84.5 million and \$130.3 million at September 30, 2009 and December 31, 2008, respectively. At September 30, 2009, foreign exchange contracts totaling \$38.9 million are accounted for as cash flow hedges. As cash flow hedges, the effective portion of the gain or loss on the contracts is reported in accumulated other comprehensive income and the ineffective portion is reported in income. Amounts in accumulated other comprehensive income are reclassified into income, primarily cost of sales, in the period that 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 other accrued expenses in the Consolidated Balance Sheets. The remaining \$45.6 million of foreign exchange contracts, all of which have a maturity date of a month or less, are recorded at their fair market value with changes in market value recorded in income.

13. Business Segment Information

The Company has three reportable segments. The Sealing Products segment manufactures sealing products, heavy-duty wheel end components, polytetrafluoroethylene (PTFE) products and rubber products. The Engineered Products segment manufactures self-lubricating, non-rolling bearing products, aluminum blocks for hydraulic applications, rotary and reciprocating air compressors, vacuum pumps, air systems and compressor components. The Engine Products and Services segment manufactures and services heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines. The Company's reportable segments are managed separately based on differences in their products and services and their end-customers. Segment profit is total segment revenue reduced by operating expenses and restructuring and other costs identifiable with the segment. Corporate expenses include general corporate administrative costs. Expenses not directly attributable to the segments, corporate expenses, net interest expense, asbestos-related expenses, gains/losses 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.

During 2009, the Company modified the methodology for allocating certain corporate expenses that specifically related to the operating segments. For comparability purposes, segment profits in 2008 have been adjusted to be consistent with the new expense allocation used by management to evaluate segment performance.

Segment operating results and other financial data for the quarters and nine months ended September 30, 2009 and 2008, are as follows:

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in millions)			
Sales				
Sealing Products	\$ 99.9	\$ 127.1	\$ 295.1	\$ 387.6
Engineered Products	88.1	131.0	264.4	408.9
Engine Products and Services	32.0	21.1	113.1	83.4
	220.0	279.2	672.6	879.9
Intersegment sales	(0.3)	(0.6)	(1.2)	(1.4)
Total sales	\$ 219.7	\$ 278.6	\$ 671.4	\$ 878.5
Segment Profit				
Sealing Products	\$ 15.1	\$ 20.2	\$ 42.1	\$ 71.2
Engineered Products	(0.3)	16.3	(8.5)	58.4
Engine Products and Services	5.7	2.8	20.9	10.5
Total segment profit	20.5	39.3	54.5	140.1
Corporate expenses	(5.2)	(5.6)	(20.1)	(23.8)
Asbestos-related expenses	(13.7)	(13.0)	(41.6)	(37.3)
Goodwill impairment charge			(113.1)	
Interest expense, net	(2.7)	(2.8)	(8.7)	(7.2)
Other income (expense), net	0.1	(0.9)	18.3	(3.9)
Income (loss) before income taxes	\$ (1.0)	\$ 17.0	\$ (110.7)	\$ 67.9

Segment assets are as follows:

	September 30, 2009	December 31, 2008
Sealing Products	\$ 286.0	\$ 291.4
Engineered Products	377.0	484.9
Engine Products and Services	93.1	72.4
Corporate	432.7	485.1
	\$ 1,188.8	\$ 1,333.8

14. Fair Value Measurements

On January 1, 2008, the Company adopted a new accounting standard regarding fair value measurements for financial assets and liabilities. As permitted by the FASB, the Company elected to defer the adoption of the fair value standard for all nonfinancial assets and nonfinancial liabilities until January 1, 2009. The standard provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. It defines

fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The standard 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.

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 September 30, 2009				
	Total	Level 1 (in millions)	Level 2	Level 3
Assets				
Cash equivalents	\$ 76.4	\$ 76.4	\$	\$
Crucible back-up trust assets	18.4	18.4		
Cash management fund	3.8		3.8	
Foreign currency derivatives	1.6		1.6	
Deferred compensation assets	2.1	2.1		
	\$ 102.3	\$ 96.9	\$ 5.4	\$
Liabilities				
Deferred compensation liabilities	\$ 4.2	\$ 4.2	\$	\$
Foreign currency derivatives	0.8		0.8	
	\$ 5.0	\$ 4.2	\$ 0.8	\$

Fair Value Measurements as of December 31, 2008				
	Total	Level 1 (in millions)	Level 2	Level 3
Assets				
Cash equivalents	\$ 65.8	\$ 65.8	\$	\$
Crucible back-up trust assets	22.4	22.4		
Cash management fund	7.1		7.1	
Foreign currency derivatives	1.8		1.8	
Deferred compensation assets	2.6	2.6		
	\$ 99.7	\$ 90.8	\$ 8.9	\$
Liabilities				
Deferred compensation liabilities	\$ 4.1	\$ 4.1	\$	\$
Foreign currency derivatives	0.7		0.7	
	\$ 4.8	\$ 4.1	\$ 0.7	\$

The Company's cash equivalents, Crucible back-up trust assets and deferred compensation assets and liabilities are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. For further discussion of the Crucible back-up trust, see Note 15, Commitments and Contingencies Crucible Materials Corporation. The fair value of the cash management fund assets is determined through broker quotations or alternative pricing sources with reasonable levels of price transparency and is reflected in the net asset value of the fund. The fair values for foreign currency derivatives are based on quoted market prices from various banks for similar instruments.

As further discussed in Note 9, goodwill with a carrying value of \$113.1 million was written down to its implied fair value of zero, resulting in a non-cash, pre-tax impairment charge of \$113.1 million, which was included in earnings for the second quarter of 2009. The fair value measurements

were calculated using unobservable inputs (primarily discounted cash flow analyses) and classified as Level 3, requiring significant management judgment due to the absence of quoted market prices or observable inputs for assets of a similar nature.

The carrying values of the Company's significant financial instruments reflected in the Consolidated Balance Sheet approximate their respective fair values at September 30, 2009 and December 31, 2008, except for the following instruments:

	September 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(in millions)			
Long-term debt	\$129.0	\$153.6	\$134.5	\$145.1

The fair values for long-term debt are based on quoted market prices or on rates available to the Company for debt with similar terms and maturities.

15. Commitments and Contingencies

General

Various claims, lawsuits and administrative proceedings, all arising in the ordinary course of business with respect to commercial, product liability and environmental matters, are pending or threatened against the Company or its subsidiaries and seek monetary damages and/or other remedies. In addition, asbestos litigation against certain of the Company's subsidiaries is described in this section in more detail. The Company believes that any liability that may finally be determined with respect to commercial and non-asbestos product liability claims should not have a material effect on the Company's consolidated financial condition or results of operations. From time to time, the Company and its subsidiaries are also involved as plaintiffs in legal proceedings involving contract, patent protection, environmental, insurance and other matters.

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 19 sites at each of which the costs to the Company or its subsidiary are expected to exceed \$100,000. Investigations have been completed for 14 sites and are in progress at the other five sites. The majority of these remediation projects involve former operating facilities that were sold or closed and primarily deal with remediation of 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 September 30, 2009 and December 31, 2008, EnPro had accrued liabilities of \$18.8 million and \$22.1 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 conditions, changing government regulations and legal standards regarding liability. Subject to the imprecision in estimating future environmental costs, the Company believes that maintaining compliance with current environmental laws and government regulations will not require significant capital expenditures or have a material adverse effect on its financial condition, but could be material to its results of operations or cash flows in a given period.

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 the Company's former Colt Firearms subsidiary for firearms manufactured prior to its divestiture in 1990 and the Company's former Central Moloney subsidiary for electrical transformers manufactured prior to its divestiture in 1994. No product liability claims are currently pending against the Company related to Colt Firearms or Central Moloney. 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 is 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.

In conjunction with the closure of a Crucible plant in the early 1980s, Coltec was required to fund two trusts for retiree medical benefits for union employees at the plant. The first 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, report will be required in 2015. The actuarial reports in 1995 and 2005 determined that there were adequate assets to fund the payment of future benefits. If it is determined in 2015 that the Benefits Trust assets are not adequate to fund the payment of future medical benefits, the Back-Up Trust (discussed below) will be required to contribute additional amounts to the Benefits Trust. In the event there are ever excess assets in the Benefits Trust, those excess assets will not revert to Coltec.

Because of the possibility there could be insufficient funds in the Benefits Trust, Coltec was required to establish and make a contribution to a second trust (the Back-Up Trust). The trust assets of the Back-Up Trust are reflected in the Company's Consolidated Balance Sheets in other non-current

assets and amounted to \$18.4 million at September 30, 2009. As noted above, based on the valuation completed in early 2005, an actuary determined there were adequate assets in the Benefits Trust to fund the estimated payments from the trust until the final valuation date in 2015. If there is no payment required or the amount of the payment is less than the value of the assets in the Back-Up Trust, the remaining assets of the Back-Up Trust will revert to the Company. During the third quarter of 2009, the Company received \$4.9 million in cash from the Back-Up Trust.

In the second quarter of 2009, the Company recorded income in connection with a reassessment of the potential liability related to the above-described retiree medical benefits. A recent actuarial analysis determined that the potential liability for any shortfalls in the Benefits Trust is significantly less than the amount previously accrued and held in the Back-Up Trust as security. As a result, the Company reduced the potential liability by \$19.2 million. The remaining potential liability of \$3.8 million is recorded in other liabilities at September 30, 2009.

The Company also has 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, that relate to the Company's period of ownership of this operation.

Debt Guarantees

As of September 30, 2009, the Company had contingent liabilities for potential payments on guarantees of certain debt and lease obligations totaling \$3.6 million. These guarantees arose from the divestiture of Crucible, and expire in 2010. In the event that Crucible, or a successor to its interests, does not fulfill their obligations under the agreements, the Company could be responsible for their payment. There is no liability for these guarantees reflected in the Company's Consolidated Balance Sheets because the Company believes that it will not be required to make payments on these obligations. The federal court overseeing the Crucible Chapter 11 bankruptcy ordered that the proceeds from a scheduled asset sale be applied to settle the related debt and lease obligations, which account for most of these guaranteed obligations.

Other Contingent Liability Matters

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 that may be incurred 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 nine months ended September 30, 2009 and 2008 are as follows:

	2009	2008
	(in millions)	
Balance at beginning of year	\$ 4.1	\$ 3.6
Charges to expense	4.2	2.6
Settlements made (primarily payments)	(3.8)	(2.4)
Balance at end of period	\$ 4.5	\$ 3.8

Asbestos

History. Certain of the Company's subsidiaries, primarily Garlock Sealing Technologies LLC (Garlock) and The Anchor Packing Company (Anchor), are among a large number of defendants in actions filed in various states by plaintiffs alleging injury or death as a result of exposure to asbestos fibers. Among the products at issue in these actions are industrial sealing products, including gaskets and packing products. The damages claimed vary from action to action, and in some cases plaintiffs seek both compensatory and punitive damages. To date, neither Garlock nor Anchor has been required to pay any punitive damage awards, although there can be no assurance that they will not be required to do so in the future. Liability for compensatory damages has historically been allocated among responsible defendants. Since the first asbestos-related lawsuits were filed against Garlock in 1975, Garlock and Anchor have processed more than 900,000 asbestos claims to conclusion (including judgments, settlements and dismissals) and, together with their insurers, have paid over \$1.4 billion in settlements and judgments and over \$400 million in fees and expenses.

Claims Mix. Of those claims resolved, approximately 3% have been claims of plaintiffs alleging the disease mesothelioma, approximately 7% have been claims of plaintiffs alleging lung or other cancers, and approximately 90% have been claims of plaintiffs alleging asbestosis, pleural plaques or other non-malignant impairment of the respiratory system. Of the approximately 97,400 open cases at September 30, 2009, the Company is aware of approximately 5,300 (5.4%) that involve claimants alleging mesothelioma. In recent years, a large percentage of settlement payments made by the Company have been in connection with mesothelioma claims.

New Filings. About 3,300 new claims were filed against the Company's subsidiaries in the first nine months of 2009, down from the 4,400 claims filed in the first nine months of 2008. The number of new actions filed against the Company's subsidiaries in 2008 (5,500) was about 5% higher than the number filed in 2007 (5,200) but was significantly lower than the number filed in 2006 (7,700). The number filed against its subsidiaries in each of those three years was much lower than the number filed in the peak filing year, 2003, when 44,700 new claims were filed. Factors in the decline include, but are not limited to, tort reform in some high profile states, especially Mississippi, Texas and Ohio; tort reform in Florida, Georgia, South Carolina, Kansas and Tennessee; actions taken and rulings by some judges and court administrators that have had the effect of limiting access to their courts for claimants without sufficient ties to the jurisdiction or claimants with no discernible disease; acceleration of claims into past years; and declining incidence of asbestos-related disease. The trend of declining new filings has been principally in non-malignant claims. The number of new filings of claims alleging mesothelioma, lung and other cancers has declined only modestly since 2005. The number of new mesothelioma filings against the Company's subsidiaries was actually higher for 2008 than for 2007 and appears to be higher again in 2009 as well.

Product Defenses. The asbestos in products formerly sold by Garlock and Anchor was encapsulated, which means the asbestos fibers were incorporated into the products during the manufacturing process and sealed in a binder. 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 Garlock's gaskets. Even though no warning label was required, Garlock included one on all of its asbestos-containing products beginning in 1978. Further, gaskets such as those previously manufactured and sold by Garlock are one of the few asbestos-containing products still permitted to be manufactured under regulations of the U.S. Environmental Protection Agency. Nevertheless, Garlock discontinued all manufacture and distribution of asbestos-containing products in the U.S. during 2000 and worldwide in mid-2001. From the mid-1980s until 2000, U.S. sales of asbestos-containing industrial sealing products were not a material part of Garlock's sales.

and were predominantly to sophisticated purchasers such as the U.S. Navy and large petrochemical facilities.

Garlock's product defenses have enabled it to be successful at trial. Garlock won a defense verdict in two of five cases tried to verdict thus far in 2009, three of the six cases tried to verdict in 2008, and four of six cases tried to verdict in 2006 and 2007. In the nine successful jury trials, the juries determined that either Garlock's products were not defective, that Garlock was not negligent, or that the claimant was not exposed to Garlock's products. Garlock's share of the adverse verdicts resulting from the other eight trials, most of which are being appealed, ranged from \$0 to \$900,000 and averaged about \$390,000.

Recent Trial Results. During the first nine months of 2009, Garlock began ten trials. A South Carolina jury returned a defense verdict in favor of Garlock in a mesothelioma lawsuit. In another South Carolina mesothelioma case, the jury awarded a plaintiff \$700,000; however, after set-offs, Garlock's share of this verdict was \$0. Garlock received a jury verdict in its favor in a Kentucky mesothelioma trial. In another Kentucky mesothelioma case, the jury awarded the plaintiff \$2.1 million. Garlock's share of this verdict was \$525,000; Garlock has appealed. In a New York City trial, the jury awarded a plaintiff \$8 million; Garlock's share of this verdict was \$160,000. Garlock plans to appeal. Lawsuits in Pennsylvania, New York and Florida settled during trial before the juries had reached a verdict. In California, Garlock received a dismissal in a mesothelioma case during trial.

In 2008, Garlock began eleven trials involving thirteen plaintiffs. Garlock received three jury verdicts in its favor, one in an Ohio case and two in a Pennsylvania trial involving two plaintiffs. A lawsuit in California was dismissed during trial. In South Carolina, Garlock obtained a dismissal in one case during trial because there was insufficient evidence of exposure to Garlock products. In a Kentucky lung cancer case, the jury awarded the plaintiff \$1.52 million. Garlock's share of this verdict was approximately \$682,000; Garlock has appealed. In a Pennsylvania lung cancer case the jury awarded the plaintiff \$400,000. Garlock's share was \$200,000, 50% of the total verdict. Garlock paid this verdict in the first quarter of 2009. In an Illinois case the jury awarded \$500,000 against Garlock to a plaintiff with asbestosis. Garlock has appealed. Also in Pennsylvania, four lawsuits involving five plaintiffs settled during trial before the jury reached a verdict.

In 2007, Garlock began nine trials involving twelve plaintiffs. A Massachusetts jury returned a defense verdict in favor of Garlock. In a Kentucky case, the jury awarded the plaintiff \$145,000 against Garlock. Garlock has appealed. Four lawsuits in Pennsylvania settled during trial before the juries had reached a verdict. Garlock also settled cases during trial in Louisiana, Maryland and Washington.

In 2006, Garlock began ten trials involving eleven plaintiffs. Garlock received jury verdicts in its favor in Oakland, California; Easton, Pennsylvania; and Louisville, Kentucky. In Pennsylvania, three other lawsuits involving four plaintiffs settled during trial before the juries reached verdict. Garlock also settled cases in Massachusetts, California and Texas during trial. In a Kentucky case, the jury awarded the plaintiff \$900,000 against Garlock. The award was significantly less than the \$1.75 million award against Garlock in a previous trial of the same case, which Garlock successfully appealed. In addition, Garlock obtained dismissals in two cases in Philadelphia after the juries were selected but before the trials began because there was insufficient evidence of exposure to Garlock products.

Appeals. Garlock has historically enjoyed success in a majority of its appeals. The Company believes that Garlock will continue to be successful in the appellate process, although there can be no assurance of success in any particular pending or future appeal. In June 2007, the New York Court of Appeals, in a unanimous decision, overturned an \$800,000 verdict that was entered against Garlock in 2004, granting a new trial. In March 2006, a three-judge panel of the Ohio Court of Appeals, in a unanimous decision, overturned a \$6.4 million verdict that was entered against Garlock in 2003, granting

a new trial. The case subsequently settled. The Maryland Court of Appeals denied Garlock's appeal from a 2005 verdict in a mesothelioma case in Baltimore and Garlock paid that verdict, with post-judgment interest, in 2006. In a separate Baltimore case in 2006, the Maryland Court of Special Appeals denied Garlock's appeal from another 2005 verdict. The subsequent appeal of that decision was also denied and Garlock paid that verdict in 2007, also with interest. At September 30, 2009, six Garlock appeals were pending from adverse verdicts totaling \$2.9 million, up from \$2.2 million at December 31, 2008 and \$1.4 million at December 31, 2007.

In some cases, appeals require the provision of security in the form of appeal bonds, potentially in amounts greater than the verdicts. The Company has been required to provide cash collateral or letters of credit to secure the full amount of the bonds, which can restrict the use of a significant amount of the Company's cash for the periods of such appeals. At September 30, 2009, the Company had approximately \$3.3 million of appeal bonds secured by letters of credit.

Settlements. Garlock settles and disposes of actions on a regular basis. Garlock's historical settlement strategy was to settle only cases in advanced stages of litigation. In 1999 and 2000, however, Garlock employed a more aggressive settlement strategy. The purpose of this strategy was to achieve a permanent reduction in the number of overall asbestos claims through the settlement of a large number of claims, including some early-stage claims and some claims not yet filed as lawsuits. Due to this short-term aggressive settlement strategy and a significant overall increase in claims filings, the settlement amounts paid in those years and several subsequent years were greater than the amounts paid in any year prior to 1999. In 2001, Garlock resumed its historical settlement strategy and focused on reducing settlement commitments. As a result, Garlock reduced new settlement commitments from \$180 million in 2000 to \$94 million in 2001 and \$86 million in 2002. New settlement commitments have continued to decline gradually and totaled \$71 million in 2008. New settlement commitments in the first nine months of 2009 were \$67.2 million, up from \$53.9 million in the first nine months of 2008.

Settlements are made without any admission of liability. Settlement amounts vary depending upon a number of factors, including the jurisdiction where the action was brought, the nature and extent of the disease alleged and the associated medical evidence, the age and occupation of the plaintiff, the presence or absence of other possible causes of the plaintiff's alleged illness and other defendants, alternative sources of payment available to the plaintiff, the availability of legal defenses, and whether the action is an individual one or part of a group.

Before any payment on a settled claim is made, the claimant is required to submit a medical report acceptable to Garlock substantiating the asbestos-related illness and meeting specific criteria of disability. In addition, sworn testimony or other reliable evidence that the claimant worked with or around Garlock asbestos-containing products is required. The claimant is also required to sign a full and unconditional release of Garlock, its subsidiaries, parent, officers, directors, affiliates and related parties from any liability for asbestos-related injuries or claims.

Status of Anchor. Anchor is an inactive and insolvent indirect subsidiary of Coltec. There is no remaining insurance coverage available to Anchor. Anchor has no remaining assets and has not committed to settle any actions since 1998. As cases reach the trial stage, Anchor is typically dismissed without payment.

Insurance Coverage. At September 30, 2009, Garlock had available \$252.7 million of insurance and trust coverage that the Company believes will be available to cover current and future asbestos claims and certain expense payments. In addition, at September 30, 2009, Garlock had classified \$10.2 million of otherwise available insurance as insolvent. Garlock collected approximately \$0.1 million from insolvent carriers in 2008, and the Company believes that Garlock may collect some additional amounts from insolvent carriers in the future. In fact, Garlock has received \$1.0 million from insolvent carriers

during the first nine months of 2009. There can be no assurance that Garlock will collect any additional insurance from insolvent carrie