

ENTRX CORP  
Form 10-Q  
August 14, 2002

**Table of Contents**

---

---

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

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the quarterly period ended **June 30, 2002**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-2000

**ENTRX CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

**95-2368719**

(State or other jurisdiction of

incorporation or organization) (I.R.S. Employer

Identification No.) **800 Nicollet Mall, Suite 2690, Minneapolis, MN**

(Address of Principal Executive Office) **55402**

(Zip Code)

Registrant's telephone number, including area code **(612) 333-0614**

Metaleclad Corporation

(Former name, former address and former fiscal year, if changed since last report)

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 such 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

As of August 1, 2002, the registrant had 7,674,015 shares outstanding of its Common Stock, \$.10 par value.

---

---

---

**TABLE OF CONTENTS**

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

CONSOLIDATED STATEMENTS OF OPERATIONS

CONSOLIDATED STATEMENTS OF CASH FLOWS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Item 3. Quantitative and Qualitative Disclosures about Market Risk

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

Item 4. Submission of Matters to a Vote of Security Holders

Item 6. Exhibits and Reports on Form 8-K

SIGNATURES

---

**Table of Contents**

**ENTRX CORPORATION AND SUBSIDIARIES**

**TABLE OF CONTENTS**

	Page
<hr/>	
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	
Consolidated Balance Sheets at June 30, 2002 (unaudited) and December 31, 2001 (audited)	1
Consolidated Statements of Operations for the three and six months ended June 30, 2002 and 2001 (unaudited)	2
Consolidated Statements of Cash Flows for the six months ended June 30, 2002 and 2001 (unaudited)	3
Notes to Consolidated Financial Statements (unaudited)	4
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	5
Item 3. Quantitative and Qualitative Disclosures about	

Market Risk  
9

PART II. OTHER  
INFORMATION

Item 1. Legal  
Proceedings  
9

Item 4. Submission  
of Matters to a Vote  
of Security Holders  
10

Item 6. Exhibits and  
Reports on Form 8-K  
10

SIGNATURES  
11

---

**Table of Contents****PART I****FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ENTRX CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

	June 30, 2002	December 31, 2001
	<u>(Unaudited)</u>	<u>(Audited)</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$8,309,238	\$13,133,311
Accounts receivable, less allowance for doubtful accounts of \$57,500 as of June 30, 2002 and December 31, 2001	2,334,992	1,853,290
Costs and estimated earnings in excess of billings on uncompleted contracts	134,398	154,601
Inventories	175,157	159,924
Prepaid expenses and other current assets	440,900	362,885
Receivables from related parties, net	537,794	
<hr/>		
<hr/>		
Total current assets	11,394,685	16,201,805
Property, plant and equipment, net	2,423,404	428,652
Investment, at cost	1,000,000	1,000,000
Goodwill	384,679	
Other assets	50,038	161,452
<hr/>		

---

\$15,252,806 \$17,791,909

---



---

**LIABILITIES AND  
SHAREHOLDERS EQUITY**

Current liabilities:

Accounts payable  
\$1,278,905 \$735,426  
Accrued expenses  
801,654 2,064,326  
Billings in excess of costs and estimated  
earnings on uncompleted contracts  
138,190 59,114  
Current portion of long-term debt  
80,583 84,749  
Current portion of mortgage payable  
71,661  
Note payable to bank  
996,002 1,000,000

---



---

Total current liabilities  
3,366,995 3,943,615  
Long-term debt, less current portion  
143,313 156,692  
Mortgage payable, less current portion  
1,457,314

---



---

Total liabilities  
4,967,622 4,100,307

---



---

Minority interests  
264,749  
Shareholders' equity :

Preferred stock, par value \$1.00 and \$10  
as of June 30, 2002 and December 31,  
2001, respectively; 5,000,000 and  
1,500,000 shares authorized as of  
June 30, 2002 and December 31, 2001,  
respectively; none issued

Common stock, par value \$.10;  
80,000,000 shares authorized; 7,674,015,  
and 7,448,015 issued and outstanding as  
of June 30, 2002 and December 31,  
2001, respectively

767,401 744,801

Additional paid-in capital

69,403,691 68,496,871

Accumulated deficit

(58,854,835) (54,295,549)

Officers' receivable

(1,295,822) (1,254,521)

---



---

10,020,435 13,691,602

---



---

\$15,252,806 \$17,791,909

---



---

See Notes to Consolidated Financial Statements



**Table of Contents**

**ENTRX CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)**

	For Three Months Ended		For Six Months Ended	
	June 30, 2002	June 30, 2001	June 30, 2002	June 30, 2001
<b>Revenue:</b>				
Contract revenues	\$4,259,845	\$5,512,708	\$7,425,469	\$11,103,510
Material sales	10,982	72,875	27,567	91,269
Other	3,241	11,449		
<hr/>				
<hr/>				
<hr/>				
<hr/>				
<b>Total revenue</b>	<b>4,270,827</b>	<b>5,588,824</b>	<b>7,453,036</b>	<b>11,206,228</b>
<hr/>				
<hr/>				
<hr/>				
<hr/>				
<b>Cost of revenue:</b>				
Contract costs and expenses	3,728,615	4,720,537	6,565,986	9,718,046
Cost of material sales	7,895	63,221	19,566	74,947
<hr/>				
<hr/>				
<hr/>				

---

Total cost of revenue  
 3,736,510 4,783,758 6,585,552 9,792,993

---



---



---



---

Gross margin  
 534,317 805,066 867,484 1,413,235

Operating expenses:

Selling, general and administrative  
 1,143,169 698,609 2,049,842 1,412,749

Restructuring charges  
 3,475,000

---



---



---



---

Total operating expenses  
 1,143,169 698,609 5,524,842 1,412,749

Operating profit (loss)  
 (608,852) 106,457 (4,657,358) 486

Interest income  
 71,726 (2,707) 142,730 4,191

Interest expense  
 (29,751) (44,144) (48,010) (86,141)

Other income (expense), net  
 (18) 3,112

Minority interest in net income (loss)  
 240 240

---



---



---



---

Income (loss) from continuing operations  
 (566,637) 59,588 (4,559,286) (81,464)

Loss from discontinued operations  
 (40,582) (271,808)

---

---

---

---

Net Income (loss)  
(\$566,637) \$19,006 (\$4,559,286) (\$353,272)

---

---

---

---

Weighted average number of common shares basic and diluted  
7,674,015 7,195,592 7,619,076 6,899,995

---

---

---

---

Earnings (loss) per share of common stock, continuing  
operations basic and diluted  
(\$.07) \$.01 (\$.60) (\$.01)

---

---

---

---

Loss per share of common stock, discontinued operations basic  
and diluted  
\$ (\$.01) \$ (\$.04)

---

---

---

---

Earnings (loss) per share of common stock basic and diluted  
(\$ .07) \$.00 (\$ .60) (\$.05)

---

---

---

---

See Notes to Consolidated Financial Statements

**Table of Contents**

**ENTRX CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Six Months Ended June 30,	
	2002	2001
	(Unaudited)	
Cash flows from operating activities:		
Net loss		
	\$(4,559,286)	\$(353,272)
Adjustments to reconcile net loss to net cash used in operating activities:		
Minority interest in net loss of consolidated subsidiary		
	(240)	
Loss from discontinued operations		
	271,808	
Depreciation and amortization		
	67,141	62,322
Loss on disposal of fixed assets		
	13,857	1,592
Issuance of common stock for interest		
	13,813	
Forgiveness of related party receivable related to restructuring		
	537,794	
Stock option compensation related to restructuring		
	348,600	
Common stock issued related to restructuring		
	580,820	
Changes in operating assets and liabilities:		
Accounts receivable		
	(481,702)	1,206,777
Unbilled receivables		
	20,203	(119,144)
Inventories		
	(15,233)	(49,936)
Prepaid expenses and other current assets		
	(78,015)	66,091
Receivables from related parties		
	(22,965)	
Other assets		
	111,414	1,776
Accounts payable and accrued expenses		
	(838,883)	(703,285)
Billings over cost		
	79,076	(8,592)

---

---

Net cash (used in) provided by  
continuing operations

(4,214,454) 366,985

Net cash used in discontinued  
operations

(306,349)

---

---

Net cash (used in) provided by  
operating activities

(4,214,454) 60,636

---

---

Cash flows from investing activities:

Capital expenditures

(2,075,750) (137,657)

Proceeds from sale of assets

1,500

---

---

Net cash used in investing activities

(2,075,750) (136,157)

---

---

Cash flows from financing activities:

Proceeds from long-term borrowings

196,658

Proceeds from mortgage payable

1,535,000

Payments on note payable to bank

(3,998)

Payments on long-term borrowings

(17,545) (35,071)

Payments on mortgage payable

(6,025)

Borrowing by an officer

(41,301)

Proceeds from sale of stock and  
warrants  
600,000

---

---

Net cash provided by financing  
activities  
1,466,131 761,587

---

---

(Decrease) increase in cash and cash  
equivalents  
(4,824,073) 686,066  
Cash and cash equivalents at beginning  
of period  
13,133,311 354,345

---

---

Cash and cash equivalents at end of  
period  
\$8,309,238 \$1,040,411

---

---

**Supplemental disclosures of cash flow  
information:**

Cash paid for interest  
\$41,638 \$24,689

---

---

**Disclosure of noncash investing and financing activities:**

During the six months ended June 30, 2001, the Company converted approximately \$324,000 of convertible subordinated debentures, principal and interest into 266,900 shares of common stock.

As part of the purchase of Surg II, Inc. the Company has goodwill of \$384,679 and minority interests of \$264,749.

Edgar Filing: ENTRX CORP - Form 10-Q

See Notes to Consolidated Financial Statements



**Table of Contents**

**ENTRX CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Six Months Ended June 30, 2002**  
(Unaudited)

1. The accompanying unaudited consolidated financial statements of Entrx Corporation and its subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q. Accordingly they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America. In the opinion of management all adjustments, consisting of normal recurring items, necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. These consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.
2. On December 20, 2001, Wayne Mills filed Form 13D/A with the Securities and Exchange Commission, indicating his intent to seek a change in management and the Board of the Company. Mr. Mills indicated that, absent a cooperative solution, he would seek shareholder consents to replace the entire Board.

It was management's decision that the shareholders would benefit by not involving the Company in a proxy contest which would hinder its opportunity to move forward with its strategy for growth. Consequently, on February 13, 2002, Grant S. Kesler, Anthony C. Dabbene and Bruce H. Haglund resigned as members of the Board of Directors of the Company. The remaining members of the Board of Directors elected Messrs. Wayne W. Mills, Kenneth W. Brimmer, Gary W. Copperud and Joseph M. Senser to fill an existing vacancy on the Board of Directors and the vacancies created by the resignations of Messrs. Kesler, Dabbene and Haglund. In addition, Messrs. Kesler and Dabbene resigned as officers of the Company and Mr. Mills was elected President and Chief Executive Officer and Brian D. Niebur was elected Treasurer and Chief Financial Officer.

In connection with their resignations, and in lieu of compensation which would otherwise be due under change of control provisions contained in previously executed and adopted employment contracts, which were amended and restated as of January 1, 2002, the Company issued Mr. Kesler 140,000 shares of the Company's common stock, forgave a loan due from Mr. Kesler in the amount of \$543,000 in exchange for future consulting services and paid Mr. Kesler \$832,000 in cash, and issued Mr. Dabbene 86,000 shares of the Company's common stock and paid Mr. Dabbene \$637,000 in cash. In addition, all outstanding unvested stock options held by the prior Board of Directors, including Messrs. Dabbene and Kesler, were immediately vested and became exercisable. Messrs. Kesler and Dabbene have each agreed to act as a consultant to Entrx under two-year and three-month consulting agreements, respectively. In addition to the payment discussed above, Mr. Dabbene's compensation for consulting will be \$5,000 per month. A portion of the cash payments due to Mr. Kesler and Mr. Dabbene (\$482,000 and \$425,000, respectively) was deposited by Entrx as income and payroll tax withholding on the total compensation paid to each of them.

In March 2002, the Company reimbursed Mr. Mills \$100,000 for legal fees expended by him to effect this change in management.

During the three months ended March 31, 2002, the Company recognized \$3,475,000 of expense related to the change of management, including insurance premiums, legal fees, severance pay and relocation of the Company's headquarters. The cash payments related to these expenses were approximately \$2,008,000. The non-cash charges primarily relate to the forgiveness of the loan due from Mr. Kesler, the issuance of common stock to Messrs. Kesler and Dabbene, the expense pursuant to APB No. 25 and related interpretations and the accelerated vesting of stock options for the prior directors.

3. Certain amounts have been reclassified from previously reported categories.
4. The earnings (loss) per share amounts for the three and six months ended June 30, 2002 and June 30, 2001 were computed by dividing the net income (loss) by the weighted average shares outstanding during the applicable period. Dilutive common equivalent shares have not been included in the computation of diluted income (loss) per share because their inclusion would be antidilutive. Antidilutive common equivalent shares issuable based on future exercise of stock options or warrants could potentially dilute basic and diluted income (loss) per share in subsequent periods.

All stock options and warrants were anti-dilutive as of June 30, 2002 and 2001.

**Table of Contents**

5. On December 10, 2001 the Company issued a \$1,250,000, 6%, non-recourse secured note to Blake Capital Partners, LLC ( Blake ), an entity controlled 100% by Wayne Mills. On February 14, 2002 Mr. Mills became President and CEO of the Company. The note is collateralized by 500,000 shares of the Company s common stock, owned by Blake and Mr. Mills. The principal and interest was due June 10, 2002. Blake had the right to extend the maturity date of this note for a period of 90 days, and on June 10, 2002 exercised that right. During the 90-day extension period, simple interest shall be payable at 12% per annum. As of June 30, 2002, the market value of the common stock held as collateral was \$960,000, \$290,000 less than the face amount of the note.

6. On May 31, 2002, the Company acquired 145,000,000 shares of common stock, constituting approximately 90% of the outstanding shares of Surg II, Inc. ( Surg II ) for \$3,000,000 invested into Surg II. Goodwill from this transaction was \$384,276 which is not deductible for tax purposes. Surg II recently sold all of its assets and discontinued its former business of manufacturing and marketing medical products. The Company plans to use Surg II for the acquisition of a yet uncommitted business enterprise. The common stock of Surg II is traded on the NASDAQ Bulletin Board under the symbol SUGR.

7. In May 2002, the Company purchased the facilities in Anaheim, California, housing the industrial insulation services operations. The purchase price was \$2,047,000. The Company obtained a \$1,535,000 mortgage on the building from Community Bank that matures on May 1, 2017 and bears interest at a floating rate based upon the bank s reference rate plus .25%.

**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

All statements, other than statements of historical fact, included in this Form 10-Q, including without limitation the statements under Management s Discussion and Analysis of Financial Condition and Results of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934. Such forward-looking statements involve assumptions, known and unknown risks, uncertainties, and other factors which may cause the actual results, performance or achievements of Entrx Corporation (the Company ) to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements contained in this Form 10-Q. Such potential risks and uncertainties include, without limitation, potential reversion of liability for the companies sold in Mexico; competitive pricing and other pressures from other businesses in the Company s markets; adequacy of insurance, including the adequacy of insurance to cover potential future asbestos-related injury claims; economic conditions generally and in the Company s primary markets; availability of capital; the adequacy of its cash and cash equivalents; the expansion of material sales; cost of labor; the likelihood of completing a transaction using Surg II for the acquisition of a yet uncommitted business enterprise and other risk factors detailed herein and in other of the Company s filings with the Securities and Exchange Commission. The forward-looking statements are made as of the date of this Form 10-Q and the Company assumes no obligation to update the forward-looking statements or to update the reasons actual results could differ from those projected in such forward-looking statements. Therefore, readers are cautioned not to place undue reliance on these forward-looking statements.

**Results of Operations: Three and Six Months Ended June 30, 2002 and 2001**

*General.* Historically, the Company s revenues were generated primarily by (i) revenues in the United States from insulation services and sales of insulation products and related materials; and, (ii) revenues in Mexico from the collection of waste oils and solvents for recycling, rental of parts washing machines, brokering the disposal of waste and remediation services.

In 1997, the Company filed a claim against the United Mexican States under the North American Free Trade Agreement ( NAFTA ) to recover the value of its investment in a completed, but unopened, treatment, storage and disposal facility in San Luis Potosi. During the fourth quarter of 1998, the Company determined, that due to political opposition in Mexico, its Mexican operations would not be successful and committed to a plan to discontinue its Mexican operations to minimize future losses and halted any further investment in Mexico. The Company settled its claims against the Mexican Government in October 2001 for \$16,002,000. This settlement completed the Company s activities in Mexico and essentially closed out all discontinued operations in Mexico.

**Revenue**

Total revenue for the three months ended June 30, 2002 was \$4,271,000 as compared to \$5,589,000 for the comparable period ended June 30, 2001, a decrease of 24%, as a result of a decrease in contract revenue. For the six months

**Table of Contents**

ended June 30, 2002, total revenue was \$7,453,000 as compared to \$11,206,000 for the six months ended June 30, 2001. These decreases are primarily due to fires at two of the Company's customer sites that generated incremental revenue in the three and six months ended June 30, 2001 and also due to the general economic slowdown in 2002. Material sales revenue, which is immaterial to overall revenue, was \$11,000 and \$28,000 for the three and six months ended June 30, 2002, respectively, as compared to \$73,000 and \$91,000 for the three and six months ended June 30, 2001, respectively. In the future, the Company intends to expand its material sales efforts and expects this area to contribute a greater percentage to the Company's overall revenue.

**Cost of Revenue and Gross Margin**

Total cost of revenue was \$3,737,000 for the three months ended June 30, 2002 as compared to \$4,784,000 for the three months ended June 30, 2001, a decrease of 22%. For the six months ended June 30, 2002, total cost of revenue was \$6,586,000 as compared to \$9,793,000 for the comparable period in 2001, a decrease of 33%. These decreases were primarily the result of the Company's decrease in revenue for the three and six months ended June 30, 2002 as compared to the three and six months ended June 30, 2001. The gross margin percentage was approximately 12.5% and 11.6% for the three and six months ended June 30, 2002 as compared to 14.4% and 12.6% for the three and six months ended June 30, 2001.

**Selling, General and Administrative**

Selling, general and administrative expenses for the three months ended June 30, 2002 were \$1,143,000 as compared to \$699,000 for the comparable period ended June 30, 2001, an increase of 64%. The increase is primarily the result of an increase in legal fees and insurance expense partially offset by a decrease in compensation expense. In addition, the three months ended June 30, 2002 includes a charge of \$129,000 for a judgment against the Company and expenses related to a lawsuit initiated under prior management. For the six months ended June 30, 2002 selling, general and administrative expenses were \$2,050,000 as compared to \$1,413,000 for the six months ended June 30, 2001, an increase of 45%. For the six months ended June 30, 2002, there were increases in legal fees, insurance expense, board fees, primarily for the period prior to February 14, 2002, and accounting fees. The above mentioned judgment and expenses also added to the increase in expenses for the six months ended June 30, 2002 as compared to the six months ended June 30, 2001. These increases were partially offset by a decrease in compensation and related expenses.

**Restructuring Charges**

On December 20, 2001, Wayne Mills filed Form 13D/A with the Securities and Exchange Commission, indicating his intent to seek a change in management and the Board of the Company. Mr. Mills indicated that, absent a cooperative solution, he would seek shareholder consents to replace the entire Board.

It was management's decision that the shareholders would benefit by not involving the Company in a proxy contest which would hinder its opportunity to move forward with its strategy for growth. Consequently, on February 13, 2002, Grant S. Kesler, Anthony C. Dabbene and Bruce H. Haglund resigned as members of the Board of Directors of the Company. The remaining members of the Board of Directors elected Messrs. Wayne W. Mills, Kenneth W. Brimmer, Gary W. Copperud and Joseph M. Senser to fill an existing vacancy on the Board of Directors and the vacancies created by the resignations of Messrs. Kesler, Dabbene and Haglund. In addition, Messrs. Kesler and Dabbene resigned as officers of the Company and Mr. Mills was elected President and Chief Executive Officer and Brian D. Niebur was elected Treasurer and Chief Financial Officer.

In connection with their resignations, and in lieu of compensation which would otherwise be due under change of control provisions contained in previously executed and adopted employment contracts, which were amended and restated as of January 1, 2002, the Company issued Mr. Kesler 140,000 shares of the Company's common stock, forgave a loan due from Mr. Kesler in the amount of \$543,000 in exchange for future consulting services and paid Mr. Kesler \$832,000 in cash, and issued Mr. Dabbene 86,000 shares of the Company's common stock and paid Mr. Dabbene \$637,000 in cash. In addition, all outstanding unvested stock options held by the prior Board of Directors, including Messrs. Kesler and Dabbene, were immediately vested and became exercisable. Messrs. Kesler and Dabbene have each agreed to act as a consultant to Entrx under two-year and three-month consulting agreements, respectively. In addition to the payment discussed above, Mr. Dabbene's compensation for consulting will be \$5,000 per month. A portion of the cash payments due to Mr. Kesler and Mr. Dabbene (\$482,000 and \$425,000, respectively) was deposited by Entrx as income and payroll tax withholding on the total compensation paid to each of them.

## **Table of Contents**

In March 2002, the Company reimbursed Mr. Mills \$100,000 for legal fees expended by him to effect this change in management.

During the three months ended March 31, 2002, the Company recognized \$3,475,000 of expense related to the change of management, including insurance premiums, legal fees, severance pay and relocation of the Company's headquarters. The cash payments related to these expenses were approximately \$2,008,000. The non-cash charges primarily relate to the forgiveness of the loan due from Mr. Kesler, the issuance of common stock to Messrs. Kesler and Dabbene, the expense pursuant to APB No. 25 and the related interpretations and the accelerated vesting of stock options for the prior directors.

### **Interest Income and Expense**

Net interest income for the three months ended June 30, 2002 was \$42,000 as compared to net interest expense of \$47,000 for the three months ended June 30, 2001. For the six months ended June 30, 2002 net interest income was \$95,000 compared with net interest expense of \$82,000 for the comparable period in 2001. These changes were primarily due to a higher average cash and cash equivalent balance for the three and six months ended June 30, 2002 as compared to June 30, 2001 and to an interest-bearing loan to a corporate officer outstanding during the three and six months ended June 30, 2002.

### **Discontinued Operations**

For the three and six months ended June 30, 2001, \$41,000 and \$272,000, respectively, in fees for the continuing costs of the NAFTA proceedings was expensed to discontinued operations. The Company does not anticipate that there will be any future costs associated with its discontinued operations.

### **Net Income (Loss)**

The Company experienced a net loss of \$567,000 (or a loss of \$0.07 per share) for the three months ended June 30, 2002, as compared to net income of \$19,000 (or an earnings of \$0.00 per share) for the comparable period ended June 30, 2001. The Company experienced a net loss of \$4,559,000 (or a loss of \$0.60 per share) for the six months ended June 30, 2002, as compared to net loss of \$353,000 (or a loss of \$0.05 per share) for the comparable period ended June 30, 2001. The net loss from continuing operations was \$567,000 and \$4,559,000, primarily due to the restructuring charges and the decrease in revenues, for the three and six months ended June 30, 2002, respectively, as compared to net income from continuing operations of \$60,000 and net loss from continuing operations of \$81,000, respectively, for the comparable period ended June 30, 2001. Without the restructuring charges the Company would have lost \$1,084,000 from continuing operations in the six months ended June 30, 2002.

### **Liquidity and Capital Resources**

As of June 30, 2002, the Company had \$8,309,000 in cash and cash equivalents, and working capital of \$8,028,000. The Company has a line of credit agreement with a bank for \$1,000,000 which matures on May 1, 2003. Borrowings under the agreement are limited to the lower of \$1,000,000 or the Company's borrowing base, which consists of a specified percentage of certain accounts receivable. As of June 30, 2002, the Company had a balance of \$996,000 outstanding on this line of credit.

Cash used in continuing operations was \$4,214,000 for the six months ended June 30, 2002 compared with cash provided by continuing operations of \$367,000 for the six months ended June 30, 2001. For the six months ended June 30, 2002 the negative cash flow from continuing operations was primarily the result of funding operating losses principally due to the Company's restructuring. In addition the company used cash to decrease its accounts payable and accrued expenses and increase its accounts receivable. These uses were partially offset by non-cash expenses for stock based compensation and the forgiveness of the loan to Mr. Kesler. For the six months ended June 30, 2001 the positive cash flow from continuing operations was primarily the result of the collection of accounts receivable offset by a decrease in accounts payable and accrued expenses.

Cash used in discontinued operations was \$306,000 for the six months ended June 30, 2001, primarily for legal fees related to the Company's NAFTA claim against the Mexican government.

Net investing activities used \$2,076,000 and \$136,000 of cash in the six months ended June 30, 2002 and 2001, respectively, for capital expenditures, primarily at the Company's subsidiary, Metalclad Insulation Corporation (Metalclad Insulation). For the six

**Table of Contents**

months ended June 30, 2002, \$2,047,000 of the investing activity related to the purchase of the building housing Metalclad Insulation.

Cash provided by financing activities totaled \$1,466,000 for the six months ended June 30, 2002 compared with cash provided by financing activities of \$762,000 for the comparable period in 2001. The Company obtained a mortgage to purchase the building housing Metalclad Insulation that provided \$1,535,000 of cash in the six months ended June 30, 2002. Payments on long-term borrowings and borrowing by an officer used \$18,000 and \$41,000 of cash, respectively, for the six months ended June 30, 2002. A private placement of the Company's common stock and warrants provided \$600,000 of cash flow during the six months ended June 30, 2001 and long-term borrowings provided \$197,000 of cash. In 2001, \$1,255,000 of cash was loaned to a then principal shareholder, of the Company under a note secured by 500,000 shares of the Company's stock. As of June 30, 2002, the market value of the common stock held as collateral was \$960,000, \$290,000 less than the face amount of the note. In September 2001 the Company obtained an accounts receivable revolving line of credit, with a maturity date of July 1, 2002, that provided \$1,000,000 of cash flow. The maturity date of the line of credit has been extended to May 1, 2003.

Prior to 1975, the Company was engaged in the sale and installation of asbestos related insulation materials, and has been the subject of numerous claims of personal injury allegedly related to asbestos exposure. Many of these claims are now being brought by the children and close relatives of persons who have died, allegedly as a result of the direct or indirect exposure to asbestos.

The number of asbestos related claims which have been initiated naming the Company as a defendant have increased from 254 in 1999, 527 in 2000 to 685 in 2001. The sympathies of juries, the aggressiveness of the plaintiff's bar, and the declining defendant base as a result of business failures, has also led to a trend of larger payments and settlements per claim. There are currently in excess of 700 of such claims pending.

The Company in the past has believed that it has adequate insurance to cover these claims; however, the terms of such insurance policies are complex and the coverage for many types of claims is limited. If the current trend of the increasing claim occurrence and amounts is not significantly reversed, it will likely have a material adverse effect on the financial condition and business of the Company in the future. Because of its insurance coverage, the Company does not anticipate any adverse effect on the Company's financial condition to develop for at least the next three to five years. Beyond that, however, the effect of those claims is uncertain.

On May 31, 2002, the Company acquired 145,000,000 shares of common stock, constituting approximately 90% of the outstanding shares of Surg II, Inc. (Surg II) for \$3,000,000 invested into Surg II. Prior to the investment of \$3,000,000, Surg II sold all of its assets and discontinued its former business of manufacturing and marketing medical products. The Company plans to use Surg II for the acquisition of a yet uncommitted business enterprise. The common stock of Surg II is traded on the NASDAQ Bulletin Board under the symbol SUGR.

In May 2002, the Company purchased the facilities in Anaheim, California, housing the industrial insulation services operations of Metalclad Insulation. The purchase price was \$2,047,000. The Company obtained a \$1,535,000 mortgage on the building from Community Bank that matures on May 1, 2017 and bears interest at a floating rate based upon the bank's reference rate plus .25%.

Management believes that its cash, cash equivalents and borrowings available under the credit agreement should be sufficient to satisfy its cash requirements for the next twelve months.

**Critical Accounting Policies and Estimates**

Our significant accounting policies are described in Note 1 to the consolidated financial statements included in our annual report for the year ended December 31, 2001. The accounting policies used in preparing our interim 2002 consolidated condensed financial statements are the same as those described in our annual report.

Our critical accounting policies are those both having the most impact to the reporting of our financial condition and results, and requiring significant judgments and estimates. Our critical accounting policies include those related to (a) revenue recognition and (b) investment, at cost. Revenue recognition for fixed price insulation installation and asbestos abatement contracts are accounted for by the percentage-of-completion method wherein costs and estimated earnings are included in revenues as the work is performed. If a loss on a fixed price contract is indicated, the entire amount of the

**Table of Contents**

estimated loss is accrued when known. The investment at less than 20% of ownership is recorded at cost and the carrying value is evaluated quarterly.

**Recently Issued Accounting Pronouncements**

In April 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. The Company believes the adoption of SFAS No. 145 will not have a material effect on the Company's consolidated financial position or results of operations.

In June 2002, FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 requires the recognition of a liability for a cost associated with an exit or disposal activity when the liability is incurred versus the date the Company commits to an exit plan. In addition, SFAS No. 146 states the liability should be initially measured at fair value. The requirements of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The Company believes the adoption of SFAS No. 146 will not have a material effect on the Company's consolidated financial position or results of operations.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Not Applicable

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

Prior to 1975, the Company was engaged in the sale and installation of asbestos related insulation materials, and has been the subject of numerous claims of personal injury allegedly related to asbestos exposure. Many of these claims are now being brought by the children and close relatives of persons who have died, allegedly as a result of the direct or indirect exposure to asbestos.

The number of asbestos related claims which have been initiated naming the Company as a defendant have increased from 254 in 1999, 527 in 2000 to 685 in 2001. The sympathies of juries, the aggressiveness of the plaintiff's bar, and the declining defendant base as a result of business failures, has also led to a trend of larger payments and settlements per claim. There are currently in excess of 700 of such claims pending.

The Company in the past has believed that it has adequate insurance to cover these claims; however, the terms of such insurance policies are complex and the coverage for many types of claims is limited. If the current trend of the increasing claim occurrence and amounts is not significantly reversed, it will likely have a material adverse effect on the financial condition and business of the Company in the future. Because of its insurance coverage, the Company does not anticipate any adverse effect on the Company's financial condition to develop for at least the next three to five years. Beyond that, however, the effect of those claims is uncertain.

**Item 2. Changes in Securities**

None

**Item 3. Defaults Upon Senior Securities**

Not Applicable

**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders**

At the Annual Meeting of Shareholders held on June 24, 2002 the following proposals were adopted by the margins indicated:

1. Elect a Board of Directors to hold office until the next Annual Meeting of Shareholders and until their successors are elected and qualified.

	Number of Shares	
	For	Withheld
Kenneth W. Brimmer	6,992,464	43,956
Wayne W. Mills	6,992,164	44,256
Gary W. Copperud	6,992,164	44,256
Joseph M. Senser	6,992,164	44,256
Joseph M. Caldwell	6,992,464	43,956

2. Amend the 2000 Omnibus Stock Option and Incentive Plan to increase the number of shares reserved for issuance thereunder.

Number of Shares Voted			Broker Non-votes
Voted For	Voted Against	Abstain	
3,942,879	307,390	6,583	2,779,568

3. Amend the Company's Certificate of Incorporation to change its name to Entrx Corporation and increase its authorized preferred stock.

Number of Shares Voted			Broker Non-votes
Voted For	Voted Against	Abstain	
3,963,571	265,201	28,080	2,779,568

**Item 5. Other Information**

None.

**Item 6. Exhibits and Reports on Form 8-K**

On April 10, 2002 the Company filed a form 8-K disclosing that its independent accounts, Moss Adams LLP, had resigned.

On April 18, 2002 the Company filed a form 8-K disclosing that it had engaged Virchow Krause & Company, LLP to audit its financial statements for 2002.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**ENTRX CORPORATION**

Date: August 14, 2002 By: /s/Wayne W. Mills  
\_\_\_\_\_

Wayne W. Mills

Chief Executive Officer Date: August 14, 2002 By: /s/Brian D.  
Niebur  
\_\_\_\_\_

Brian D. Niebur  
Chief Financial Officer  
(Principal Accounting Officer)