

ENTRX CORP
Form 10-Q
November 08, 2002

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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 September 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**

(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 November 1, 2002, the registrant had 7,577,015 shares outstanding of its Common Stock, \$.10 par value.

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CONSOLIDATED BALANCE SHEETS**

	September 30, 2002	December 31, 2001
	(Unaudited)	(Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,148,951	\$ 13,133,311
Available-for-sale securities	454,600	
Restricted cash	2,100,000	
Accounts receivable, less allowance for doubtful accounts of \$57,500 as of September 30, 2002 and December 31, 2001	2,132,933	1,853,290
Costs and estimated earnings in excess of billings on uncompleted contracts	280,470	154,601
Inventories	237,056	159,924
Prepaid expenses and other current assets	715,644	362,885
Receivables from related parties, net		537,794
	<hr/>	<hr/>
Total current assets	11,069,654	16,201,805
Property, plant and equipment, net	2,463,161	428,652
Investment, at cost	1,000,000	1,000,000
Goodwill	387,897	
Other assets	104,739	161,452
	<hr/>	<hr/>
	\$ 15,025,451	\$ 17,791,909
	<hr/>	<hr/>
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,474,292	\$ 735,426
Accrued expenses	833,657	2,064,326
Billings in excess of costs and estimated earnings on uncompleted contracts	230,160	59,114
Current portion of long-term debt	84,549	84,749
Current portion of mortgage payable	72,539	
Note payable to bank	996,002	1,000,000
	<hr/>	<hr/>
Total current liabilities	3,691,199	3,943,615
Long-term debt, less current portion	185,872	156,692
Mortgage payable, less current portion	1,439,279	
	<hr/>	<hr/>
Total liabilities	5,316,350	4,100,307
	<hr/>	<hr/>
Minority interest	267,430	
Shareholders equity:		
Preferred stock, par value \$1.00 and \$10 as of September 30, 2002 and December 31, 2001, respectively; 5,000,000 and 1,500,000 shares authorized as of September 30, 2002 and December 31, 2001,		

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respectively; none issued		
Common stock, par value \$.10; 80,000,000 shares authorized; 7,674,015 and 7,552,015 issued and outstanding as of September 30, 2002, respectively and 7,448,015 issued and outstanding as of December 31, 2001	767,401	744,801
Additional paid-in capital	69,403,691	68,496,871
Less treasury stock at cost, 122,000 shares	(154,449)	
Accumulated deficit	(59,909,830)	(54,295,549)
Accumulated other comprehensive loss	(76,512)	
Officers' receivable, net	(588,630)	(1,254,521)
	<u>9,441,671</u>	<u>13,691,602</u>
	<u>\$ 15,025,451</u>	<u>\$ 17,791,909</u>

See Notes to Consolidated Financial Statements

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ENTRX CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	For Three Months Ended		For Nine Months Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
Revenue:				
Contract revenues	\$ 3,465,422	\$ 3,295,841	\$ 10,890,891	\$ 14,399,351
Material sales	49,135	18,154	76,702	109,423
Other				11,449
Total revenue	3,514,557	3,313,995	10,967,593	14,520,223
Cost of revenue:				
Contract costs and expenses	2,998,370	2,741,318	9,564,356	12,459,364
Cost of material sales	39,243	(12,156)	58,809	62,791
Total cost of revenue	3,037,613	2,729,162	9,623,165	12,522,155
Gross margin	476,944	584,833	1,344,428	1,998,068
Operating expenses:				
Selling, general and administrative	831,132	562,809	2,880,974	1,975,558
Increase in allowance on officers' receivable	745,000		745,000	
Restructuring charges			3,475,000	
Total operating expenses	1,576,132	562,809	7,100,974	1,975,558
Operating profit (loss)	(1,099,188)	22,024	(5,756,546)	22,510
Interest income	79,321	6,843	222,050	11,034
Interest expense	(35,665)	(26,474)	(83,674)	(112,615)
Other income (expense), net			3,112	
Minority interest in net loss	537		777	
Income (loss) from continuing operations	(1,054,995)	2,393	(5,614,281)	(79,071)
Loss from discontinued operations		(130,159)		(401,967)
Net loss	(1,054,995)	(127,766)	(5,614,281)	(481,038)
Other comprehensive loss:				
Unrealized loss on available-for-sale securities	(76,512)		(76,512)	
Comprehensive loss	(\$1,131,507)	(\$127,766)	(\$5,690,793)	(\$481,038)
Weighted average number of common shares - basic and diluted	7,645,830	7,448,015	7,628,092	7,084,676

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Earnings (loss) per share of common stock, continuing operations basic and diluted	(\$.14)	\$.00	(\$.74)	(\$.01)
Loss per share of common stock, discontinued operations basic and diluted	\$ (\$.02)		\$ (\$.06)	
Loss per share of common stock basic and diluted	(\$.14)	(\$.02)	(\$.74)	(\$.07)

See Notes to Consolidated Financial Statements

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ENTRX CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2002	2001
	(Unaudited)	
Cash flows from operating activities:		
Net loss	\$ (5,614,281)	\$ (481,038)
Adjustments to reconcile net loss to net cash used in operating activities:		
Minority interest in net loss of consolidated subsidiary	(777)	
Loss from discontinued operations		401,967
Depreciation and amortization	92,743	95,307
Loss on disposal of property, plant and equipment	11,211	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	
Allowance on officer's receivable	745,000	
Interest income recorded on officer's receivable	(79,109)	
Changes in operating assets and liabilities:		
Restricted cash	(2,100,000)	
Accounts receivable	(279,643)	2,069,672
Costs and estimated earnings in excess of billings on uncompleted contracts	(125,869)	23,615
Inventories	(77,132)	(48,414)
Prepaid expenses and other current assets	(352,759)	(188,694)
Receivables from related parties		(23,125)
Other assets	56,713	1,454
Accounts payable and accrued expenses	(611,493)	(1,071,180)
Billings in excess of costs and estimated earnings on uncompleted contracts	171,046	30,608
	(6,697,136)	825,577
Net cash (used in) provided by continuing operations		(366,416)
Net cash used in discontinued operations		
	(6,697,136)	459,161
Cash flows from investing activities:		
Capital expenditures	(2,138,463)	(137,657)
Purchases of available-for-sale securities	(531,112)	
Proceeds from sale of assets		1,500
	(2,669,575)	(136,157)
Cash flows from financing activities:		
Proceeds from long-term borrowings	105,003	1,202,438
Proceeds from mortgage payable	1,535,000	
Payments on note payable to bank	(3,998)	
Payments on long-term borrowings	(76,023)	(1,154,934)
Payments on mortgage payable	(23,182)	
Purchase of treasury stock	(154,449)	
Proceeds from sale of stock and warrants		600,000
	1,382,351	647,504
Net cash provided by financing activities		

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(Decrease) increase in cash and cash equivalents	(7,984,360)	970,508
Cash and cash equivalents at beginning of period	13,133,311	354,345
Cash and cash equivalents at end of period	\$ 5,148,951	\$ 1,324,853

See Notes to Consolidated Financial Statements

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ENTRX CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Nine Months Ended September 30, 2002 and 2001
(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 nine months ended September 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 loss per share amounts for the three and nine months ended September 30, 2002 and September 30, 2001 were computed by dividing the net loss by the weighted average shares outstanding during the applicable period. Dilutive common equivalent shares have not been included in the computation of diluted 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 loss per share in subsequent periods.

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

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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 and beyond, simple interest shall be payable at 12% per annum. As of September 30, 2002, the market value of the common stock held as collateral was \$505,000, \$745,000 less than the face amount of the note. The note was not repaid on the extended due date of September 8, 2002. The Company recorded a \$745,000 allowance to record the face amount of the note at the value of the underlying collateral on September 30, 2002. The carrying value will continue to fluctuate as the market value of the common stock of the Company held as collateral changes.

It is the Company s policy to recognize interest income on notes receivable as long as the Company deems the note to be collectible.

6. On May 29, 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, and on September 25, 2002 acquired an additional 14,285,714 shares by investing an additional \$300,000 into Surg II. Goodwill from these transactions was 387,994 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 SURG. (See Note 12)

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%.

8. On September 27, 2002, the Company purchased a certificate of deposit (CD) for \$2,100,000. This CD is being used as collateral for a letter of credit issued by Community Bank to a customer of the Company s subsidiary Metalclad Insulation Corporation, as a substitute for a bond to secure a project engaged in by that subsidiary. The letter of credit and CD both mature on July 1, 2003. The CD cannot be redeemed until the letter of credit has matured or been cancelled and therefore the CD has been classified as restricted cash.

9. The Company classified all equity securities, which are not cash equivalents, as available-for-sale securities. Available-for-sale securities were reported at fair value with all unrealized gains or losses included in other comprehensive income. The fair value of the securities was determined by quoted market prices of the underlying security.

10. On July 31, 2002, the Board of Directors authorized a stock repurchase program under which the Company is authorized to repurchase up to 500,000 shares of its common stock in the open market. Through September 30, 2002, the Company repurchased 122,000 common shares for an aggregate price of approximately \$154,000, excluding commissions or other expenses associated with the repurchase.

11. Supplemental disclosures of cash flow information:

Cash paid for interest was \$83,674 and \$261,200 for the nine months ended September 30, 2002 and 2001, respectively.

Disclosure of non-cash investing and financing activities:

During the nine months ended September 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 \$387,897 and minority interest of \$267,430.

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12. Subsequent Events:

The 159,285,714 shares of no par value common stock of Surg II owned by the Company became 3,982,142 shares of \$0.01 par value common stock as of the close of business on October 4, 2002, as the result of a one for 40 reverse stock split of Surg II's common stock.

On October 22, 2002, the Company spun-off 3,791,576 shares of Surg II to its shareholders as a dividend. Each shareholder of record as of October 11, 2002 received one share of Surg II, Inc. common stock for every two shares of Entrx Corporation common stock held. The Company still owns 190,566 shares of Surg II common stock.

The pro-forma consolidated balance sheet to reflect this dividend as if it occurred on September 30, 2002 is as follows:

**ENTRX CORPORATION AND SUBSIDIARIES
PRO-FORMA CONSOLIDATED BALANCE SHEET**

	September 30, 2002
ASSETS	
Current assets:	
Cash and cash equivalents	\$ 1,950,270
Available-for-sale securities	645,166
Restricted cash	2,100,000
Accounts receivable, net	2,132,933
Other current assets	1,219,670
Total current assets	8,048,039
Property, plant and equipment, net	2,463,161
Investment, at cost	1,000,000
Other assets	104,739
	\$ 11,615,939
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities	\$ 3,650,626
Long-term debt, less current portion	185,872
Mortgage payable, less current portion	1,439,279
Total liabilities	5,275,777
Shareholders' equity:	
Common stock	767,401
Additional paid-in capital	69,403,691
Less treasury stock at cost	(154,449)
Accumulated deficit	(63,011,339)
Accumulated other comprehensive loss	(76,512)
Officers' receivable, net	(588,630)
	6,340,162
	\$ 11,615,939

Information as of December 31, 2001 would remain the same since the acquisition and dividend of Surg II both occurred during 2002.

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The pro-forma consolidated statements of operations to reflect this dividend as if it occurred on May 31, 2002 is as follows:

ENTRX CORPORATION AND SUBSIDIARIES
PRO-FORMA CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended	For the Nine Months Ended
	September 30, 2002	September 30, 2002
Total revenue	\$ 3,514,557	\$ 10,967,593
Total cost of revenue	3,037,613	9,623,165
Gross margin	476,944	1,344,428
Total operating expenses	1,552,625	7,068,781
Operating profit (loss)	(1,075,681)	(5,724,353)
Other income (expense), net	26,237	117,997
Net loss	\$ (1,049,444)	\$ (5,606,356)
Weighted average number of common shares basic and diluted	7,645,830	7,628,092
Loss per share of common stock basic and diluted	(\$.14)	(\$.74)

Information for the periods ended September 30, 2001 would remain the same since the acquisition and dividend of Surg II both occurred during 2002.

On November 4, 2002 the Company entered an agreement whereby it will lend up to \$2.5 million to Zamba Corporation (Zamba) in the form of a collateralized convertible note. The loan will be collateralized with shares of NextNet Wireless, Inc. stock owned by Zamba. The loan is not repayable in cash, but at Entrx's option, may be repaid either by conversion at any time into shares of Zamba's NextNet Wireless Series A Preferred stock, or if and when fully funded, by conversion into 25% of Zamba's common stock outstanding prior to the conversion. Additionally, depending upon the level of funding and other factors, Entrx will have the option to purchase up to an additional 750,000 common equivalent shares of NextNet Wireless stock from Zamba. The note matures on March 31, 2003.

Of the \$2.5 million, \$1.0 million was delivered to Zamba upon closing. If Zamba achieves certain agreed-upon milestones on December 15, 2002, and February 15, 2003, the remaining \$1.5 million may be delivered to Zamba in two equal installments on those dates.

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,

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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 Nine Months Ended September 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 September 30, 2002 was \$3,515,000 as compared to \$3,314,000 for the comparable period ended September 30, 2001, an increase of 6%, as a result of an increase in contract revenue. For the nine months ended September 30, 2002, total revenue was \$10,968,000 as compared to \$14,520,000 for the nine months ended September 30, 2001. This decrease was primarily due to fires at two of the Company's customer sites that generated incremental revenue in the nine months ended September 30, 2001 and also due to the general economic slowdown in 2002. Material sales revenue, which is immaterial to overall revenue, was \$49,000 and \$77,000 for the three and nine months ended September 30, 2002, respectively, as compared to \$18,000 and \$109,000 for the three and nine months ended September 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 \$3,038,000 for the three months ended September 30, 2002 as compared to \$2,729,000 for the three months ended September 30, 2001, an increase of 11% primarily related to the increase in revenue. For the nine months ended September 30, 2002, total cost of revenue was \$9,623,000 as compared to \$12,522,000 for the comparable period in 2001, a decrease of 23%. This decrease was primarily the result of the Company's decrease in revenue for the nine months ended September 30, 2002 as compared to the nine months ended September 30, 2001. The gross margin percentage was approximately 13.6% and 12.3% for the three and nine months ended September 30, 2002 as compared to 17.6% and 13.8% for the three and nine months ended September 30, 2001.

Selling, General and Administrative

Selling, general and administrative expenses for the three months ended September 30, 2002 were \$831,000 as compared to \$563,000 for the comparable period ended September 30, 2001, an increase of 48%. The increase is primarily the result of an increase in legal fees and insurance expense partially offset by a decrease in compensation expense. For the nine months ended September 30, 2002 selling, general and administrative expenses were \$2,881,000 as compared to \$1,976,000 for the nine months ended September 30, 2001, an increase of 46%. The increase for the nine months ended September 30, 2002, was primarily related to increases in legal fees, insurance expense, board fees (primarily for the period prior to February 14, 2002) and accounting fees. The nine months ended September 30, 2002 also include a charge of \$129,000 for a judgment and expenses related to a lawsuit initiated under the prior management. These increases were partially offset by a decrease in compensation and related expenses.

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Other Expense

For the three and nine months ended September 30, 2002, the Company recorded an allowance of \$745,000 related to a loan to a corporate officer. The Company adjusted the carrying value of the note to the market value of the 500,000 shares of the Company's common stock held as collateral as of September 30, 2002. The carrying value will continue to fluctuate as the market value of the common stock of the Company held as collateral changes.

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.

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 September 30, 2002 was \$44,000 as compared to net interest expense of \$20,000 for the three months ended September 30, 2001. For the nine months ended September 30, 2002 net interest income was \$138,000 compared with net interest expense of \$102,000 for the comparable period in 2001. These changes were primarily due to a higher average cash and cash equivalent balance for the three and nine months ended September 30, 2002 as compared to September 30, 2001 and to an interest-bearing loan to a corporate officer outstanding during the three and nine months ended September 30, 2002.

Table of Contents**Discontinued Operations**

For the three and nine months ended September 30, 2001, \$130,000 and \$402,000, 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 Loss

The Company experienced a net loss of \$1,055,000 (or a loss of \$0.14 per share) for the three months ended September 30, 2002, as compared to net loss of \$128,000 (or a loss of \$0.02 per share) for the comparable period ended September 30, 2001. The Company experienced a net loss of \$5,614,000 (or a loss of \$0.74 per share) for the nine months ended September 30, 2002, as compared to net loss of \$481,000 (or a loss of \$0.07 per share) for the comparable period ended September 30, 2001. The net loss from continuing operations was \$1,055,000 and \$5,614,000, for the three and nine months ended September 30, 2002, respectively, primarily related to the non-cash charge for the loan to the corporate officer and, for the nine months ended September 30, 2002, due to the restructuring charges. These net losses compared with net income from continuing operations of \$2,000 and net loss from continuing operations of \$79,000, respectively, for the comparable periods ended September 30, 2001. Without the restructuring charges the Company would have lost \$2,139,000 from continuing operations in the nine months ended September 30, 2002.

Liquidity and Capital Resources

As of September 30, 2002, the Company had \$5,149,000 in cash and cash equivalents \$455,000 in available-for-sale securities and \$2,100,000 in restricted cash. The Company had working capital of \$7,378,000. 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 September 30, 2002, the Company had a balance of \$996,000 outstanding on this line of credit.

Cash used in continuing operations was \$6,697,000 for the nine months ended September 30, 2002 compared with cash provided by continuing operations of \$826,000 for the nine months ended September 30, 2001. For the nine months ended September 30, 2002 the negative cash flow from continuing operations was primarily the result of funding operating losses principally due to the Company's restructuring and the use of cash as collateral for a letter of credit related to a bonded project at the Company's subsidiary, Metalclad Insulation Corporation. In addition the company used cash to decrease its accounts payable and accrued expenses and increase its accounts receivable and prepaid expenses. These uses were partially offset by non-cash expenses for stock based compensation, the adjustment of the carrying value of the loan to a corporate officer and the forgiveness of the loan to Mr. Kesler. For the nine months ended September 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 \$366,000 for the nine months ended September 30, 2001, primarily for legal fees related to the Company's NAFTA claim against the Mexican government.

Net investing activities used \$2,670,000 and \$136,000 of cash in the nine months ended September 30, 2002 and 2001, respectively, for capital expenditures, primarily at the Company's subsidiary, Metalclad Insulation Corporation (Metalclad Insulation) and for the purchase of available-for-sale securities. For the nine months ended September 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 \$1,382,000 for the nine months ended September 30, 2002 compared with cash provided by financing activities of \$648,000 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 nine months ended September 30, 2002. Long-term borrowing provided net cash of \$29,000. For the nine months ended September 30, 2002, the Company used \$155,000 of cash in a buy-back of its common stock. A private placement of the Company's common stock and warrants provided \$600,000 of cash flow during the nine months ended September 30, 2001 and long-term borrowings provided a net of \$48,000 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. The note was not repaid on the extended due date of September 8, 2002. As of September 30, 2002, the market value of the common stock held as collateral was \$505,000, \$745,000 less than the face amount of the note. The Company recorded a \$745,000 allowance to record the face amount of

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the note at the value of the underlying collateral on September 30, 2002. The carrying value will continue to fluctuate as the market value of the common stock of the Company held as collateral changes. The Company has continued to accrue interest on the note at 12% per annum. 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.

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%.

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 and on September 25, 2002 acquired an additional 14,285,714 shares by investing an additional \$300,000 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 SURG.

The 159,285,714 shares of no par value common stock owned by the Company became 3,982,142 shares of \$0.01 par value common stock as of the close of business on October 4, 2002, as the result of a one for 40 reverse stock split.

On October 22, 2002, the Company spun-off 3,791,576 shares of Surg II to its shareholders as a dividend. Each shareholder of record as of the close of business on October 11, 2002 received one share of Surg II, Inc. common stock for every two shares of Entrx Corporation common stock held. The Company still owns 190,566 shares of Surg II common stock.

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

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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 October 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 147, Acquisitions of Certain Financial Institutions. SFAS No. 147 is effective October 1, 2002. The Company believes the adoption of SFAS No. 147 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

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

None

Item 5. Other Information

None.

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Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

99.1 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.2 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b) Reports on Form 8-K

On July 16, 2002 the Company filed a form 8-K disclosing the acquisition of approximately 90% of Surg II.

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.

Date: November 8, 2002

ENTRX CORPORATION

By: /s/ Wayne W. Mills

Wayne W. Mills
Chief Executive Officer

Date: November 8, 2002

By: /s/ Brian D. Niebur

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

CERTIFICATIONS

I, Wayne W. Mills, certify that:

1. I have reviewed this quarterly report on 10-Q of Entrx Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date) and

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- c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
- 5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

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- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 8, 2002

/s/ Wayne W. Mills

By: Wayne W. Mills
President and Chief Executive Officer

I, Brian D. Niebur, certify that:

1. I have reviewed this quarterly report on 10-Q of Entrx Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date) and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 8, 2002

/s/ Brian D. Niebur

By: Brian D. Niebur

