ENTRX CORP
Form 10-K
March 24, 2004

Table of Contents

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

FORM 10-K

(Mark One)
(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the year ended December 31, 2003

Commission File Number 0-2000

Entrx Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-2368719** (I.R.S. Employer ID No.)
800 Nicollet Mall, Suite 2690 **Minneapolis , Minnesota** (Address of Principal Executive Office)	**55402** (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	**None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock $.10 Par Value
(Title of Class)

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 (X) No ( )

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ( )

Indicate by check mark whether the registrant is an accelerated filer (as defined by rule 12b-2 of the Act). Yes ( ) No (X)

The aggregate market value of the Common Stock held by non-affiliates of the registrant on March 9, 2004 was approximately $8,082,080, based upon the average of the bid and asked prices of the Common Stock, as reported on The Nasdaq Stock Market®.

The number of shares of the Common Stock of the registrant outstanding as of March 9, 2004 was 7,244,215.

Documents incorporated by reference:

Portions of the Company s Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Company s 2004 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

TABLE OF CONTENTS

Table of Contents

All statements, other than statements of historical fact, included in this Form 10-K, including without limitation the statements under Management s Discussion and Analysis of Financial Condition and Results of Operations and Business 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-K. Such potential risks and uncertainties include, without limitation; the outcome of existing litigation; 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; the valuation of the Company s investments; economic conditions generally and in the Company s primary markets; availability of capital; the adequacy of the Company s cash and cash equivalents; cost of labor; 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-K 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.

PART I

References to we , us , our , the registrant and the Company in this annual report on form 10K shall me Entrx Corporation and its consolidated subsidiary, Metalclad Insulation Corporation, unless the context in which those words are used would indicate a different meaning.

ITEM 1. BUSINESS

General

The Company, incorporated originally in 1947 as an Arizona corporation, was reincorporated in Delaware on November 24, 1993. In June 2002, the Company changed its name from Metalclad Corporation to Entrx Corporation. We conduct our business operations primarily through a wholly owned subsidiary, Metalclad Insulation Corporation, a California corporation.

Between May and September 2002, we acquired approximately 90% of the outstanding shares of Surg II, Inc. (Surg II) (Nasdaq: SURG), and on October 22, 2002, we distributed 3,791,576 shares of Surg II to our shareholders as a dividend. We still own 190,566 shares of Surg II common stock. Surg II is now known as Chiral Quest, Inc., and trades on the OTC Bulletin Board under the symbol CQST.

For over 30 years, the Company and its predecessors have been providing insulation and asbestos abatement services, primarily on the West Coast. We currently provide these services through Metalclad Insulation Corporation to a wide range of industrial, commercial and public agency clients.

Our principal executive offices are located at 800 Nicollet Mall, Suite 2690, Minneapolis, Minnesota 55402, and our telephone number is (612) 333-0614. Metalclad Insulation Corporation s principal facilities are located at 2198 South Dupont Drive, Anaheim, California 92806.

Insulation Services

Background. Our insulation services include the installation of high- and low-temperature insulation on pipe, ducts, furnaces, boilers, and various other types of equipment. We also maintain and repair existing insulation systems, generally under one or multi-year maintenance contracts. Our customers include refineries, utilities, chemical plants, manufacturing facilities, commercial properties, office buildings and various governmental facilities. This may include complete removal of existing insulation during the repair operations. The removed insulation may or may not be asbestos containing. We also fabricate specialty items for the insulation industry, and occasionally sell insulation material and accessories to our customers. Metalclad Insulation Corporation is a licensed general contractor and typically provides project management, labor, tools, equipment and materials necessary to complete the installation.

We perform substantially all of the work required to complete most contracts, while generally subcontracting to others the scaffolding, painting and other trades not performed by Metalclad Insulation. In a typical insulation project, we obtain plans and specifications prepared by the owner of a facility or its agent. In projects where the customer is the owner of the facility, we may act as the general contractor. We may also work as a subcontractor for other general contractors. Projects for the installation of insulation in new construction may require one or more years to complete.

If a project involves the removal of asbestos containing materials, we first treat the material with water and a wetting agent to minimize fiber release. Dry removal is conducted in special cases where wetting is not feasible, provided Environmental Protection Agency (EPA) approval is obtained. Our workers also remove asbestos laden pipe insulation by cutting the wrapping into sections in an enclosed containment area or utilizing special glovebags which provide containment around the section of pipe where the insulation is being removed. In some instances, the Company performs asbestos removal and provides related re-insulation contracting services, including insulation material sales; in other cases, the Company performs only asbestos removal services

Insulation Contracts. We normally enter into service contracts on either a cost plus or fixed-price basis, either through competitive bids or direct negotiations.

Cost plus contracts, sometimes referred to as time and materials contracts, generally provide for reimbursement of our costs incurred on a particular project, including labor and materials, plus the payment of a fee normally equal to a percentage of these costs. These contracts generally provide for monthly payments covering both reimbursements for costs incurred to date and a portion of the fee based upon the amount of work performed and are customarily not subject to retention of fees or costs.

Fixed-price contracts generally require that we perform all work for an agreed upon price, often by a specified date. Such contracts usually provide for increases in the contract price if our construction costs increase due to changes in or delays of the project initiated or caused by the customer or owner. However, absent causes resulting in increases in contract prices, we take certain risks, including the risk that our costs associated with the project exceed the agreed upon price. Under these types of contracts we normally receive periodic payments based on the work performed to a particular date, less certain retentions. The amounts retained are held by the customer pending either satisfactory completion of our work or, in some cases, satisfactory completion of the entire project.

In accordance with industry practice, most of our contracts are subject to termination or modification by the customer, with provision for the recovery of costs incurred and the payment to us of a proportionate part of our fees, in the case of a cost-plus contract, and overhead and profit, in the case of a fixed price contract. Such termination or modification occurs in the regular course of our business due to changes in the work to be performed as determined by the customer throughout the term of a project. No single termination or modification has had or is expected to have a material adverse impact on our business.

Operations and Employee Safety. All contract work is performed by trained personnel, and supervised by project managers trained and experienced in both construction and asbestos abatement. Each employee involved in asbestos abatement must complete a general training and safety program conducted by the Company or union affiliation. Training topics include approved work procedures, instruction on protective equipment and personal safety, dangers of asbestos, methods for controlling friable asbestos and asbestos transportation and handling procedures. In addition, all full-time employees engaged in asbestos abatement activities are required to attend a minimum four-day course approved by the EPA and the Occupational Safety and Health Administration (OSHA), and all supervisors of abatement projects are required to attend an eight-hour first aid/CPR/safety course and an eight-hour EPA/AHERA refresher course annually. One of our full-time salaried employees and 22 hourly employees have been trained and certified as competent individuals under EPA regulations relating to the training of asbestos abatement workers. All employees are issued detailed training materials. We typically conduct a job safety analysis in the job bidding stage.

We require the use of protective equipment on all projects, and sponsor periodic medical examinations of all of our field employees. During removal procedures, asbestos containing material is generally treated to minimize fiber release, and filtration devices are used to reduce contamination levels. Air monitoring to determine asbestos fiber contamination levels is conducted on all abatement projects involving the removal of friable asbestos. We have a comprehensive policy and procedure manual that covers all activities of an asbestos abatement project, and the specific responsibilities and implementation of procedures and policies to be followed on each project. The manual is reviewed periodically by management and updated to insure compliance with federal, state, and local regulations, to include information from in-house project review findings, and to include updated information regarding industry practices. To separate our responsibilities and limit our liability, we utilize unaffiliated third party laboratories for asbestos sampling analysis, and licensed independent waste haulers for the transportation and disposal of asbestos waste.

Table of Contents

Materials and Supplies. We purchase our insulating and asbestos abatement materials and supplies used in our insulation services from a number of national manufacturers, and we are not dependent on any one source.

Marketing and Sales

Insulation Contracting Services. We currently obtain most of our insulation contracting business from existing customers, and through referrals by customers, engineers, architects, and construction firms. Additional business is obtained by referrals obtained through labor, industry and trade association affiliations.

Projects are often awarded through competitive bidding, although major companies frequently rely on selected bidders chosen by them based on a variety of criteria such as adequate capitalization, bonding capability, insurance carried, and experience. We are frequently invited to bid on projects, and obtain a significant amount of our contracts through the competitive bidding process.

Our marketing and sales effort emphasizes our experience, reputation for timely performance, and knowledge of the insulation and asbestos abatement industry. We are a member of the Western Insulation Contractors Association, the National Insulation Contractors Association, and various local business associations.

Curtom-Metalclad Joint Venture. In 1989, Metalclad Insulation Corporation entered into a joint venture with a minority service firm, which qualifies for preferential contract bidding because of minority status. Metalclad Insulation Corporation owns a 49% interest in the joint venture. The joint venture, known as Curtom-Metalclad, submits bids for insulation and asbestos abatement services. When contracts are obtained by the joint venture, we perform the work specified in the contract as a subcontractor to the joint venture. We also receive an interest in 49% of the profits or losses of the joint venture. Sales for the year ended December 31, 2003 to Curtom-Metalclad were approximately $5,113,000 or 40.2% of our revenue, compared to $6,384,000 or 45.2% of revenue in 2002. While the revenues and gross profit of Curtom-Metalclad are significant to us, the assets, liabilities and earnings of that joint venture are insignificant, and not material. The termination of the Curtom-Metalclad joint venture and the loss of revenues that joint venture generates, would have a material adverse affect on us.

Customers. Our customers are generally either industrial or commercial. The industrial customers are predominately public utilities (power, natural gas and water/water treatment), major oil companies for oil refineries and petrochemical plants, chemical and food processors, other heavy manufacturers, and engineering/construction companies. The commercial customers are primarily government installations, schools, hospitals, institutions, an array of manufacturing/commercial facilities, and the general or mechanical construction contractors. During 2003, we received a significant portion of our revenues from Southern California Edison Company (17.5%) and LA Power Joint Venture (14.1%), both through our Curtom-Metalclad joint venture. Shell Oil Products US accounted for 10% of our revenues. We cannot project whether a significant portion of our revenues derived from these customers in 2004. (See Note 19 to the Consolidated Financial Statements.)

Competition. Competition in the insulation contracting services business is intense and is expected to remain intense in the foreseeable future. Competition includes a few national and regional companies that provide integrated services and many regional and local companies that provide insulation and asbestos abatement specialty contracting services. Many of the national and regional competitors providing integrated services are well established and have substantially greater marketing, financial, and technological resources than we do. The regional and local specialty contracting companies, which compete with us, either provide one service or they provide integrated services by subcontracting part of their services to other companies. We believe that the primary competitive factors for our services are price, technical performance and reliability. We obtain a significant number of our insulation service contracts through the competitive bidding process. We believe that our bids are generally competitively priced. Our policy is to bid all projects with the expectation of a reasonable gross profit.

Backlog. Our backlog for insulation services at December 31, 2003 and December 31, 2002 was $5,559,000 and $5,848,000, respectively. Backlog is calculated in terms of estimated revenues on fixed-price and cost-plus projects in progress or for which contracts have been executed. Approximately 15% of our backlog is under cost-plus contracts. Our backlog as of any date is not necessarily indicative of future revenues. We estimate that our entire backlog as of December 31, 2003 will be completed during the next eighteen months.

Table of Contents

Insurance and Bonding.

Our combined general liability and contractor pollution insurance policy provides base coverage of $1,000,000 per occurrence and excess liability coverage of $5,000,000.

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 us (primarily our subsidiary, Metalclad Insulation Corporation) as a defendant had increased from 254 in 1999 to 527 in 2000 and 685 in 2001. The number of claims initiated slightly decreased to 583 in 2002, and further decreased to 337 in 2003. As of December 31, 2003, there were approximately 1,212 asbestos cases pending, of which approximately 390 have been settled but not yet closed for lack of final documentation or payment. At December 31, 2000, 2001 and 2002, there were, respectively, approximately 860, 1,450 and 1,635 cases pending. It had been previously improperly reported in the Company s Form 10K for the period ended December 31, 2002, filed with the Securities and Exchange Commission, that there were approximately 660 cases pending at December 31, 2002, and 700 cases pending at the end of 2001. Although, the number of claims made in 2002 and 2003 reflected a downward trend from 2001, and the number of cases pending on December 31, 2003, dropped from those pending on December 31, 2002, it cannot be assumed that this trend will continue. 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.

It is difficult to determine if we have adequate insurance to cover these claims. The terms of such insurance policies are complex, and the coverage for many types of claims is limited. If the current trend of the claim occurrence and amounts is not significantly reversed, it will likely have a material adverse effect on our financial condition and business in the future. Because of our insurance coverage, we do not anticipate any adverse effect on our financial condition to develop for at least the next four to five years. Beyond that, however, the effect of those claims is uncertain.

In 2003, the United States Congress considered legislation to create a privately funded, publicly administered fund to provide the necessary resources for an asbestos injury claims resolution program. The latest draft of the legislation called for the fund to be funded 50% by asbestos defendant companies, of which the Company is one, and 50% by insurance companies. The impact, if any, this potential legislation will have on us cannot be determined at this time, although the latest draft of the legislation did not appear favorable to us.

While our current insulation and asbestos abatement services customers generally do not require performance bonds, an increasing number of customers have requested such bonds. Due to changes in the bonding industry, we had difficulty obtaining performance bonds for two large projects in 2003. We obtained bonds for these two projects by having Arrowhead Consulting Group post a letter of credit with the bonding company. The bonding company required a credit enhancement and accepted the letters of credit as the credit enhancement. The Company paid Arrowhead Consulting Group cash consideration for these letters of credit and issued them three-year warrants to purchase 100,000 shares of our common stock at $1.50 per share, which were valued at fair market value and expensed during the year ended December 31, 2003. While the changes in the bonding industry have made it more difficult to obtain performance bonds, we believe that our current bonding arrangements are adequate for our anticipated future needs.

Employees.

As of December 31, 2003, we had two part-time salaried employees in our executive offices and 14 full-time salaried employees in our insulation business in California, for a total of 16 employees. These included three executive officers, project managers/estimators, purchasing, accounting, and office staff.

As of December 31, 2003, our subsidiary, Metalclad Insulation Corporation, employed approximately 87 hourly employees for insulation contracting services, nearly all of whom are members of the International Association of Heat and Frost Insulators and Asbestos Workers (AFL-CIO) or Laborers Local Union 300. Metalclad Insulation Corporation is a party to agreements with various local chapters of various trade unions. The number of hourly employees employed by us fluctuates depending upon the number and size of projects that we have under construction at any particular time. It has been our experience that hourly employees are generally available for our projects, and we have continuously employed a number of hourly employees on various projects over an extended period of time. We consider our relations with our hourly employees and the unions representing them to be good, and have not experienced any recent work stoppages due to strikes by such employees. Additionally, the trade union agreements we are a party to include no strike, no work stoppage provisions. One agreement, the Maintenance Agreement with Local No. 5 of the International Association of Heat and Frost Insulators and Asbestos Workers expired in December 2003. The Maintenance Agreement is currently under negotiation. The Basic Agreement with Local No. 5 of the International Association of Heat and Frost Insulators and Asbestos Workers expires in August 2004. An agreement with the Laborers Local 300 was signed in January 2004 and expires in December 2006.

Government Regulation

Insulation Services and Material Sales Regulation. As a general and insulation specialty contractor, we are subject to regulation requiring us to obtain licenses from several state and municipal agencies. Other than licensing, our industrial insulation services and material sales business is not subject to material or significant regulation.

Asbestos Abatement Regulation. Asbestos abatement operations are subject to regulation by federal, state, and local governmental authorities, including OSHA and the EPA. In general, OSHA regulations set maximum asbestos fiber exposure levels applicable to employees and the EPA regulations provide asbestos fiber emission control standards. The EPA requires use of accredited persons for both inspection and abatement. In addition, a number of states have promulgated regulations setting forth such requirements as registration or licensing of asbestos abatement contractors, training courses for workers, notification of intent to undertake abatement projects and various types of approvals from designated entities. Transportation and disposal activities are also regulated.

OSHA has promulgated regulations specifying airborne asbestos fiber exposure standards for asbestos workers, engineering and administrative controls, workplace practices, and medical surveillance and worker protection requirements. OSHA s construction standards require companies removing asbestos on construction sites to utilize specified control methods to limit employee exposure to airborne asbestos fibers, to conduct air monitoring, to provide decontamination units and to appropriately supervise operations. EPA regulations restrict the use of spray applied ACM and asbestos insulation, establish procedures for handling ACM during demolition and renovations, and prohibit visible emissions during removal, transportation and disposal of ACM.

We believe that we are substantially in compliance with all regulations relating to its asbestos abatement operations, and currently have all material government permits, licenses, qualifications and approvals required for our operations.

ITEM 2. PROPERTIES

Our executive offices are located in Minneapolis, Minnesota, which consists of approximately 2,400 square feet leased at a current rate of $5,400 per month, on a month-to-month basis.

Our wholly owned subsidiary, Metalclad Insulation Corporation, is housed in a facility in Anaheim, California. This facility consists of 26,000 square feet of office and warehouse space. In May, 2002 we purchased this facility for $2,047,000.

An inactive subsidiary of the Company owns an approximately 92-hectare parcel (approximately 227 acres) of land in Santa Maria del Rio near San Luis Potosi, Mexico. We are presently attempting to dispose of this property. Such sale or disposition will not have a material effect on the Company.

We believe that the properties currently owned and leased by us are adequate for our operations for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

Asbestos Related Claims

Prior to 1975, we were engaged in the sale and installation of asbestos related insulation materials, and have 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.

Table of Contents

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In the past we believed that we had 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 claim occurrence and amounts is not significantly reversed, it will likely have a material adverse effect on our financial condition and business in the future. Because of our insurance coverage, we do not anticipate any adverse effect on our financial condition to develop for at least the next four to five years. Beyond that, however, the effect of those claims is uncertain.

In 2003 the United States Congress considered legislation to create a privately funded, publicly administered fund to provide the necessary resources for an asbestos injury claims resolution program. The latest draft of the legislation called for the fund to be funded 50% by asbestos defendant companies, of which the Company is one, and 50% by insurance companies. The impact, if any, this potential legislation will have on us cannot be determined at this time although the latest draft of the legislation did not appear favorable to us.

Claim Against Former Employee, Etc.

In October 1999, we completed the sale of our operating businesses and development project located in Aguascalientes, Mexico. That sale specifically excluded those Mexican assets involved in the Company s NAFTA claim which was settled in 2001. Under the terms of the sale we received an initial cash payment of $125,000 and recorded a receivable for $779,000. On November 13, 2000, the Company filed a complaint in the Superior Court of California against a former employee, the U.S. parent of the buyer and its representative for breach of contract, fraud, collusion and other causes of action in connection with this sale seeking damages in the form of a monetary award. An arbitration hearing was held in September, 2002 in Mexico City, as requested by one of the defendants. This arbitration hearing was solely to determine the validity of the assignment of the purchase and sale agreement by the buyer to a company formed by the former employee defendant. The Superior Court action against the U.S. parent was stayed pending the Mexican arbitration. On April 8, 2003, the arbitrator ruled that the assignment was inexistent, due to the absence of our consent. In June 2003, the Court of Appeal for the State of California ruled that the U.S. parent was also entitled to compel a Mexican arbitration of the claims raised in our complaint. We are now prepared to pursue our claim in an arbitration proceeding for the aforementioned damages. No assurances can be given on the outcome. We have fully reserved for the $779,000 note receivable, which was recorded at the date of sale.

In a related action, a default was entered against us in December, 2002, in favor of the same former employee referred to in the foregoing paragraph by the Mexican Federal Labor Arbitration Board, for an unspecified amount. The former employee was seeking in excess of $9,000,000 in damages as a result of his termination as an employee. The default was obtained without the proper notice being given to us, and was set aside in the quarter ended June 30, 2003. Most of the evidentiary hearings on the merits of the former employee s claim have taken place and we are preparing for final arguments. We believe this claim is without merit and intend to vigorously defend against it.

Claim by Former Attorney

On February 5, 2003, a Notice of Involuntary Lien was filed against the Company with the County Recorder for Orange County California in the amount of $104,046. This lien relates to a judgment against the Company for attorney fees in the Company s NAFTA settlement. The total amount of the claim including interest and collection costs was $111,406. Subsequent to the lien being filed, $27,050 was paid to the lien holder from a trust fund established by the Company and a third party to pay for any judgments and defense costs related to this lawsuit. We agreed to pay the remaining $84,356 of the claim in three installments. As of December 31, 2003, the Company has paid the judgment in full.

Table of Contents

The Company has been indemnified by the third party against any judgments and costs related to this lawsuit in excess of the trust fund and has contacted the third party seeking indemnification. The third party has refused to honor its indemnification obligation and the Company has therefore initiated legal proceedings against the third party. The third party has filed a cross-complaint against the Company seeking $100,000 due to undue influence, duress, fraud, unconscionability and conspiracy related to the original indemnification agreement. The Company believes the cross-complaint is without merit.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Table of Contents

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY AND RELATED STOCK HOLDER MATTERS

Market for Common Stock

Our Common Stock is traded on The Nasdaq SmallCap Market under the symbol ENTX. The following table sets forth, for the fiscal periods indicated, the high and low bid prices for the Common Stock as reported by Nasdaq:

	Bid Price	
	High	Low
Fiscal Year Ended December 31, 2002		
Quarter Ended March 31, 2002	$3.65	$1.80
Quarter Ended June 30, 2002	2.40	1.59
Quarter Ended September 30, 2002	1.92	0.80
Quarter Ended December 31, 2002	2.00	0.70
Fiscal Year Ended December 31, 2003		
Quarter Ended March 31, 2003	$0.81	$0.34
Quarter Ended June 30, 2003	1.71	0.37
Quarter Ended September 30, 2003	1.45	1.00
Quarter Ended December 31, 2003	1.35	0.77

As of March 9, 2004, the closing bid price for the common shares on The Nasdaq SmallCap Market was $1.41.

On December 11, 2002, we received a notice from The Nasdaq Stock Market, Inc. advising us that because the minimum bid price of our Common Stock was not at least $1.00 for thirty consecutive trading days, we did not meet the requirements for continued listing on The Nasdaq SmallCap Market. We had 180 calendar days from the notice, or until June 9, 2003, to regain compliance, obtain an extension or be delisted. On June 11, 2003, we received a 180 day extension to December 8, 2003, in order to come back in compliance or be delisted. On July 14, 2003, we received a notice from The Nasdaq Stock Market that we had regained compliance with the $1.00 minimum bid price and that the matter was closed.

Shareholders of Record

As of March 9, 2004, the approximate number of record holders of our Common Stock was 1,553.

Dividends

We have not paid any cash dividends on our Common Stock since our incorporation, and anticipate that, for the foreseeable future, earnings, if any, will continue to be retained for use in our business. On October 22, 2002, we distributed 3,791,576 shares of Surg II, Inc. common stock which we owned as a dividend to our shareholders of record as of the close of business on October 11, 2002. The dividend was equal to one share of Surg II, Inc. common stock for each two shares of the Company s common stock owned. Since that date, Surg II, Inc. has changed its name to Chiral Quest, Inc., and its shares are being traded on the over-the-counter Bulletin Board under the symbol CQST .

Table of Contents

Unregistered Sales of Securities

The following table sets forth certain information regarding the sale of common stock by the Company during the calendar year 2003 in transactions which were not registered under the Securities Act of 1933 (the Act).

Date of Sale	Number of Shares Sold	Person(s) to Whom Sold	Consideration Paid	Exemption from Registration Relied Upon Under the Act
4/8/03	Options for 100,000 Shares	President of wholly owned subsidiary, Metalclad Insulation Corporation	Services Options exercisable at $0.50 per Share through 4/6/10	Section 4(2) of the Securities Act of 1933, as a transaction not involving a public offering.
4/11/03	Options for 110,000 Shares	Members of the Board of Directors of Entrx Corporation (4 members) and its subsidiary, Metalclad Insulation Corporation (1 member), and the Chief Financial Officer of Entrx Corporation	Services 50,000 Share options exercisable at $0.50 per Share, 40,000 Share options exercisable at $0.80 per Share, and 20,000 Share options exercisable at $0.65 per Share	Section 4(2) of the Securities Act of 1933, as a transaction not involving a public offering.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data is derived from the consolidated financial statements of the Company and should be read in conjunction with the consolidated financial statements, related notes and other financial information included herein.

	Year Ended December 31,				
	2003	2002 (4)	2001	2000	1999
	(in thousands, except share and per share amounts)				
Statement of Operations Data (1)					
Revenues from continuing operations	$ 12,733	$ 15,021	$ 18,008	$ 17,769	$ 13,422
Loss from continuing operations	(3,006)	(5,286)	(1,503)	(1,702)	(1,971)
Income (loss) from discontinued operations			7,079	(63)	(2,228)
Net income (loss)	(3,006)	(5,286)	5,576	(1,765)	(4,199)
Earnings per share: (2)					
Loss per share of common stock, continuing operations basic	$ (0.42)	$ (0.69)	$ (0.21)	$ (0.31)	$ (0.50)
Loss per share of common stock, continuing operations diluted	$ (0.42)	$ (0.69)	$ (0.21)	$ (0.31)	$ (0.50)
Income (loss) per share of common stock, discontinued operations basic	$	$	$ 0.98	$ (0.01)	$ (0.57)
Income (loss) per share of common stock, discontinued operations diluted	$	$	$ 0.97	$ (0.01)	$ (0.57)
Income (loss) per share of common stock basic	$ (0.42)	$ (0.69)	$ 0.77	$ (0.32)	$ (1.07)
Income (loss) per share of common stock diluted	$ (0.42)	$ (0.69)	$ 0.77	$ (0.32)	$ (1.07)

Weighted average shares outstanding basic (2)	7,303,338	7,608,823	7,200,490	5,470,002	3,918,912
Weighted average shares outstanding diluted (2)	7,303,338	7,608,823	7,261,568	5,470,002	3,918,912
Balance Sheet Data					
Total assets	$ 8,664	$ 11,063	$ 17,792	$ 11,422 (3)	$ 9,472 (3)
Convertible notes	914			1,029	2,071
Convertible debentures				310	360
Long-term debt	297	308	241	186	149
Mortgage payable	1,587	1,494			
Shareholders equity	3,339	6,509	13,692	6,891 (3)	5,155 (3)
Common shares outstanding (2)	7,244,215	7,504,215	7,448,015	6,581,114	4,859,498

(1) In the forth quarter of 1998, the company committed to a plan to discontinue its operations in Mexico and to seek a buyer. Consequently, the Statement of Operations Data has been restated to reflect this decision.

(2) Effective July 2, 1999, the Company implemented a 1 for 10 reverse stock split. All prior periods have been restated.

(3) Restated to reflect reclassification of certain related party receivables.

(4) Includes the operations of the Company s majority-owned subsidiary Surg II, Inc. for the period May 30, 2002 through October 22, 2002.

No dividends were paid or declared during the years ended December 31, 2003, 2001, 2000, or 1999. On October 22, 2002 the Company distributed 3,791,576 shares of Surg II, Inc. common stock as dividend to its shareholders of record as of the close of business on October 11, 2002. The dividend was equal to one share of Surg II, Inc. common stock for each two shares of Entrx Corporation common stock owned.

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Summary.

Our revenues have decreased over the past two years from $18,008,000 in 2001 to $12,733,000 in 2003. Gross margin percentages have also decreased over the same two-year period, from 13.7% in 2001 to 11.2% in 2003. We do not anticipate that our revenues will continue to decrease in 2004, and anticipate that gross margin percentages in 2004 will exceed those of 2003.

We had net losses in 2002 and 2003 of approximately $5,286,000 and $3,006,000, respectively. Included in these losses is $3,333,000 in 2002 resulting from a restructuring charge, and $1,000,000 in losses in 2003 as the result of an impairment charge on one of our investments in a privately-held company. While we anticipate an improvement in overall operating results in 2004, we still project an operating loss for 2004.

We currently have an investment in two privately-held companies, totaling $1,757,000, both of which are in the early stages of their business development. One of these investments incurred an impairment in 2003. Either or both of these investments could be further impaired in the future.

Our revenues from maintenance contracts as opposed to new installation contracts have declined over the past, reflecting greater competition in our markets. While efforts are underway to reverse that trend, we are not sure these efforts will be successful.

In December of 2003, our operating subsidiary, Metalclad Insulation Corporation, obtained a line of credit financing from the Far East National Bank, Newport Beach, California. While the line of credit is for up to $1,500,000, Metalclad Insulation Corporation is required to maintain a cash balance with the Far East Bank for borrowings greater than $1,000,000 on a dollar-for-dollar basis. Whether Far East Bank will be willing to renew this line of credit in December of 2004 will be partially contingent upon our financial condition and compliance with certain loan covenants. Currently, the loan covenants require, among other things, that we maintain a net worth of $4,400,000. We may not be in compliance with all of the loan covenants at the end of 2004, in which case Far East National Bank may not provide us with any debt financing.

We obtained a $1,300,000 loan in December of 2003 from Pandora Select Partners, LP, a British Virgin Islands limited partnership. The proceeds of this loan should provide us with sufficient cash to operate through 2004.

Our subsidiary, Metalclad Insulation Corporation, continues to be engaged in lawsuits involving asbestos-related injury or potential injury claims. The 337 claims made in 2003 were down from the 685 and 583 claims made in 2001 and 2002 respectively, although the average severity of each claim has slightly increased. These claims are currently defended and covered by insurance. We have projected that we have sufficient insurance to provide coverage for the next four to five years. This projection assumes that there is not a significant increase in the annual number of new claims and that the severity of each claim does not increase significantly. The projection also assumes that the insurance companies live up to what we believe their obligation to continue to cover our exposure with regards to these claims. Whether we will be able to continue in business when our insurance coverage runs out is subject to a significant number of variables, which are impossible to predict. In addition, we paid approximately $175,000 in 2003 in legal fees to assess and monitor the asbestos-related claims, and to assess and monitor our insurance coverage and insurance company activities involving the defense and payment of these claims. We anticipate that this cost will continue.

Presentation of Consolidated Financial Statements

The consolidated financial statements of the Company reflect our ongoing business in the insulation contracting segment and the discontinuance in 1999 of our waste management segment in Mexico. Certain amounts have been reclassified from previously reported categories.

Results of Operations

General. Our revenues have been generated primarily from insulation services and sales of insulation products and related materials in the

United States. Until 1999, we received revenues from the collection of waste oils and solvents for recycling, rental of parts washing machines, brokering the disposal of waste and remediation services in Mexico. Our financial statements for 1999 and subsequent years reflect the winding down of those operations.

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

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002.

Revenue. Total revenues were $12,733,000 in 2003 as compared to $15,021,000 for 2002, a decrease of 15.2%. The decrease was primarily a result of the competitive nature of the construction industry, the general economic business environment and our efforts, in the last half of the year, to concentrate on higher gross margin projects.

Cost of Revenue and Gross Margin. Total cost of revenue for the year ended December 31, 2003 was $11,312,000 as compared to $13,158,000 for the year ended December 31, 2002, a decrease of 14.0%. This decrease was primarily due to the decrease in revenue. The gross margin as a percentage of revenue was approximately 11.2% for the year ended December 31, 2003 compared to 12.4% for the year ended December 31, 2002. The gross margin percentage decreased primarily due to unanticipated costs on certain fixed bid projects during the first quarter of 2003. Throughout the year our gross margin as a percentage of revenue steadily increased from (1.7)% in the first quarter, to 14.3% in the second quarter, to 16.7% in the third quarter and finally to 20% in the fourth quarter.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $3,786,000 for the year ended December 31, 2003 as compared to $3,658,000 for the year ended December 31, 2002, an increase of 3.5% due primarily to increases in insurance expense, consulting and financing expenses offset by a decrease in legal and travel expenses. Insurance expense increased due to the increased cost of Directors and Officers insurance and to charges related to workers compensation insurance. Financing expenses increased due to the costs associated with obtaining a new bank line of credit and a mortgage on our facilities in California, and the obtaining of additional financing through the issuance of convertible promissory notes.

Other Operating Expense. For the year ended December 31, 2003, we reversed an allowance of $387,000 related to a non-recourse loan to an affiliate of a person who subsequently became a corporate officer. During 2003, we amended the note with this officer s affiliate to our net benefit, such that the new note is now with full recourse to this affiliate, and guaranteed by the officer. Since this was a non-recourse loan, we had adjusted the carrying value of the note to the value of the collateral as of December 31, 2002, and then recorded an allowance of $387,000. The collateral consists of 500,000 shares of the Company s common stock and 250,000 shares of the $0.01 par value common stock of Chiral Quest, Inc. (OTC Bulletin Board: CQST).

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 Directors 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. 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 three 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 valued at $359,800, 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. In addition, the Company issued Mr. Dabbene 86,000 shares of the Company s common stock valued at $221,020 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 each agreed to act as our consultants under two-year and three-month consulting agreements, respectively. In addition to the payment discussed above, Mr. Dabbene s compensation for consulting was $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 us as income and payroll tax withholding on the total compensation paid to each of them.

In March 2002, we reimbursed Mr. Mills $100,000 for legal fees expended by him in excess of that amount to effect this change in management.

During the year ended December 31, 2002, we recognized $3,333,000 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 related to the accelerated vesting of stock options for the prior directors.

Interest Income and Expense. Interest income for the year ended December 31, 2003 was $154,000 as compared with $293,000 for the year ended December 31, 2002. The decrease in 2003 was primarily due to lower average cash and cash equivalent balances in 2003 as compared to 2002 generating lower interest income, partially offset by an increase in interest income related to an interest-bearing loan to a corporate officer. Interest expense was $172,000 for the year ended December 31, 2003 compared to interest expense of $119,000 for the year ended December 31, 2002. This increase in interest expense was primarily due to the mortgage which was obtained on Metalclad Insulation Corporation s building; which mortgage was outstanding for the entire year ended December 31, 2003, as compared to only a portion of the year ended December 31, 2002. In addition, there were loans with Venture Bank and a convertible promissory note outstanding for part of the year ended December 31, 2003, that increased interest expense as compared with the year ended December 31, 2002.

Other Income and Expense. For the year ended December 31, 2003, we recognized an impairment charge of $1,000,000 related to one of our investments in a privately-held company. The impairment charge was due to the decline in the fair value below the cost basis that was judged to be other than temporary. We recognized a $15,000 loss on sale of available-for-sale securities in the year ended December 31, 2003, and a $57,000 gain on sale of available-for-sale securities in the year ended December 31, 2002.

In March 2003, the Company converted a note receivable from Zamba Corporation into 415,340 shares of NextNet Wireless, Inc. Series A Preferred Stock owned by Zamba. NextNet is a privately held provider of non-line-of-sight plug-and-play broadband wireless access systems. Each preferred share is convertible into three shares of common stock. On February 23, 2004, however, the Company was notified of a proposed merger between NextNet and a recently formed privately owned company (the "Acquirer"), to which we gave our consent. The Acquirer has experience in the wireless communication industry.

Under the terms of the merger, the Company will receive warrants to purchase 290,738 shares of the class A common stock of the Acquirer in exchange for the 415,340 shares of Series A Preferred Stock that it owns of NextNet. The warrants the Company will receive from the Acquirer will have an exercise price of $4.00 per share, are immediately exercisable and have a term which terminates after the earlier of six years or upon the occurrence of certain events which gives the holders of the warrant liquidity with respect to the underlying common stock. The Company has been informed that the merger was completed on March 16, 2004. Based upon the foregoing, the Company determined that there had been an other-than-temporary decline in the fair value of its investment below the cost and recorded an impairment charge of $1,000,000 for the year ended December 31, 2003. The Company valued the warrants received using the Black-Scholes pricing model using 113% as the volatility, 1.24% as the risk free interest rate, an expected life of six years and no expected dividends. The Company has not obtained, and will not obtain, an independent appraisal of the value of the warrants.

Net Loss. We experienced a net loss of $3,006,000 (or a loss of $0.41 per share) for the year ended December 31, 2003, as compared to net loss of $5,286,000 (or a loss of $0.69 per share) for the comparable period ended December 31, 2002. The $5,286,000 net loss from continuing operations for the year ended December 31, 2002, included the restructuring charges of $3,333,000, and the net loss of $3,006,000 for the year ended December 2003 included a $1,000,000 impairment charge on one of our investments in a privately-held company.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001.

Revenue. Total revenues were $15,021,000 in 2002 as compared to $18,008,000 for 2001, a decrease of 17%. Contract revenues for the year ended December 31, 2002 were $14,837,000 as compared to $17,865,000 for the year ended December 31, 2001, a decrease of 17%. The decrease was primarily attributable to fires at two of our customer s sites that generated incremental revenue in the year ended December 31, 2001, and was also due to the general economic slowdown in 2002.

Cost of Revenue and Gross Margin. Total cost of revenue for the year ended December 31, 2002 was $13,158,000 as compared to $15,540,000 for the year ended December 31, 2001, a decrease of 15%. This decrease was primarily due to the decrease in revenue. The gross margin as a percentage of revenue was approximately 12.4% for the year ended December 31, 2002 compared to 13.7% for the year ended December 31, 2001. The decrease in gross margin as a percentage of revenue was primarily attributed to the performance of several major emergency jobs in response to major fires at a refinery and power plant that allowed for higher contract margins in the year ended December 31, 2001.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $3,658,000 for the year ended December 31, 2002 as compared to $3,015,000 for the year ended December 31, 2001, an increase of 21.3% due primarily to an increase in legal and professional fees, insurance expense and board fees, offset by a decrease in salaries and bonus expense.

Other Operating Expense. For the year ended December 31, 2002, the Company recorded an allowance of $387,000 related to a non-recourse loan made to an affiliate of a person who subsequently became a corporate officer. The Company adjusted the carrying value of the note to the value of the collateral as of December 31, 2002. The collateral consists of 500,000 shares of the Company s common stock and 250,000 shares of the $0.01 par value common stock of Chiral Quest, Inc. (OTC Bulletin Board: CQST).

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 Directors 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. 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 three 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 valued at $359,800, 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. In addition, the Company issued Mr. Dabbene 86,000 shares of the Company s common stock valued at $221,020 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 each agreed to act as our consultants under two-year and three-month consulting agreements, respectively. In addition to the payment discussed above, Mr. Dabbene s compensation for consulting was $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 us as income and payroll tax withholding on the total compensation paid to each of them.

In March 2002, we reimbursed Mr. Mills $100,000 for legal fees expended by him in excess of that amount to effect this change in management.

During the year ended December 31, 2002, we recognized $3,333,000 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 related to the accelerated vesting of stock options for the prior directors.

Interest Income and Expense. Interest income for the year ended December 31, 2002 was $293,000 as compared with $80,000 for the year ended December 31, 2001. The increase in 2002 was primarily due to the larger cash balances, that resulted from the receipt of the NAFTA award and to an interest-bearing loan to a corporate officer in December 2001 that remained outstanding at December 31, 2002. Interest expense was $119,000 for the year ended December 31, 2002 compared to interest expense of $132,000 for the year ended December 31, 2001. This reduction in interest expense was primarily due to the conversion of debt into 266,901 shares of our common stock, and the repayment of convertible zero coupon notes, with an interest rate of 15%, in the year ended December 31, 2001. This reduction was partially offset by interest payable one bank borrowings outstanding for all of 2002, as compared to only a portion of 2001.

Other Income and Expense. We recognized a $57,000 gain on sale of available-for-sale securities in the year ended December 31, 2002. Other expense of $904,000 in 2001 consisted principally of the reserve established for a note receivable related to the sale of our Mexican assets not included in the NAFTA claim.

Discontinued Operations. The gain of $7,079,000 in 2001 was a result of the settlement of the NAFTA claim, net of all fees and expenses, including the write-off of all assets associated with the claim. No future costs are anticipated. If any future costs arise, they will be charged to operations as incurred.

Net Income (Loss). We experienced a net loss of $5,286,000 (or a loss of $0.69 per share) for the year ended December 31, 2002, as compared to net income of $5,576,000 (or income of $0.77 per share) for the comparable period ended December 31, 2001. The net income for the year ended December 31, 2001, was due to the receipt of the proceeds from the

NAFTA claim. The net loss from continuing operations for the year ended December 31, 2002, was primarily related to the restructuring charges. This net loss compares with the net loss from continuing operations of $1,503,000 for the comparable period ended December 31, 2001.

Liquidity and Capital Resources

As of December 31, 2003, we had $1,644,000 in cash and cash equivalents and $279,000 in available-for-sale securities. The Company had working capital of $1,519,000 as of December 31, 2003. Our subsidiary, Metalclad Insulation Corporation, has a line of credit with Far East National Bank, Los Angeles, California. The line of credit agreement with Far East National Bank matures on October 28, 2004, and bears interest at a floating rate based upon the bank s prime rate plus 1%. Borrowings under the agreement are limited to $1,000,000 plus the amount of cash collateral posted, up to $500,000, in the form of certificate of deposit at the bank. At December 31, 2003, we had a balance of $1,000,000 outstanding on this line of credit.

Cash provided by continuing operations was $227,000 for 2003, compared with cash used in continuing operations of $6,939,000 in 2002. For 2001, $1,187,000 of cash was provided by continuing operations. Cash flows were used primarily to fund operating losses for continuing operations in each of the years 2003, 2002 and 2001, which were partially offset by non-cash expenses for depreciation and amortization. In 2003, there was also a $1,000,000 non-cash expense related to an impairment charge for one of our investments in a privately-held company. In 2002, we placed $2,111,000 of cash in a certificate of deposit at a bank to secure a standby letter of credit payable to a customer in lieu of a performance bond. The letter of credit and the certificate of deposit matured on July 1, 2003. At December 31, 2002, we recorded the certificate of deposit as restricted cash. On March 25, 2003, the letter of credit was cancelled and the CD was released as collateral which provided $2,111,000 of cash in 2003. $814,000 of cash was also provided from continuing operations in 2003 due to a decrease in costs and estimated earnings in excess of billings on uncompleted contracts, a decrease in other receivables, and an increase in billings in excess of costs and estimated earnings on uncompleted contracts. There was also a non-cash item related to the allowance on officer s receivable that decreased cash flows by $387,000 in 2003. A decrease in accounts payable used $486,000 of cash in 2003.

During 2002, we recognized $3,333,000 of expense related to the change of management, including insurance premiums, legal fees, severance pay and relocation of our headquarters. The cash payments related to these expenses were approximately $2,044,000. The non-cash charges of $1,156,000 primarily relate to the forgiveness of a loan due from Mr. Kesler and the issuance of common stock to Messrs. Kesler and Dabbene.

We used $1,057,000 of cash in 2002 to decrease our accounts payable and accrued 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.

In 2001, the positive cash flow from continuing operations was primarily the result of a $2,105,000 decrease in accounts receivable. The large workload in the fourth quarter of 2000 as compared with 2001 resulted in a larger accounts receivable balance at December 31, 2000 as compared with December 31, 2001. There was also a non-cash expense due to the provision for uncollectible notes receivable related to the 1999 sale of certain Mexican assets in 2001. Increases in prepaid expenses and other current assets, primarily related to prepaid insurance also resulted in decreased cash flows from continuing operations in 2001 of $225,000.

Cash provided by discontinued operations was $13,450,000 for 2001. In 2001, the positive cash flow from discontinued operations was primarily the result of the $16,002,000 received from the Mexican government as settlement of our claim under the North American Free Trade Agreement, offset by expenses related to the settlement.

Net investing activities used $643,000, $6,723,000 and $1,230,000 of cash in 2003, 2002 and 2001, respectively. Of these uses, $150,000, $2,258,000 and $231,000 was used for additions to property and equipment in 2003, 2002 and 2001, respectively, primarily for our subsidiary, Metalclad Insulation Corporation.

On November 4, 2002, we entered an agreement whereby we would lend up to $2.5 million to Zamba Corporation (Zamba) in the form of a collateralized convertible note. The note, when fully funded, was convertible into common stock of Zamba, or at the Company s option, was payable by Zamba in shares of NextNet Wireless, Inc. (NextNet) Series A Preferred Stock owned by Zamba and which collateralized the note. The note was not repayable in cash. The agreement also gave us the option to acquire additional shares of NextNet Series A Preferred Stock. We had advanced $1,000,000 on the note as of December 31, 2002. On January 13, 2003, we advanced $100,000, and on February 17, 2003, advanced an additional $650,000 on the note. On February 17, 2003, we amended the agreement with Zamba whereby the total amount we would lend to Zamba was reduced to $1,750,000. In connection with this amendment, provisions allowing us to convert the loan into Zamba s common stock and our option to purchase an additional 750,000 shares of NextNet Series A Preferred Stock from Zamba were removed. The loan was not repayable in cash, but was repayable through conversion into shares of Zamba s NextNet Series A Preferred Stock. The note matured on March 31, 2003, and was then converted into 415,340 shares of NextNet Series A Preferred Stock. Each share of NextNet Series A Preferred Stock is convertible into three shares of NextNet common stock. On November 4, 2002, Wayne W. Mills, the Company s President, owned approximately 6.3% of the outstanding common stock of Zamba and approximately 3.3% of NextNet and as of December 31, 2003, Mr. Mills owned approximately 1.4% of NextNet.

Subsequent to December 31, 2003, the stockholders of NextNet have been presented with a merger proposal, which will likely be adopted. Under the merger proposal, the privately held acquiring company would issue warrants to purchase 290,738 shares of its class A common stock in exchange for all of the 415,340 shares of NextNet Series A Preferred Stock held by us. The warrants as proposed, will be exercisable over six years at $4.00 per share. We have approved of the merger. As a result of the anticipated merger, we have reduced the fair value of our investment in NextNet by $1,000,000 effective for the year ended December 31, 2003.

In 2002, $2,047,000 of the additions to property related to the purchase of the building housing the business at Metalclad Insulation Corporation. Also in 2002, we used $3,300,000 to acquire and distribute 3,791,576 shares of Surg II, Inc. common stock to our shareholders as a dividend. Additionally in 2002 we used $197,000 for net purchases of available-for-sale securities.

In 2001, we used $1,000,000 of cash to make an equity investment in Catalytic Solutions, Inc., a privately held company.

Cash provided by financing activities totaled $1,216,000 in 2003 compared with cash provided by financing activities of $1,372,000 in 2002 and cash used in financing activities of $628,000 in 2001. Long-term borrowings provided $121,000, $190,000 and $202,000 of cash in 2003, 2002 and 2001, respectively. We used $159,000 and $222,000 of cash in 2003 and 2002, respectively, to repurchase 260,000 and 194,800 shares, respectively, of our outstanding common stock.

In 2003, our subsidiary, Metalclad Insulation Corporation, obtained a new line of credit and mortgage with Far East National Bank (Far East), and repaid its prior line of credit and mortgage with Community Bank. The line of credit agreement with Far East matures in October 2004 and bears interest at a floating rate based upon the bank s prime rate plus 1% (5.00% on the date of the loan). The line of credit is secured by certain assets of the Company. Borrowings under the agreement are limited to $1,000,000 plus the amount of cash collateral posted, up to $500,000, in the form of certificate of deposit at the bank. Metalclad Insulation Corporation also obtained a $1,596,000 mortgage on the building from Far East that matures in October 2008, and bears interest at a floating rate based upon the bank s prime rate plus 1% (5.00% on the date of the loan). The line of credit and mortgage are guaranteed by our President, Wayne W. Mills, who received a fee for such guarantees of $92,880.

In December 2003, we issued a $1,300,000, 10% convertible promissory note. The note is payable interest only through April 15, 2004, and thereafter is payable in equal monthly installments over the next 33 months. The note is convertible by the noteholder into common stock of the Company at $1.35 per share, and allows us, subject to certain conditions and limitations, to make monthly installment payments with our common stock at a price per share approximating the then market value. In connection with the financing we paid a 3% origination fee, issued a five year warrant for the purchase of 400,000 shares of the Company s common stock at $1.50 per share, and granted the noteholder a security interest in 249,200 shares of NextNet Wireless, Inc. Series A Preferred Stock, and 33,800 shares of Catalytic Solutions, Inc. Series C Preferred Stock, owned by the Company. The proceeds of $1,300,000 were allocated between the note, and the fair value of the warrants based on using the Black Scholes pricing model. The resulting original issue discount, the fair value of the warrant, and the beneficial conversion of the note payable into common stock as defined in EITF 00-27 (Application of Issue No. 98-5 to Certain Convertible Instruments), is being amortized over the life of the note using the straight-line method, which approximates the interest method. In addition, we agreed to file a registration statement with the U.S. Securities and Exchange Commission, covering the issuance or resale of the shares of the Company s common stock which may be issued in connection with the note and warrant issued to the noteholder. In addition, the note is personally guaranteed by the Company s President, Wayne W. Mills, for which he was not compensated.

During 2003, we obtained and repaid a $750,000 loan from a bank.

Table of Contents

In 2001, $1,255,000 was loaned to an affiliate of Wayne W. Mills, Blake Capital Partners, under a note (Note) secured by 500,000 shares of the Company s common stock and any dividends received on those shares. At the time the loan was made, Mr. Mills was a principal shareholder of the Company, and was subsequently elected as the Company s President and Chief Executive Officer. The Board of Directors of the Company negotiated an amendment to the security agreement (the Amended and Restated Security Agreement) which it believed to be beneficial to the Company. The Note as amended (the New Note) is in the principal amount of $1,496,370, and now provides for an October 31, 2007 due date, with interest at 2% over the prime rate established by Wells Fargo Bank, NA in Minneapolis, Minnesota, adjusted on March 1 and September 1 of each year, instead of the 12% rate established in the Note. Interest only is payable commencing March 1, 2004, and at the end of each six-month period thereafter. The New Note is with full recourse to Blake Capital Partners. The Amended and Restated Security Agreement, unlike the original Security Agreement, does not require us, or permit Blake Capital Partners or Mr. Mills, to cancel the shares of the Company s common stock held as collateral as full payment of the loan, or require us to apply the value of those cancelled shares at $2.50 per share against the principal balance of the amounts due. In addition, Mr. Mills has personally guaranteed the repayment of the New Note.

We obtained a mortgage to purchase the building housing Metalclad Insulation Corporation that provided net cash of $1,494,000 in 2002. During 2002, net cash of $37,500 was provided by proceeds from the exercise of common stock warrants.

We used $1,176,000 of cash to repay long-term borrowings in 2001, primarily to repay Five-Year Zero Coupon Notes originally issued in December 1997, and $123,000 to repay long long-term borrowings in 2002. The uses of cash in 2001 were partially offset by the Company obtaining an accounts receivable revolving line of credit that provided $1,000,000 of cash flow, which was primarily used to repay the Five-Year Zero Coupon Notes discussed above. A private placement of the Company s common stock and warrants completed by us in March 2001 also provided $600,000 of cash flow in 2001.

Prior to 1975, we were 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 us (primarily Metalclad Insulation Corporation) as a defendant had increased from 254 in 1999, 527 in 2000 and 685 in 2001. The number of claim initiated slightly decreased to 583 in 2002, and further decreased to 337 in 2003. As of December 31, 2003, there were approximately 1,212 asbestos cases pending, of which approximately 390 have been settled but not yet closed for lack of final documentation or payment. At December 31, 2000, 2001 and 2002, there were, respectively, approximately 860, 1,450 and 1,635 cases pending. It had been previously improperly reported in the Company s Forms 10K for the period ended on December 31, 2002, filed with the Securities and Exchange Commission, that there were approximately 660 cases pending at December 31, 2002, and 700 cases pending at the end of 2001. Although, the number of claims made in 2002 and 2003 reflected a downward trend from 2001, and the number of cases pending on December 31, 2003, dropped from those pending on December 31, 2002, it cannot be assumed that this trend will continue. 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.

It is difficult to determine if we have adequate insurance to cover these claims. The terms of such insurance policies are complex, and the coverage for many types of claims is limited. If the current trend of the claim occurrence and amounts is not significantly reversed, it will likely have a material adverse effect on our financial condition and business in the future. Because of our insurance coverage, we do not anticipate any adverse effect on our financial condition to develop for at least the next four to five years. Beyond that, however, the effect of those claims is uncertain.

In 2003, the United States Congress considered legislation to create a privately funded, publicly administered fund to provide the necessary resources for an asbestos injury claims resolution program. The latest draft of the legislation calls for the fund to be funded 50% by asbestos defendant companies, of which the Company is one, and 50% by insurance companies. The impact, if any, this potential legislation will have on us cannot be determined at this time, although the latest draft of the legislation did not appear favorable to us.