

ENTRX CORP
Form 10KSB
May 22, 2006

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

FORM 10-KSB

(Mark One)

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

For the fiscal year ended December 31, 2005

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:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
None	None

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

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

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Check whether the issuer (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

Check if there is no disclosure of delinquent filers in response to Items 405 of Regulation S-B in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-KSB or any amendment to this Form 10-KSB. ___

Indicate by checkmark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

The Company's revenues from operations for the fiscal year ended December 31, 2005 totaled \$14,711,095.

The aggregate market value of the common stock held by nonaffiliates of the registrant as of May 16, 2006 was approximately \$839,956 based on the average of the closing bid and asked price of the registrant's common stock on such date. The number of shares outstanding of the registrant's common stock, as of May 13, 2006 was 7,951,147.

Transitional Small Business Issuer Format (Check One):

Yes No

All statements, other than statements of historical fact, included in this Form 10-KSB, including without limitation the statements under “Management’s Discussion and Analysis or Plan of Operation” and “Description of 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-KSB. 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; the accuracy of the Company’s estimate of future liability for asbestos-related injury claims; the adequacy of insurance, including the adequacy of insurance to cover current and future asbestos-related injury claims; the valuation of the Company’s investments; collectibility of a loan due from an affiliate of a principal shareholder; economic conditions generally and in the Company’s primary markets; availability of capital; the adequacy of the Company’s cash and cash equivalents; the cost of labor; the accuracy of the Company’s cost analysis for fixed price contracts; 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-KSB 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.

References to “we”, “us”, “our”, “the registrant”, “Entrx” and “the Company” in this annual report on Form 10KSB shall mean or refer to 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. DESCRIPTION OF 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.

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.

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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. Our failure to accurately predict the extent of the effort required and cost of labor on one insulation removal project commenced on April 18, 2005, resulted in a loss of \$1,050,000 during 2005. Under these fixed-price 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. At December 31, 2005, one of our full-time salaried employees and 47 hourly employees had 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 hourly 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.

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 and various local business associations.

Curtom-Metalclad Joint Venture. In 1989, Metalclad Insulation Corporation entered into a joint venture with a minority service firm, known as Curtom Building & Development Corporation (“Curtom Building”), which was designated as qualifying for preferential contract bidding because of minority status, by Metropolitan Transportation Authority, and until September 2005, by Supplier Clearinghouse. 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. The joint venture agreement, as amended, provides that Curtom-Metalclad will receive 2.5% of revenues obtained by Metalclad Insulation Corporation as a subcontractor, of which 80% will be distributed to Curtom Building and 20% will be retained by Curtom-Metalclad. We retain the remaining revenues. Sales for the year ended December 31, 2005 for Curtom-Metalclad projects were approximately \$1,418,000 or 9.6% of our revenue, compared to \$3,457,000 or 26.6% of revenue in 2004. While the revenues and gross profit from the subcontracts we perform for Curtom-Metalclad are significant to us, the joint venture of Curtom-Metalclad has no material assets, liabilities or earnings. The termination of the Curtom-Metalclad joint venture and the loss of revenues that joint venture generates, could have a material adverse affect on us. In accordance with FIN 46 “Consolidation of Variable Interest Entities”, as amended by FIN 46R, we have consolidated Curtom-Metalclad since we have determined we are the primary beneficiary as defined by FIN 46R.

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 agencies, schools, hospitals, commercial and light manufacturing companies, and the general or mechanical construction contractors. During 2005, JE Merit Constructors, Inc. accounted for 19.1% of our revenues and Calpine Construction Management Company, Inc. accounted for 13.4% of our revenues. We cannot project whether a significant portion of our revenues will be derived from these customers in 2006. It is often the case in our business that a customer that represented over 10% of our revenues in one year would not represent over 10% of our revenues in the following year. (See Note 18 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 similar to the Company. 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.

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Backlog. Our backlog for insulation services at December 31, 2005 and December 31, 2004 was \$10,120,000 and \$9,003,000, 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 76% 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, 2005 will be completed during the next eighteen months.

Insurance and Bonding.

General Liability. Our combined general liability and contractor pollution insurance policy provides base coverage of \$1,000,000 per occurrence and excess liability coverage of \$10,000,000.

Performance Bonds. While our current insulation and asbestos abatement services customers generally do not require performance bonds, an increasing number of customers have requested such bonds. 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.

Asbestos Insurance Coverage. Prior to 1975, the Company was engaged in the sale and installation of asbestos-related insulation materials, which has resulted in 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. To date all of the asbestos-related injury claims have been defended and paid by our insurance carriers.

Based on the trend of reducing asbestos-related injury claims made against the Company over the past four years, we project that 533 asbestos-related injury claims will be made against the Company in the future, in addition to the 507 claims existing as of December 31, 2005, totaling 1,040 claims. Multiplying the average indemnity paid per resolved claim over the past five years of \$20,056, times 1,040, we project the probable future indemnity to be paid on those claims to be equal to approximately \$21 million. In addition, multiplying an estimated cost (which cost is included within the limits of our insurance coverage) of defense per resolved claim of approximately \$13,500 times 1,040, we project the probable future defense costs to equal approximately \$14 million. See Item 3 - "Legal Proceedings - Asbestos-related Claims."

There are numerous insurance carriers which have issued a number of policies to us over a period extending from approximately 1967 through approximately 1985 that still provide coverage for asbestos-related injury claims. After approximately 1985 the policies were issued with provisions which purport to exclude coverage for asbestos related claims. The terms of our insurance policies are complex, and coverage for many types of claims is limited as to the nature of the claim and the amount of coverage available. It is clear, however, under California law, where the substantial majority of the asbestos-related injury claims are litigated, that all of those policies cover any asbestos-related injury occurring during the 1967 through 1985 period when these policies were in force.

We have engaged legal counsel to review all of our known insurance policies, and to provide us with the amount of coverage which such counsel believes to be probable under those policies for current and future asbestos-related injury claims against us. Such legal counsel has provided us with its opinion of the minimum probable coverage available to satisfy asbestos-related injury claims, which significantly exceeds our estimated \$35,000,000 liability for such claims at December 31, 2005.

On February 23, 2005 ACE Property & Casualty Company ("ACE"), Central National Insurance Company of Omaha ("Central National") and Industrial Underwriters Insurance Company ("Industrial"), which are all related entities, filed a declaratory relief lawsuit ("the ACE Lawsuit") against Metalclad Insulation Corporation ("Metalclad") and a number of Metalclad's other liability insurers, in the Superior Court of the State of California, County of Los Angeles. ACE, Central National and Industrial issued umbrella and excess policies to Metalclad, which has sought and obtained from

the plaintiffs both defense and indemnity under these policies for the asbestos lawsuits brought against Metalclad during the last four to five years. The ACE Lawsuit seeks declarations regarding a variety of coverage issues, but is centrally focused on issues involving whether historical and currently pending asbestos lawsuits brought against Metalclad are subject to either an "aggregate" limits of liability or separate "per occurrence" limits of liability. Whether any particular asbestos lawsuit is properly classified as being subject to an aggregate limit of liability depends upon whether or not the suit falls within the "products" or "completed operations" hazards found in most of the liability policies issued to Metalclad. Resolution of these classification issues will determine if, as ACE and Central National allege, their policies are nearing exhaustion of their aggregate limits and whether or not other Metalclad insurers who previously asserted they no longer owed any coverage obligations to Metalclad because of the claimed exhaustion of their aggregate limits, in fact, owe Metalclad additional coverage obligations. The ACE Lawsuit also seeks to determine the effect of the Settlement Agreement (as discussed below) between the Company and Allstate Insurance Company on the insurance obligations of various other insurers of Metalclad, and the effect of the "asbestos exclusion" in the Allstate policy. The ACE Lawsuit does not seek any monetary recovery from Metalclad. Nonetheless, we anticipate that we will incur attorneys' fees and other associated litigation costs in defending the lawsuit and any counter claims made against us by any other insurers, and in prosecuting any claims we may seek to have adjudicated regarding our insurance coverage. In addition, the ACE Lawsuit may result in our incurring costs in connection with obligations we may have to indemnify Allstate under the Settlement Agreement. Allstate, in a cross-complaint filed against Metalclad Insulation Corporation in October, 2005, asked the court to determine the Company's obligation to assume and pay for the defense of Allstate in the ACE Lawsuit under the Company's indemnification obligations in the Settlement Agreement. The Company is taking the position that it has no legal obligation to assume or pay for such defense.

Insurance Policy Settlement. In June 2004, Metalclad Insulation Corporation, our wholly owned subsidiary, and Entrx Corporation, entered into a Settlement Agreement and Full Policy Release (the "Agreement") releasing Allstate Insurance Company from its policy obligations for a broad range of claims arising from injury or damage which may have occurred during the period March 15, 1980 to March 15, 1981, under an umbrella liability policy (the "Policy"). The Policy provided limits of \$5,000,000 in the aggregate and per occurrence. Allstate claimed that liability under the Policy had not attached, and that regardless of that fact, an exclusion in the Policy barred coverage for virtually all claims of bodily injury from exposure to asbestos, which is of primary concern to Metalclad Insulation Corporation. Metalclad Insulation Corporation took the position that such asbestos coverage existed. The parties to the Agreement reached a compromise, whereby Metalclad Insulation Corporation received \$2,500,000 in cash, and Metalclad Insulation Corporation and Entrx Corporation agreed to indemnify and hold harmless Allstate from all claims which could be alleged against the insurer respecting the policy, limited to \$2,500,000 in amount. Based on past experience related to asbestos insurance coverage, we believe that the Agreement we entered into in June 2004, will result in a probable loss contingency for future insurance claims based on the indemnification provision in the Agreement. Although we are unable to estimate the exact amount of the loss, we believe at this time the reasonable estimate of the loss will not be less than \$375,000 or more than \$2,500,000 (the \$2,500,000 represents the maximum loss we would have based on the indemnification provision in the Agreement). Based on the information available to us, no amount in this range appears at this time to be a better estimate than any other amount. The \$375,000 estimated loss contingency noted in the above range represents 15% of the \$2,500,000 we received and is based upon our attorney's informal and general inquiries to an insurance company of the cost for us to purchase an insurance policy to cover the indemnification provision we entered into. We recorded a reserve of \$375,000 at the time we entered into the Agreement and nothing has come to our attention that would require us to record a different estimate at December 31, 2005.

Employees.

As of December 31, 2005, we had two part-time salaried employees in our executive offices and 11 full-time salaried employees in our insulation business in California, for a total of 13 employees. These included three executive officers, project managers/estimators, purchasing, accounting, and office staff.

As of December 31, 2005, our subsidiary, Metalclad Insulation Corporation, employed approximately 124 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, which makes the hourly employees available to us from time to time. Metalclad Insulation Corporation is a party to agreements with 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. In August, 2004 a new "Basic Agreement" was signed with Local No. 5 of the International Association of Heat and Frost Insulators and Asbestos Workers that expires in September 2008. The "Basic Agreement" included a "Maintenance Agreement" as an addendum. Approximately 95% of our hourly employees are covered by the Local No. 5 agreement. An agreement with the Laborers Local 300 was signed in January 2004 and expires in December 2006. Approximately 5% of our hourly employees are covered by the Labors Local 300 agreement.

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 asbestos containing material ("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 our asbestos abatement operations, and currently have all material government permits, licenses, qualifications and approvals required for our operations.

ITEM 2. DESCRIPTION OF PROPERTY

Our executive offices are located in Minneapolis, Minnesota, which consists of approximately 2,400 square feet leased at a current rate of \$2,000 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. We purchased this facility in May 2002, for \$2,047,000, and sold the facility on April 20, 2006, for \$3,900,000. The Company has leased the building back for eight months at \$21,800 per month, while it seeks a new facility to lease.

An inactive subsidiary of the Company, Ecosistemas del Potosi SA de CV, 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 as the land has a value of less than \$15,000.

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, which has resulted in 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 cases which have been initiated naming us (primarily our subsidiary, Metalclad Insulation Corporation) as a defendant had increased from approximately 254 in 1999 to 527 in 2000 and 725 in 2001. The number of cases filed decreased after 2001 to 590 in 2002, to 351 in 2003, to 265 in 2004 and to 199 in 2005. At December 31, 2001, 2002, 2003, 2004 and 2005, there were, respectively, approximately 1,009, 988, 853, 710 and 507 cases pending. Of the decrease from 710 cases pending at December 31, 2004 to 507 cases pending at December 31, 2005, were 80 cases which had been previously counted in error, so that the actual decrease for the year ended December 31, 2005 was 123 cases. To date all of our asbestos-related injury claims have been paid and defended by our insurance carriers. See Item 1 - "Description of Business - Insurance and Bonding."

Set forth below is a table for the years ended December 31, 2001, 2002, 2003, 2004 and 2005, which sets forth for each such period the approximate number of asbestos-related cases filed, the number of such cases resolved by dismissal or by trial, the number of such cases resolved by settlement, the total number of resolved cases, the number of filed cases pending at the end of such period, the total indemnity paid on all resolved cases, the average indemnity paid on all settled cases and the average indemnity paid on all resolved cases:

	2001	2002	2003	2004	2005 ⁽²⁾
New cases filed	725	590	351	265	199
Defense Judgments and dismissals	162	382	311	311	294
Settled cases	158	229	175	97	108
Total resolved cases ⁽¹⁾	320	611	486	408	402 ⁽²⁾
Pending cases ⁽¹⁾	1,009	988	853	710	507 ⁽³⁾
Total indemnity payments	\$ 8,486,348	\$ 9,244,000	\$ 10,618,700	\$ 6,366,750	\$ 8,513,750
Average indemnity paid on settled cases	\$ 53,711	\$ 40,366	\$ 60,678	\$ 65,637	\$ 78,831
Average indemnity paid on all resolved cases	\$ 26,520	\$ 15,129	\$ 21,849	\$ 15,605	\$ 21,178 ⁽²⁾

⁽¹⁾ Total resolved cases includes, and the number of pending cases excludes, cases which have been settled but which have not been closed for lack of final documentation or payment.

⁽²⁾ The average indemnity paid on resolved cases does not include, and the number of pending cases includes, a jury award rendered on March 22, 2005 and a judgment on that award rendered on April 4, 2005, finding Metalclad Insulation Corporation liable for \$1,117,000 in damages, which is covered by insurance. The judgment is being appealed by our insurer.

⁽³⁾ Of the decrease from 710 cases pending at December 31, 2004 to 507 cases pending at December 31, 2005, were 80 cases which had been previously counted in error, so that the actual decrease over the year ended December 31, 2005 was 123 cases.

The number of asbestos-related claims made against the Company since 2001 has reflected a relatively consistent downward trend from 2002 through 2005, as has the number of cases pending at the end of those years. We believe that it is probable that this trend will continue, although such continuance cannot be assured. The average indemnity

paid on all resolved claims has fluctuated over the past five-year period ended December 31, 2005 from a high of \$26,520 in 2001, to a low of \$15,129 in 2002, with an average indemnity payment of \$20,056 over the same five-year period. We believe that the sympathies of juries, the aggressiveness of the plaintiffs' bar and the declining base of potential defendants as the result of business failures, have tended to increase payments on resolved cases. This tendency, we believe, has been mitigated by the declining pool of claimants resulting from death, and the likelihood that the most meritorious claims have been ferreted out by plaintiffs' attorneys and that the newer cases being brought are not as meritorious nor do they have as high a potential for damages as do cases which were brought earlier. We have no reason to believe, therefore, that the average future indemnity payments or direct defense costs will increase materially in the future.

In addition, direct defense costs per resolved claim have increased from \$9,407 in 2001 to \$12,240 in 2005. We believe that these defense costs increased as a result of a change in legal counsel in 2004, and the more aggressive defense posture taken by new legal counsel since that change. We do not believe that the defense costs will increase materially in the future, and we are projecting those costs to be approximately \$13,500 per claim.

Based on the trend of reducing asbestos-related injury claims made against the Company over the past four years, we project that approximately 533 asbestos-related injury claims will be made against the Company in the future, in addition to the 507 claims existing as of December 31, 2005, totaling 1,040 claims. Multiplying the average indemnity per resolved claim over the past five years of \$20,056, times 1,040, we project the probable future indemnity to be paid on those claims after December 31, 2005 to be equal to approximately \$21 million. In addition, multiplying an estimated cost of defense per resolved claim of approximately \$13,500 times 1,040, we project the probable future defense costs to equal approximately \$14 million. Accordingly, our total estimated asbestos-related future liability at December 31, 2005 was \$35 million. After estimating our asbestos-related liabilities as of December 31, 2005, and by adopting a methodology similar to that described above, we estimated our future asbestos-related liability to be \$48.5 million at December 31, 2004, which was consistent with actual results. These estimated liabilities are included as liabilities on our 2004 and 2005 balance sheets.

We intend to re-evaluate our estimate of future liability for asbestos-related claims at the end of each fiscal year. We estimate that the effects of economic inflation on either the average indemnity payment or the projected direct legal expenses will be approximately equal to a discount rate applied to or future liability based on the time value of money. It is probable that we have adequate insurance to cover current and future asbestos-related claims, although such coverage cannot be assured. See Item 1 - "Description of Business - Insurance and Bonding."

Although defense costs are included in our insurance coverage, we expended \$220,000, \$174,000, \$304,000 and \$188,000 in 2002, 2003, 2004 and 2005, respectively, to administer the asbestos claims. These amounts were primarily fees paid to attorneys to monitor the activities of the insurers, and their selected defense counsel, and to look after our rights under the various insurance policies. These costs are expenses as incurred.

On February 23, 2005 ACE Property & Casualty Company ("ACE"), Central National Insurance Company of Omaha ("Central National") and Industrial Underwriters Insurance Company ("Industrial"), which are all related entities, filed a declaratory relief lawsuit ("the ACE Lawsuit") against Metalclad Insulation Corporation ("Metalclad") and a number of Metalclad's other liability insurers, in the Superior Court of the State of California, County of Los Angeles. ACE, Central National and Industrial issued umbrella and excess policies to Metalclad, which has sought and obtained from the plaintiffs both defense and indemnity under these policies for the asbestos lawsuits brought against Metalclad during the last four to five years. The ACE Lawsuit seeks declarations regarding a variety of coverage issues, but is centrally focused on issues involving whether historical and currently pending asbestos lawsuits brought against Metalclad are subject to either an "aggregate" limits of liability or separate "per occurrence" limits of liability. Whether any particular asbestos lawsuit is properly classified as being subject to an aggregate limit of liability depends upon whether or not the suit falls within the "products" or "completed operations" hazards found in most of the liability policies issued to Metalclad. Resolution of these classification issues will determine if, as ACE and Central National allege, their policies are nearing exhaustion of their aggregate limits and whether or not other Metalclad insurers who previously asserted they no longer owed any coverage obligations to Metalclad because of the claimed exhaustion of their aggregate limits, in fact, owe Metalclad additional coverage obligations. The ACE Lawsuit also seeks to determine the effect of the Settlement Agreement (as disc