

ENTRX CORP  
Form 10QSB  
November 09, 2006

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

**FORM 10-QSB**

(Mark One)

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

For the quarterly period ended **September 30, 2006**

OR

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

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

Commission File Number 0-2000

**ENTRX CORPORATION**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**95-2368719**  
(I.R.S. Employer  
Identification No.)

**800 Nicollet Mall, Suite 2690, Minneapolis, MN**  
(Address of Principal Executive Office)

**55402**  
(Zip Code)

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

Check 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 past 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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

As of November 1, 2006, the registrant had 8,001,147 shares outstanding of its Common Stock, \$.10 par value.

Transitional Small Business Disclosure Format (check one): Yes  No



**ENTRX CORPORATION AND SUBSIDIARIES**

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**References to “we”, “us”, “our”, “the registrant” and “the Company” in this quarterly report on Form 10-QSB 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.**

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**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements****ENTRX CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

	September 30, 2006 (unaudited)	December 31, 2005 (audited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,638,856	\$ 413,395
Available-for-sale securities	118,151	142,925
Accounts receivable, less allowance for doubtful accounts of \$11,000 as of September 30, 2006 and December 31, 2005	2,730,122	2,916,505
Costs and estimated earnings in excess of billings on uncompleted contracts	710,095	193,231
Inventories	76,215	135,391
Prepaid expenses and other current assets	299,220	243,364
Insurance claims receivable	7,000,000	8,000,000
Other receivables	293,271	540,136
<b>Total current assets</b>	<b>12,865,930</b>	<b>12,584,947</b>
Property, plant and equipment, net	344,591	363,910
Asset held for sale, net	-	1,979,047
Investments in unconsolidated affiliates	1,206,889	1,206,889
Shareholder note receivable, net of allowance of \$1,271,000 and \$250,000 as of September 30, 2006 and December 31, 2005, respectively	225,000	1,246,370
Insurance claims receivable	32,000,000	27,000,000
Other assets	225,596	75,596
	\$ 46,868,006	\$ 44,456,759
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Note payable to bank	\$ -	\$ 775,000
Current portion of note payable	-	510,121
Current portion of long-term debt	91,292	85,875
Current portion of mortgage payable	-	39,946
Accounts payable	612,444	746,057
Accrued expenses	1,274,920	1,694,607
Reserve for asbestos liability claims	7,000,000	8,000,000
Billings in excess of costs and estimated earnings on uncompleted contracts	65,027	176,641
<b>Total current liabilities</b>	<b>9,043,683</b>	<b>12,028,247</b>
Long-term debt, less current portion	85,327	59,294
Note payable, less current portion	-	44,848

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Reserve for asbestos liability claims	32,000,000	27,000,000
Mortgage payable, less current portion	-	1,460,732
Total liabilities	41,129,010	40,593,121
Shareholders' equity:		
Preferred stock, par value \$1; 5,000,000 shares authorized; none issued	-	-
Common stock, par value \$0.10; 80,000,000 shares authorized; 8,455,947 and 8,001,147 issued and outstanding, respectively, at September 30, 2006 and 8,405,947 and 7,951,147 issued and outstanding, respectively, at December 31, 2005	845,595	840,595
Additional paid-in capital	70,260,746	70,257,746
Less treasury stock at cost, 454,800 shares at both September 30, 2006 and December 31, 2005	(380,765)	(380,765)
Accumulated deficit	(64,914,165)	(66,806,297)
Accumulated other comprehensive loss	(72,415)	(47,641)
Total shareholders' equity	5,738,996	3,863,638
	\$ 46,868,006	\$ 44,456,759

See Notes to Consolidated Financial Statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Contract revenues	\$ 3,889,086	\$ 3,577,236	\$ 12,862,912	\$ 10,634,691
Contract costs and expenses	3,343,365	3,724,758	11,012,530	9,481,635
Gross margin (loss)	545,721	(147,522)	1,850,382	1,153,056
Operating expenses:				
Selling, general and administrative	508,427	529,481	1,630,608	1,846,303
Change in allowance on shareholder note receivable	568,885	-	1,068,885	-
(Gain) loss on disposal of property, plant and equipment	1,790	(1,172)	(1,062)	(290)
Total operating expenses	1,079,102	528,309	2,698,431	1,846,013
Operating income (loss)	(533,381)	(675,831)	(848,049)	(692,957)
Interest income	15,707	34,073	92,411	99,658
Interest expense	(2,988)	(104,723)	(102,210)	(316,049)
Gain on sale of building, land and building improvements	-	-	1,724,980	-
Other income - settlements	100,000	-	1,025,000	-
Net income (loss)	(420,662)	(746,481)	1,892,132	(909,348)
Other comprehensive income (loss)				
Unrealized gains (losses) on available-for-sale securities	(34,302)	66,698	(24,774)	47,641
Comprehensive income (loss)	\$ (454,964)	\$ (679,783)	\$ 1,867,358	\$ (861,707)
Weighted average number of common shares — basic and diluted	8,001,147	7,651,147	7,972,392	7,651,147
Income (loss) per share of common stock — basic and diluted	\$ (0.05)	\$ (0.10)	\$ 0.24	\$ (0.12)

See Notes to Consolidated Financial Statements

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

	Nine Months Ended September 30,	
	2006	2005
	(unaudited)	
Cash flows from operating activities:		
Net income (loss)	\$ 1,892,132	\$ (909,348)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	131,588	150,077
Gain on disposal of property, plant and equipment	(1,726,042)	(290)
Change in allowance for doubtful accounts	-	(17,888)
Net interest income recorded on shareholder note receivable	42,513	22,058
Common stock issued for services	8,000	-
Issuance of stock warrants related to note payable	-	21,460
Amortization of original issue discount	-	93,789
Allowance on shareholder note receivable	1,021,370	-
Changes in operating assets and liabilities:		
Accounts receivable	186,383	(587,101)
Costs and estimated earnings in excess of billings on uncompleted contracts	(516,864)	144,439
Inventories	59,176	581
Prepaid expenses and other current assets	(55,856)	(146,801)
Other receivables	204,352	(555,345)
Other assets	(150,000)	3,125
Accounts payable and accrued expenses	(553,300)	647,802
Billings in excess of costs and estimated earnings on uncompleted contracts	(111,614)	55,288
Net cash provided by (used in) operating activities	431,838	(1,078,154)
Cash flows from investing activities:		
Capital expenditures	(139,107)	(188,450)
Proceeds from sale of property, plant and equipment, net of expenses	3,731,927	10,325
Net cash provided by (used in) investing activities	3,592,820	(178,125)
Cash flows from financing activities:		
Proceeds from long-term debt	114,178	73,176
Payments on long-term debt	(82,728)	(120,562)
Payments on note payable to bank	(775,000)	-
Payments on note payable and convertible note payable	(554,969)	(341,979)
Payments on mortgage payable	(1,500,678)	(30,362)
Payments on capital lease obligation	-	(11,955)
Net cash used in financing activities	(2,799,197)	(431,682)
Increase (decrease) in cash and cash equivalents	1,225,461	(1,687,961)
Cash and cash equivalents at beginning of period	413,395	2,357,208
Cash and cash equivalents at end of period	\$ 1,638,856	\$ 669,247





**ENTRX CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Three and Nine Months Ended September 30, 2006 and 2005**  
(Unaudited)

1. The accompanying unaudited consolidated financial statements of Entrx Corporation and its subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America. In the opinion of management all adjustments, consisting of normal recurring items, necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. These consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2005.

2. Certain accounts in the previous quarter's consolidated financial statements have been reclassified for comparative purposes to conform with the current quarter consolidated financial statements. The reclassifications had no effect on net income (loss) or shareholders' equity.

3. The income (loss) per share amounts for the three and nine months ended September 30, 2006 and September 30, 2005 were computed by dividing the net income (loss) by the weighted average shares outstanding during the applicable period. Dilutive common equivalent shares have not been included in the computation of diluted loss per share because their inclusion would be antidilutive since the Company had a loss for the three and nine months ended September 30, 2005. Antidilutive common equivalent shares issuable based on future exercise of stock options or warrants could potentially dilute basic and diluted loss per share in subsequent periods.

All stock options and warrants were anti-dilutive for the three and nine months ended September 30, 2006 because their respective exercise prices were greater than the average market price of the common stock.

4. Investments held by the Company are classified as available-for-sale securities. Available-for-sale securities are reported at fair value with all unrealized gains or losses included in other comprehensive income (loss). The fair value of the securities was determined by quoted market prices of the underlying security. For purposes of determining gross realized gains (losses), the cost of available-for-sale securities is based on specific identification.

	Aggregate fair value	Gross unrealized gains	Gross unrealized losses	Cost
Available for sale securities - September 30, 2006	\$ 118,151	\$ -	\$ (72,415)	\$ 190,566
Available for sale securities - December 31, 2005	\$ 142,925	\$ -	\$ (47,641)	\$ 190,566

The Company's net unrealized holding gain (loss) was \$(34,302) and \$66,698 for the three months ended September 30, 2006 and 2005, respectively and \$(24,774) and \$47,641 for the nine months ended September 30, 2006 and 2005, respectively.

On an ongoing basis, the Company evaluates its investments in available-for-sale securities to determine if a decline in fair value is other-than-temporary. When a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established. Based on the investment and volatility of common stock in a publicly-traded company and the ability and the intent of the Company to hold the

investment until a recovery of fair value, the Company believes that the cost of the investment is recoverable within a reasonable period of time. The Company also reviewed the stock price history of the investment and noted that for approximately 23% of the trading days in 2005 and for approximately 11% of the trading days from January 1, 2006 through September 30, 2006, the investment's stock price was greater than or equal to the Company's cost basis in the investment. Therefore, the impairment was not considered other-than-temporary at September 30, 2006.

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The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2006.

Description of Securities	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Marketable equity securities	\$ 118,151	\$ (72,415)	\$ -	\$ -	\$ 118,151	\$ (72,415)
Total	\$ 118,151	\$ (72,415)	\$ -	\$ -	\$ 118,151	\$ (72,415)

The Company also has minority investments in privately held companies. These investments are included in investments in unconsolidated affiliates on the Consolidated Balance Sheets and are carried at cost unless the fair value of the investment below the cost basis is judged to be other-than-temporary. The Company monitors these investments for impairment and makes appropriate reductions in carrying values. At September 30, 2006 and December 31, 2005, the Company's investments in unconsolidated affiliates consisted of an investment in Catalytic Solutions, Inc. valued at \$450,000 and an investment in Clearwire Corporation valued at \$756,889. The Company did not note any impairment for the three or nine months ended September 30, 2006.

5. Inventories, which consist principally of insulation products and related materials, are stated at the lower of cost (determined on the first-in, first-out method) or market.

6. Due to the increase in real estate value in southern California and the resulting increase in the Company's equity in its facility and the Company's then need for cash, the Company signed an agreement in December 2005 to sell its facilities in Anaheim, California for \$3,900,000. The sale of the building was completed in April 2006. At the time of the sale the cost basis of the building, land and building improvements was \$2,080,000 and accumulated depreciation was \$101,000. The Company recorded a gain on the sale of \$1,725,000 in the three months ended June 30, 2006. The Company is leasing the facilities back for eight months. The Company had a mortgage on the building of \$1,500,000, including accrued interest of \$9,000 at the time of sale that was repaid upon the sale of the building. In accordance with Statement of Financial Accounting Standards (SFAS) 144 "Accounting for the Impairment or Disposal of Long-lived Assets," the Company classified the building and land as assets held for sale on the balance sheet as of December 31, 2005.

7. Blake Capital Partners, LLC was current in the payment of interest through the payment due March 1, 2006. The payment due September 1, 2006, however, was not made, and we have been informed by Mr. Mills, the principal of Blake Capital Partners and guarantor on the note, that no payment can be expected in the foreseeable future. As a result of our review of Mr. Mills' financial condition, as of December 31, 2004 we booked a reserve of \$250,000 against the shareholder note receivable and as of June 30, 2006 increased the reserve to \$750,000. As of September 30, 2006, as a result of the non-payment of interest and other information received from Mr. Mills, we booked an additional reserve of \$521,370 against the note receivable and wrote-off the interest receivable through June 30, 2006 of \$47,515, bringing the net of the note receivable less the reserve down to \$225,000, the approximate value of the collateral securing the note.

8. Accrued expenses consist of the following:

	September 30, 2006	December 31, 2005
Accrued interest	\$ -	\$ 3,344
Wages, bonuses and payroll taxes	143,254	135,858
Union dues	178,056	197,972

Accounting and legal fees	30,000	85,000
Insurance	314,928	256,084
Insurance settlement reserve	375,000	375,000
Accrued loss on projects	52,000	466,002
Other	181,682	175,347
	\$ 1,274,920	\$ 1,694,607

9. On December 16, 2004, the Financial Accounting Standards Board, or FASB, issued SFAS No. 123(R), "Share-Based Payment", which is a revision of SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123 (R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share-based payments is no longer an alternative. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. We implemented SFAS No. 123(R) on January 1, 2006 using the modified prospective method. SFAS 123(R) did not have an impact on the Company's consolidated financial statements since all of the Company's outstanding stock options were fully vested at December 31, 2005 and no additional options were granted through September 30, 2006.

As more fully described in our Annual Report on Form 10-KSB for the year ended December 31, 2005, the Company has granted stock options over the years to employees and directors under various stockholder approved stock option plans. At September 30, 2006, 2,220,710 stock options are outstanding. The fair value of each option grant was determined as of grant date, utilizing the Black-Scholes option pricing model.

In prior years, we applied the intrinsic-value method prescribed in Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees,” to account for the issuance of stock incentives to employees and directors. No compensation expense related to employees’ and directors’ stock incentives was recognized in the prior year consolidated financial statements, as all options granted under stock incentive plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Had the Company applied the fair value recognition provisions of SFAS No. 123 “Accounting for Stock-Based Compensation,” to stock based employee compensation for periods prior to January, 2006, the Company’s net income (loss) would have changed to the pro forma amounts indicated below:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net loss as reported	\$ (746,481)	\$ (909,348)
Add: Stock-based employee compensation included in reported net income (loss), net of related tax effects	-	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(12,789)	(83,030)
Net loss pro forma	\$ (759,270)	\$ (992,378)
Basic and diluted net loss per share as reported	\$ (0.10)	\$ (0.12)
Stock-based compensation expense	-	(0.01)
Basic and diluted net loss per share pro forma	\$ (0.10)	\$ (0.13)

The following significant assumptions were utilized to calculate the fair value information for options issued during the three and nine months ended September 30, 2006 and 2005 utilizing the Black-Scholes pricing model:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Risk Free interest rate	N/A	N/A	N/A	2.77%
Expected life	N/A	N/A	N/A	3.0 Years
Expected volatility	N/A	N/A	N/A	153%
Expected dividends	N/A	N/A	N/A	-

Expected volatility is based on implied volatility from historical volatility of our stock price. The Company uses historical Company and industry data along with implied data to estimate the expected option life, the expected forfeiture rate and the expected dividend yield. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury rate in effect at the time of grant.

10. In June 2004, Metalclad Insulation Corporation, our wholly owned subsidiary, and Entrx Corporation, entered into a Settlement Agreement and Full Policy Release (the “Settlement Agreement”) releasing one of its insurers, Allstate Insurance Company (“Allstate”) 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 Settlement 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. In February 2005, ACE Property & Casualty Company (and affiliated entities) commenced an action (the "Ace Lawsuit") seeking declaratory relief to determine the extent of Metalclad Insulation Corporation's insurance coverage for asbestos-related claims, including the effect of the Allstate Settlement Agreement on the insurance obligations of other insurers that have provided Metalclad Insulation Corporation with insurance coverage. On November 1, 2005, Metalclad Insulation Corporation received a cross complaint by Allstate, asking the court to determine the Company's obligation to undertake and pay for the legal defense of Allstate in the ACE Lawsuit under the terms of the indemnification provisions of the Settlement Agreement. Metalclad has not accepted a tender by Allstate of the defense of the ACE Lawsuit, or its obligation to pay for such defense, and has taken the position that it has no legal obligation to do so.

Based on past experience related to asbestos insurance coverage, we believe that the Settlement 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 Settlement 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 September 30, 2006.

11. In order to fund operations of the Company until the sale of the Company's facilities in Anaheim, California was completed, on February 9, 2006 the Company borrowed \$150,000 from Peter Hauser, the Company's Chairman and Chief Executive Officer. The promissory note evidencing the loan was due and payable 10 days following written demand and bore interest at 2% over the prime interest rate as published in the Wall Street Journal (9.5% at March 31, 2006). The loan was secured by a deed of trust on the Company's facilities in Anaheim, California, housing the industrial insulation services operations of the Company's subsidiary, Metalclad Insulation Corporation. The Company repaid the loan and accrued interest upon the sale of the Company's facilities in April 2006. (See Note 6)

12. Sales for the three and nine months ended September 30, 2006 to i) Southern California Edison Company ("SCE") under the strategic alliance program with Curtom-Metalclad were approximately \$284,000 and \$1,749,000, representing 7.3% and 13.6% of total revenues, respectively, ii) JE Merit Constructors, Inc. were approximately \$744,000 and \$1,998,000, representing 19.1% and 15.5% of total revenues, respectively, and iii) Cleveland Wrecking Company were approximately \$416,000 and \$1,741,000, representing 10.7% and 13.5% of total revenues, respectively. Sales for the three and nine months ended September 30, 2005 to i) Calpine Construction Management Company, Inc. ("Calpine") were approximately \$0 and \$1,993,000, respectively, representing 0% and 18.7% of total revenues, respectively, ii) JE Merit Constructors, Inc. were approximately \$1,045,000 and \$2,015,000, respectively, representing 29.2% and 18.9% of total revenues, respectively and iii) Cleveland Wrecking Company were approximately \$804,000 and \$1,291,000, respectively, representing 22.5% and 12.1% of total revenues, respectively. Accounts receivable from Sempra Energy was approximately \$307,000 and accounts receivable from Cleveland Wrecking Company was approximately \$348,000, representing 11.2% and 12.7% of total accounts receivable, respectively, as of September 30, 2006. Accounts receivable from Cleveland Wrecking Company was approximately \$444,000 at December 31, 2005 and accounts receivable from JE Merit Constructors, Inc. was approximately \$495,000 at December 31, 2005, representing 15.2% and 16.9% of total accounts receivable, respectively.

13. In June 2006, the FASB issued FASB Interpretation No. 48 (FIN No. 48), *Accounting for Uncertainty in Income Taxes*, to address the noncomparability in reporting tax assets and liabilities resulting from a lack of specific guidance in SFAS No. 109, *Accounting for Income Taxes*, on the uncertainty in income taxes recognized in an enterprise's financial statements. Specifically, FIN No. 48 prescribes (a) a consistent recognition threshold and (b) a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides related guidance on derogation, classification, interest and penalties, accounting in interim periods, disclosure and transition.

In September 2006, the FASB issued SFAS No. 157 (SFAS No. 157), *Fair Value Measurements*, to eliminate the diversity in practice that exists due to the different definitions of fair value and the limited guidance for applying those definitions in GAAP that are dispersed among the many accounting pronouncements that require fair value measurements. SFAS No. 157 retains the exchange price notion in earlier definitions of fair value, but clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or liability in the principal or most advantageous market for the asset or liability. Moreover, the SFAS states that the transaction is

hypothetical at the measurement date, considered from the perspective of the market participant who holds the asset or liability. Consequently, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price), as opposed to the price that would be paid to acquire the asset or received to assume the liability at the measurement date (an entry price).

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SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). Finally, SFAS No. 157 expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. Entities are encouraged to combine the fair value information disclosed under SFAS No. 157 with the fair value information disclosed under other accounting pronouncements, including SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, where practicable. The guidance in this Statement applies for derivatives and other financial instruments measured at fair value under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, at initial recognition and in all subsequent periods.

SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application is encouraged. Additionally, prospective application of the provisions of SFAS No. 157 is required as of the beginning of the fiscal year in which it is initially applied, except when certain circumstances require retrospective application.

The Company is currently evaluating the effect of adopting SFAS No. 157 on its consolidated financial statements.

In September 2006, the FASB has issued SFAS No. 158 (SFAS No. 158), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, to require an employer to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare, and other postretirement plans in their financial statements. Previous standards required an employer to disclose the complete funded status of its plan only in the notes to the financial statements. Moreover, because those standards allowed an employer to delay recognition of certain changes in plan assets and obligations that affected the costs of providing benefits, employers reported an asset or liability that almost always differed from the plan's funded status. Under SFAS No. 158, a defined benefit postretirement plan sponsor that is a public or private company or a nongovernmental not-for-profit organization must (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for the plan's underfunded status, (b) measure the plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions), and (c) recognize, as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87, *Employers' Accounting for Pensions*, or SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. SFAS No. 158 also requires an employer to disclose in the notes to financial statements additional information on how delayed recognition of certain changes in the funded status of a defined benefit postretirement plan affects net periodic benefit cost for the next fiscal year. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. The Company is evaluating the effect of adopting SFAS No. 158 on their consolidated financial statements.

14. The Company, through its subsidiary Metalclad Insulation Corporation, had a line of credit agreement with Far East National Bank which matured on January 27, 2005, and which bore interest at a floating rate based upon the bank's prime rate plus 1%. The line of credit was collateralized by certain assets of the Company and personally guaranteed by the Company's former President and Chief Executive Officer, Wayne Mills. Borrowings under the agreement were limited to \$1,000,000 plus the amount of cash collateral posted, up to \$500,000, in the form of a certificate of deposit at the bank.

On January 27, 2005, we renewed our line of credit with Far East National Bank. The renewed line of credit was for up to \$1,000,000, subject to 80% of eligible accounts receivable as defined in the loan agreement, and bore interest at a floating rate based upon the bank's prime rate plus 1.5%. The line of credit was collateralized by certain assets of the Company and personally guaranteed by the Company's former President and Chief Executive Officer, Wayne Mills.

The new line of credit agreement with Far East National Bank originally matured on October 28, 2005, but in October 2005 the maturity date was extended to January 1, 2006 and was further extended to May 1, 2006 in December 2005.

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At December 31, 2005, \$775,000 was outstanding on the credit agreement with available borrowings of \$225,000. The loan terms stipulated that the Company maintain compliance with certain financial covenants and ratios, including minimum book value and cash flow ratios. At December 31, 2005, the Company was not in compliance with the minimum cash flow ratio and the covenant requiring Entrx Corporation to maintain a tangible net worth of not less than \$4,000,000. The Company has received a waiver from Far East National Bank with regards to the non-compliance of the minimum cash flow ratio as of December 31, 2005. The Company paid-off the line of credit in April 2006 with proceeds from the sale of the building (See Note 6).

15. 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. In November, 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. On May 31, 2006, Entrx Corporation entered into a Settlement Agreement with Ventana Global Environmental Organizational Partnership, L.P. and North America Environmental Fund, L.P. (collectively referred to as "Ventana") whereby Ventana agreed to pay Entrx Corporation \$1,250,000 in exchange for the dismissal with prejudice by Entrx Corporation of the law suit (the "Ventana Action") filed by Entrx Corporation against Ventana and others in Orange County, California Superior Court. Entrx Corporation and Ventana also entered into a mutual release of all claims each may have had against the other. In addition, Entrx Corporation released Carlos Alberto de Rivas Oest and Geologic de Mexico S.A. de C.V., which were parties related to Ventana, and against whom Entrx Corporation had claims pending in Mexico. The Settlement Agreement does not limit claims that Entrx had or currently has against Javier Guerra Cisneros and Promotora Industrial Galeana, S.A. de C.V., which Entrx Corporation continues to pursue in Mexico. Javier Guerra Cisneros and Promotora Industrial Galeana, S.A. de C.V. were involved with the transactions which were the subject of the Ventana Action. Entrx Corporation received \$925,000 net after payment of legal fees and expenses associated with the Ventana Action and the Settlement Agreement.

16. In June 2006 the Company repaid the remaining principal balance of \$348,573 and accrued interest of \$2,905 outstanding under the note issued to Pandora Select Partners L.P.

17. In August of 2001, Metalclad Insulation Corporation purchased a workers' compensation policy from American Home Assurance Company ("American Home"), an American International Group ("AIG") company, for the period of September 1, 2001 to September 1, 2002. The premium for the workers' compensation policy was to be calculated retrospectively. The American Home policy required Metalclad to pay an initial estimated premium, but Metalclad's premium is recalculated periodically, through March 1, 2006, based on actual workers' compensation losses incurred.

In November 2003, a dispute arose between Metalclad, on the one hand, and American Home and Metalclad's insurance broker, Meyers-Reynolds & Associates, on the other hand regarding calculation of the first periodic premium adjustment. Specifically, American Home employed the use of a loss development factor and estimated payroll figure in its premium calculation which substantially increased the premium it charged Metalclad. Metalclad believes that American Home's calculations were inconsistent with the terms of the American Home policy and representations made by American Home and Meyers-Reynolds regarding how the premium would be calculated.

On February 27, 2004, the Company filed an action in Orange County Superior Court against American Home, National Union and Meyers-Reynolds for breach of contract, breach of the covenant of good faith and fair dealing, declaratory relief, reformation, injunctive relief, negligent and intentional misrepresentation and breach of fiduciary duty. On May 2, 2005, the Company reached a settlement in principal with American Home and National Union which resulted in the payment by the Company to American Home of approximately \$39,000 in the three months ended December 31, 2005 and resulted in the Company paying an additional \$45,000 in the three months ended June 30, 2006 which had been accrued at December 31, 2005. During the three months ended September 30, 2006 the

Company reached a settlement with Meyers-Reynolds which resulted in the payment to the Company by Meyers-Reynolds of \$100,000.

18. Our subsidiary, Metalclad Insulation Corporation, continues to be engaged in lawsuits involving asbestos-related injury or potential injury claims. The 199 claims made in 2005 were down from the 725, 590, 351 and 265 claims made in 2001, 2002, 2003 and 2004, respectively, although the average payment on these claims increased from \$15,129 in 2002 to \$21,849 in 2003, decreased to \$15,605 in 2004 and increased to \$21,178 in 2005. The average payment on claims was \$17,306 for the nine months ended September 30, 2006. There were 179 new claims made in the first nine months of 2006, compared to 154 in the first nine months of 2005. There were 458 cases pending at September 30, 2006. These claims are currently defended and covered by insurance.

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, particularly in view of what appears will be an increase in the number of claims which will be made in 2006 as compared to 2005. 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. Factoring in the average indemnity of \$11,679 for the first six months of 2006, we have adjusted our projected average future indemnity per claim to be \$19,300. 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 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 are projecting those costs to be approximately \$13,500 per resolved claim.

Based on the trend of reducing asbestos-related injury claims made against the Company over the past four calendar years, we projected in our Form 10-KSB filed with the Securities and Exchange Commission for the year ended December 31, 2005 that approximately 533 asbestos-related injury claims would be made against the Company after December 31, 2005. These claims, in addition to the 507 claims existing as of December 31, 2005, totaled 1,040 current and future claims. Multiplying the average indemnity per resolved claim over the past five years of \$20,056, times 1,040, we previously projected 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 projected the probable future defense costs to equal approximately \$14 million. Accordingly, our total estimated future asbestos-related liability at December 31, 2005 was \$35 million. These estimated liabilities are included as liabilities on our December 31, 2005 balance sheet.

As of December 31, 2005, we projected that approximately 145 new asbestos-related claims would be commenced, and approximately 245 cases would be resolved, in 2006, resulting in an estimated 407 cases pending at December 31, 2006. Since we projected that an aggregate of 533 new cases would be commenced after December 31, 2005, and that 145 of these cases would be commenced in 2006, we estimated that an aggregate of 388 new cases would be commenced after December 31, 2006. Accordingly, the cases pending and projected to be commenced in the future at December 31, 2006, would be 795 cases. Multiplying 795 claims times the approximate average indemnity paid and defense costs incurred per resolved claim from 2002 through 2005 of \$33,500, we had previously estimated our liability for current and future asbestos-related claims at December 31, 2006 to be approximately \$27,000,000. This amounted to an \$8,000,000 reduction from the \$35,000,000 liability we estimated as of December 31, 2005, or a \$2,000,000 reduction per quarter.

As of June 30, 2006, we re-evaluated our estimates, based upon the fact that we previously estimated that there would be 145 asbestos-related claims made in 2006, and that 123 claims had already been made in the first half of 2006, and that we previously estimated that 245 claims would be resolved in 2006, and that 145 claims had already been resolved in the first six months of 2006. We now estimate that there will be 889 asbestos-related injury claims made against the Company after December 31, 2005. The 889 claims, in addition to the 507 claims existing as of December 31, 2005, totaled 1,396 current and future claims. There were 145 resolved claims in the first six months of 2006, which means that as of June 30, 2006, the Company estimated that there were 1,251 current and future claims. Multiplying the average indemnity per resolved claim over the past five and one half years of \$19,300, times 1,251,

we projected the probable future indemnity to be paid on those claims after June 30, 2006 to be equal to approximately \$24 million. In addition, multiplying an estimated cost of defense per resolved claim of approximately \$13,500 times 1,251, we projected the probable future defense costs to equal approximately \$17 million. Accordingly, our total estimated future asbestos-related liability at June 30, 2006 was \$41 million. These estimated liabilities were included as liabilities on our June 30, 2006 balance sheet.

As of June 30, 2006, we projected that approximately 196 new asbestos-related claims would be commenced, and approximately 277 cases would be resolved, in 2006, resulting in an estimated 426 cases pending at December 31, 2006. Based upon these new estimates, we now project that an aggregate of 889 new cases will be commenced after December 31, 2005, and that 196 of these cases will be commenced in 2006, we estimate that an aggregate of 693 new cases will be commenced after December 31, 2006. Accordingly, the cases pending and projected to be commenced in the future at December 31, 2006, would be 1,119 cases. Multiplying 1,119 claims times the approximate average indemnity paid and defense costs incurred per resolved claim from 2002 through June 2006 of \$32,800, we estimated our liability for current and future asbestos-related claims at December 31, 2006 to be approximately \$37,000,000. This amounts to a \$4,000,000 reduction from the \$41,000,000 liability we estimated as of June 30, 2006, or a \$2,000,000 reduction per quarter. Accordingly, we reduced our asbestos-related liability at the quarter ended September 30, 2006, by \$2,000,000.

We intend to re-evaluate our estimate of future liability for asbestos claims at the end of each fiscal year, or whenever actual results are materially different from our estimates, integrating our actual experience in that fiscal year with that of prior fiscal years since 2002. 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 our future liability based upon the time value of money.

Although defense costs are included in our insurance coverage, we expended \$174,000, \$304,000 and \$188,000 in 2003, 2004 and 2005, respectively, and \$28,000 and \$170,000 in the three and nine months ended September 30, 2006, respectively, relative to the asbestos claims, which is not covered by any insurance. 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. We anticipate that this cost will continue. These costs are expensed as incurred.

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 insurance coverage available to satisfy asbestos-related injury claims, which significantly exceeds our estimated \$35 million and \$39 million future liability for such claims as of December 31, 2005 and September 30, 2006, respectively. This determination assumes that the insurance companies live up to what we believe is their obligation to continue to cover our exposure with regards to these claims. Based upon this determination of probability, we have recorded an insurance recovery as an asset equal to our projected asbestos-related liability.

19. Supplemental disclosures of cash flow information:

Cash paid for interest was \$105,554 and \$210,084 for the nine months ended September 30, 2006 and 2005, respectively.

**Item 2. Management's Discussion and Analysis or Plan of Operation**

All statements, other than statements of historical fact, included in this Form 10-QSB, including without limitation the statements under "Management's Discussion and Analysis or Plan of Operation" 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-QSB. 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-QSB 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.



**General.** The Company provides insulation and asbestos abatement services, primarily on the West Coast. Through our wholly-owned subsidiary Metalclad Insulation Corporation, we provide these services to a wide range of industrial, commercial and public agency clients. Insulation services include the installation of high- and low-temperature insulation on pipe, ducts, furnaces, boilers, and other types of industrial equipment and commercial applications. Asbestos abatement services include removal and disposal of asbestos-containing products in similar applications. We fabricate specialty items for the insulation industry, and sell insulation material and accessories incident to our services business to our customers as well as to other contractors. A diverse list of clientele includes refineries, utilities, chemical/petrochemical plants, manufacturing facilities, commercial properties, office buildings and various governmental facilities.

### **Results of Operations: Three and Nine Months Ended September 30, 2006 and 2005**

#### **Revenue**

Revenue for the three months ended September 30, 2006 was \$3,889,000, an increase as compared to \$3,577,000 for the three months ended September 30, 2005. Revenue for the nine months ended September 30, 2006 was \$12,863,000, an increase as compared to \$10,635,000 for the nine months ended September 30, 2005. Revenues increased during the three and nine months ended September 30, 2006 as compared with the three and nine months ended September 30, 2005 due to the Company obtaining new maintenance contracts and the Company hiring additional project managers which allows the Company to bid on more projects compared to the year ago period and which ultimately increased the number of jobs in which we were the winning bidder.

#### **Cost of Revenue and Gross Margin**

Cost of revenue was \$3,343,000 for the three months ended September 30, 2006, as compared to \$3,725,000 for the three months ended September 30, 2005. Cost of revenue was \$11,013,000 for the nine months ended September 30, 2006, as compared to \$9,482,000 for the nine months ended September 30, 2005. The gross margin (loss) percentage was approximately 14.0% for the three months ended September 30, 2006 as compared to (4.1)% for the three months ended September 30, 2005. The gross margin percentage was approximately 14.4% for the nine months ended September 30, 2006 as compared to 10.8% for the nine months ended September 30, 2005. The increase in the gross margin percentage during the three and nine months ended September 30, 2006 as compared with the three and nine months ended September 30, 2005 is primarily the result of the Company recording a charge of \$650,000 related to an anticipated loss on a project during the three and nine months ended September 30, 2005.

#### **Selling, General and Administrative**

Selling, general and administrative expenses for the three months ended September 30, 2006 were \$508,000 as compared to \$529,000 for the comparable period ended September 30, 2005, a decrease of 4.0%. Selling, general and administrative expenses for the nine months ended September 30, 2006 were \$1,631,000 as compared to \$1,846,000 for the comparable period ended September 30, 2005, a decrease of 11.7%. The decrease for the three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2005 was primarily due to decreases in legal and insurance expenses.

#### **Change in Allowance on Shareholder Note Receivable**

For the year ended December 31, 2004, we established a reserve of \$250,000 against the note receivable from Blake Capital Partners, LLC ("Blake"). The reserve was established based upon the Company's estimate of the collectibility of the note receivable. The Company increased the reserve by \$500,000, for a total reserve of \$750,000, against the note receivable during the six months ended June 30, 2006 based upon the Company's estimate of the collectibility of the note receivable at that time. Blake Capital Partners, LLC was current in the payment of interest through the payment

due March 1, 2006. The payment due September 1, 2006, however, was not made, and we have been informed by Mr. Mills, the principal of Blake Capital Partners and guarantor on the note, that no payment can be expected in the foreseeable future. As of September 30, 2006, as a result of the non-payment of interest and other information received from Mr. Mills, we booked an additional reserve of \$521,000 against the note receivable and wrote-off the interest receivable through June 30, 2006 of \$48,000, bringing the net of the note receivable less the reserve down to \$225,000, the approximate value of the collateral securing the Note.

### **Gain (Loss) on Disposal of Property, Plant and Equipment**

Gain (loss) on the disposal of property plant and equipment was \$(2,000) and \$1,000 for the three and nine months ended September 30, 2006, respectively. For the three and nine months ended September 30, 2005 the Company had a gain on disposal of property plant and equipment of \$1,000 and \$0, respectively.

### **Interest Income and Expense**

Net interest income for the three months ended September 30, 2006 was \$13,000 as compared to net interest expense of \$71,000 for the three months ended September 30, 2005 and net interest expense for the nine months ended September 30, 2006 was \$10,000 as compared to net interest expense of \$216,000 for the nine months ended September 30, 2005, primarily due to a decrease in the average balance, as well as no amortization of the original issue discount, of the note with Pandora Select Partners L.P. during the three and nine months ended September 30, 2006. During the three months ended September 30, 2006, the Company did not record any interest income on the note receivable from Blake Capital Partners, LLC. In addition, the note with Pandora Select Partners L.P., the line of credit and mortgage with Far East National Bank were all paid-off in the nine months ended September 30, 2006.

### **Gain on Sale of Building, Land, and Building Improvements**

Gain on sale of building, land and building improvements was \$1,725,000 for the nine months ended September 30, 2006. This gain was related to the sale of the Company's facilities in Anaheim, California that houses the Company's insulation operations.

### **Other Income**

Other income for the three months ended September 30, 2006 was \$100,000 related to the settlement agreement with Meyers-Reynolds whereby Meyers-Reynolds agreed to pay Entrx Corporation \$100,000 in exchange for the dismissal with prejudice by Entrx Corporation of the law suit filed by Entrx Corporation against Meyers-Reynolds. Also included in the \$1,025,000 of other income for the nine months ended September 30, 2006 was \$925,000 related to the settlement agreement with Ventana Global Environmental Organizational Partnership, L.P. and North America Environmental Fund, L.P. (collectively referred to as "Ventana") whereby Ventana agreed to pay Entrx Corporation \$1,250,000 in exchange for the dismissal with prejudice by Entrx Corporation of the law suit (the "Ventana Action") filed by Entrx Corporation against Ventana and others in Orange County, California Superior Court in November 2000. Entrx Corporation received \$925,000 net after payment of legal fees and expenses associated with the settlement.

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

We had a net loss of \$421,000 for the three months ended September 30, 2006 as compared to a net loss of \$746,000 for the three months ended September 30, 2005. We had net income of \$1,892,000 for the nine months ended September 30, 2006 as compared to a net loss of \$909,000 for the nine months ended September 30, 2005. The decrease in net loss for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, primarily was the result of the lack of a charge of \$650,000 related to an anticipated loss on a project which occurred in 2005, the settlement with Meyers-Reynolds and net interest income as opposed to net interest expense, partially offset by charges of \$569,000 related to the increase in the allowance and the write-off of the interest receivable on the note receivable from Blake. The net income for the nine months ended September 30, 2006 was primarily due to the gain on the sale of our facilities in Anaheim, California and our settlement with Ventana Global Environmental Organizational Partnership, L.P. and North America Environmental Fund, L.P., partially offset by the increase in our reserve on the note receivable from Blake. An increase in revenues and the associated increase in gross margin also contributed to the increase in net income for the nine months ended September 30, 2006 as compared to

the nine months ended September 30, 2005.

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## **Liquidity and Capital Resources**

As of September 30, 2006, we had \$1,639,000 in cash and cash equivalents and \$118,000 in available-for-sale securities. The Company had working capital of \$3,822,000 as of September 30, 2006. We own 190,566 shares of the common stock of VioQuest Pharmaceuticals, Inc., the common stock of which is publicly traded on the NASD Bulletin Board under the symbol "VQPH". Of the 190,566 shares, 75,000 shares are subject to options exercisable by two current and one former member of our Board of Directors at \$1.25 per share.

On January 27, 2005, our subsidiary, Metalclad Insulation Corporation, renewed its line of credit with Far East National Bank, Newport Beach, California, originally obtained in 2003. The renewed line of credit was for up to \$1,000,000, subject to 80% of eligible accounts receivable as defined in the loan agreement, and bore interest at a floating rate based upon the bank's prime rate plus 1.5%. The new line of credit agreement with Far East National Bank originally matured on October 28, 2005, but the maturity date was extended to May 1, 2006. Metalclad Insulation Corporation also obtained a \$1,596,000 mortgage on its facilities in Anaheim, California, from Far East National Bank that matured in October 2008, and bore interest at a floating rate based on the bank's prime rate plus 1%. The line of credit was collateralized by certain assets of the Company, including the Company's operating facilities in the Anaheim California, and both the mortgage and the line of credit were personally guaranteed by the Company's former President and Chief Executive Officer, Wayne Mills.

Under the loan agreement with Far East National Bank we made a number of warranties, representations and covenants, which if violated, would constitute an event of default under the loan agreement and allow Far East National Bank to call the loan immediately due. The covenants required, among other things, that Metalclad Insulation Corporation maintain a current ratio in excess of 1.25 to 1, a cash flow ratio in excess of 1.5 to 1, a tangible net worth of not less than \$3,000,000, and a debt to worth ratio in excess of 2 to 1, and that Entrx Corporation maintain a tangible net worth of not less than \$4,000,000. As of December 31, 2005, the Company was not in compliance with the minimum cash flow ratio and the covenant requiring Entrx Corporation to maintain a tangible net worth of not less than \$4,000,000. The Company received a waiver, through April 3, 2006, from Far East National Bank with regards to non-compliance of the minimum cash flow ratio as of December 31, 2005. The Company paid off the line of credit in April 2006 with proceeds from the sale of a building discussed below (See Note 6).

Due to the increase in real estate value in southern California and the resulting increase in the Company's equity in its facility, and the Company's need for cash, the Company signed an agreement in December 2005 to sell its facilities in Anaheim, California for \$3,900,000. The sale of the building was completed in April 2006. At the time of sale, the cost basis of the building, land and building improvements was \$2,080,082 and accumulated depreciation was \$101,035. The Company will be leasing the facilities back for eight months and recognized the gain on the sale during the three months ended June 30, 2006. The Company had a first mortgage on the building of \$1,499,978, including accrued interest of \$8,698, at the time of sale and a second mortgage on the building of \$150,000 at the time of the sale. The mortgages were repaid upon the sale of the building. After repayment of the line of credit and mortgages, we had approximately \$960,000 in cash to be used as working capital.

In December 2003, we issued a \$1,300,000, 10% convertible promissory note to Pandora Select Partners L.P. The note was payable interest only through April 15, 2004, and thereafter was payable in equal monthly installments over the next 33 months. The balance outstanding on the note at December 31, 2005 was \$554,969. In June 2006, the Company repaid the remaining principal balance of \$348,573 and accrued interest of \$2,905 outstanding under the note.

In an effort to increase shareholder value and to diversify from our insulation services business, we have made equity investments in several companies that are not in the insulation services business and which we believed had the ability to provide acceptable return on our investments. We currently have investments in two privately-held companies, Catalytic Solutions, Inc. and Clearwire Corporation, which we value at \$450,000 and \$757,000, respectively. Both of

these companies are in the early stages of their business development. Our investments represent less than 5% ownership in each company and represent approximately 2.5% and 2.7% of the Company's total assets at September 30, 2006 and December 31, 2005, respectively. Catalytic Solutions, Inc. manufactures and delivers proprietary technology that improves the performance and reduces the cost of catalytic converters. Clearwire Corporation is a provider of non-line-of-sight plug-and-play broadband wireless access systems. Either or both of these investments could be impaired in the future. There is no market for the securities of Catalytic Solutions, Inc. or Clearwire Corporation.

For the year ended December 31, 2004, we established a reserve of \$250,000 against the note receivable from Blake Capital Partners, LLC ("Blake"). The reserve was established based upon the Company's estimate of the collectibility of the note receivable. The Company increased the reserve by \$500,000, for a total reserve of \$750,000, against the note receivable during the six months ended June 30, 2006 based upon the Company's estimate of the collectibility of the note receivable at that time. Blake Capital Partners, LLC was current in the payment of interest through the payment due March 1, 2006. The payment due September 1, 2006, however, was not made, and we have been informed by Mr. Mills, the principal of Blake Capital Partners and guarantor on the note, that no payment can be expected in the foreseeable future. As of September 30, 2006, as a result of the non-payment of interest and other information received from Mr. Mills, we booked an additional reserve of \$521,000 against the note receivable and wrote-off the interest receivable through June 30, 2006 of \$48,000, bringing the net of the note receivable less the reserve down to \$225,000, the approximate value of the collateral securing the Note.

Cash provided by operations was \$432,000 for the nine months ended September 30, 2006 compared with cash used in operations of \$1,078,000 for the nine months ended September 30, 2005. For the nine months ended September 30, 2006 the positive cash flow from operations was primarily the result of our net income, and a decrease in accounts receivable and other receivables, partially offset by a decrease in accounts payable and accrued expenses and an increase costs and estimated earnings in excess of billings on uncompleted contracts. For the nine months ended September 30, 2005 the negative cash flow from operations was primarily the result of funding our operating loss, and increases in accounts receivable and other receivables. The increase in other receivables is primarily related to an increase in cash held by our bonding company as security for completion bonds on some of our projects. The amount held by the bonding company totaled \$397,000 on September 30, 2006. These uses of cash were partially offset by non-cash charges for depreciation and amortization and an increase in accounts payable and accrued expenses.

Net investing activities provided \$3,593,000 of cash in the nine months ended September 30, 2006 and used \$178,000 of cash in the nine months ended September 30, 2005, respectively. For the nine months ended September 30, 2006 and 2005, we used cash of \$139,000 and \$188,000, respectively, for capital expenditures, primarily at our subsidiary, Metalclad Insulation Corporation. During the nine months ended September 30, 2006, cash of \$3,732,000 was provided by proceeds from sales of assets, primarily related to the sale of the Company's facilities in Anaheim, California. During the nine months ended September 30, 2005, cash of \$10,000 was provided by proceeds from sales of assets.

Cash used in financing activities totaled \$2,799,000 for the nine months ended September 30, 2006 compared with cash used in financing activities of \$432,000 for the comparable period in 2005. During the nine months ended September 30, 2006, cash was used to repay the note payable to bank, the mortgage payable on the building we sold and the Company's note to Pandora Select Partners L.P. Proceeds from long-term debt provided cash during the nine months ended September 30, 2006. During the nine months ended September 30, 2005, we used cash for payments on our note payable to Pandora Select Partners L.P., payments on our capital lease obligation, and payments on our mortgage payable. Payments on long-term borrowings used \$83,000 and \$121,000 of cash in the nine months ended September 30, 2006 and 2005, respectively.

On May 31, 2006, Entrx Corporation entered into a Settlement Agreement with Ventana Global Environmental Organizational Partnership, L.P. and North America Environmental Fund, L.P. (collectively referred to as "Ventana") whereby Ventana agreed to pay Entrx Corporation \$1,250,000 in exchange for the dismissal with prejudice by Entrx Corporation of the law suit (the "Ventana Action") filed by Entrx Corporation against Ventana and others in Orange County, California Superior Court in November 2000. Entrx Corporation and Ventana also entered into a mutual release of all claims each may have had against the other. In addition, Entrx Corporation released Carlos Alberto de Rivas Oest and Geologic de Mexico S.A. de C.V., which were parties related to Ventana, and against whom Entrx Corporation had claims pending in Mexico. The Settlement Agreement does not limit claims that Entrx had or currently has against Javier Guerra Cisneros and Promotora Industrial Galeana, S.A. de C.V., which Entrx Corporation continues to pursue in Mexico. Javier Guerra Cisneros and Promotora Industrial Galeana, S.A. de C.V. were involved with the transactions which were the subject of the Ventana Action. Entrx Corporation received approximately \$925,000 net after payment of legal fees and expenses associated with the Ventana Action and the Settlement Agreement.

Our subsidiary, Metalclad Insulation Corporation, continues to be engaged in lawsuits involving asbestos-related injury or potential injury claims. The 199 claims made in 2005 were down from the 725, 590, 351 and 265 claims made in 2001, 2002, 2003 and 2004, respectively. There were 179 new claims made in the first nine months of 2006, compared to 154 in the first nine months of 2005, and 228 cases resolved in the first nine months of 2006, compared to 357 cases resolved in the first nine months of 2005. There were 458 cases pending at September 30, 2006 and 507 claims pending at December 31, 2005. The average indemnity payment on all resolved claims during each of said years has fluctuated from a high of \$26,520 in 2001, to a low of \$15,129 in 2002, and was \$21,178 in 2005. These claims are currently defended and covered by insurance. We have projected that our future liability for currently

outstanding and estimated future asbestos-related claims was approximately \$48,500,000 and \$35,000,000, at December 31, 2004 and December 31, 2005, respectively.



As of December 31, 2005, we projected that approximately 145 new asbestos-related claims would be commenced, and approximately 245 cases would be resolved, in 2006, resulting in an estimated 407 cases pending at December 31, 2006. Since we projected that an aggregate of 533 new cases would be commenced after December 31, 2005, and that 145 of these cases would be commenced in 2006, we estimated that an aggregate of 388 new cases would be commenced after December 31, 2006. Accordingly, the cases pending and projected to be commenced in the future at December 31, 2006, would be 795 cases. Multiplying 795 claims times the approximate average indemnity paid and defense costs incurred per resolved claim from 2002 through 2005 of \$33,500, in our Form 10-KSB filed with the Securities and Exchange Commission for the year ended December 31, 2005 we had estimated our liability for current and future asbestos-related claims at December 31, 2006 to be approximately \$27,000,000. This amounted to an \$8,000,000 reduction from the \$35,000,000 liability we estimated as of December 31, 2005, or a \$2,000,000 reduction per quarter.

As of June 30, 2006, we re-evaluated our estimates, based upon the fact that we previously estimated that there would be 145 asbestos-related claims made in 2006, and that 123 claims had already been made in the first half of 2006, and that we previously estimated that 245 claims would be resolved in 2006, and that 145 claims had already been resolved in the first six months of 2006. In that re-evaluation, we also took into consideration that at June 30, 2006, the average indemnity paid on each claim over the past five and one-half years had decreased from \$20,056 to \$19,300. As of June 30, 2006, we projected that approximately 196 new asbestos-related claims would be commenced, and approximately 277 cases would be resolved, in 2006, resulting in an estimated 426 cases pending at December 31, 2006. Based upon these new estimates, we projected that an aggregate of 889 new cases would be commenced after December 31, 2005, and that 196 of these cases would be commenced in 2006, we estimated that an aggregate of 693 new cases would be commenced after December 31, 2006. Accordingly, the cases pending and projected to be commenced in the future at December 31, 2006, would be 1,119 cases. Multiplying 1,119 claims times the approximate average indemnity paid and defense costs incurred per resolved claim from 2002 through June 2006 of \$32,800, we estimated our liability for current and future asbestos-related claims at December 31, 2006 to be approximately \$37,000,000. This amounts to a \$4,000,000 reduction from the \$41,000,000 liability we estimated as of June 30, 2006, or a \$2,000,000 reduction per quarter. Accordingly, we reduced our asbestos-related liability at the quarter ended September 30, 2006, by \$2,000,000.

We have determined that it is probable that we have sufficient insurance to provide coverage for both current and future projected asbestos-related injury claims. This determination assumes that the current trend of reducing asbestos-related injury claims will continue and that the average indemnity and direct legal costs of each resolved claim will not materially increase. The determination also assumes that the insurance companies live up to what we believe is their obligation to continue to cover our exposure with regards to these claims. Several affiliated insurance companies have brought a declaratory relief action against our subsidiary, Metalclad, as well as a number of other insurers, to resolve certain coverage issues. (See Part II, Item 1, "Legal Proceedings - Asbestos-related Claims")

We intend to re-evaluate our estimate of future liability for asbestos claims at the end of each fiscal year, or whenever actual results are materially different from our estimates, integrating our actual experience in that fiscal year with that of prior fiscal years since 2002. 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 our future liability based upon the time value of money.

Although defense costs are included in our insurance coverage, we expended \$174,000, \$304,000 and \$188,000 in 2003, 2004 and 2005, respectively, and \$28,000 and \$170,000 in the three and nine months ended September 30, 2006, respectively, to administer the asbestos claims, which is not covered by any insurance. 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. We anticipate that this cost will continue. These costs are expensed as incurred.

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 insurance coverage available to satisfy asbestos-related injury claims, which significantly exceeds our estimated \$35 million and \$39 million future liability for such claims as of December 31, 2005 and September 30, 2006, respectively.

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 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 does not believe that it has any legal obligation to assume or pay for such defense.

In 2003 and 2004 the Judiciary Committee of the United States Senate considered legislation to create a privately funded, publicly administered fund to provide the necessary resources for an asbestos injury claims resolution program, and is commonly referred to as the "FAIR" Act. In 2005, a draft of the "FAIR" Act was approved by the Judiciary Committee, but the bill was rejected by the full Senate in February 2006, when a cloture motion on the bill was withdrawn. An amended version of the 2006 "FAIR" Act (S 3274) was introduced in the Senate in May 2006, but has not been scheduled for a vote. A similar bill was introduced in the House (HR 1360) in March 2005, but was referred to a subcommittee in May 2005. The latest draft of the "FAIR" Act calls for the fund to be funded partially by asbestos defendant companies, of which the Company is one, and partially by insurance companies. The bill could be voted on by the Senate or the House at any time in the future. The impact, if any, the "FAIR" Act will have on us if passed cannot be determined at this time although the latest draft of the legislation did not appear favorable to us.

The Company projects that cash flow generated through the operation of its subsidiary, Metalclad Insulation Corporation, and the Company's net cash assets as of September 30, 2006 will be sufficient to meet the Company's cash requirements for at least the next twelve months.

### **Critical Accounting Policies and Estimates**

Our significant accounting policies are described in Note 1 to the consolidated financial statements included in our annual report for the year ended December 31, 2005. The accounting policies used in preparing our interim 2006 consolidated condensed financial statements are the same as those described in our annual report.

Our critical accounting policies are those both having the most impact to the reporting of our financial condition and results, and requiring significant judgments and estimates. Our critical accounting policies include those related to (a)

revenue recognition, (b) investments in unconsolidated affiliates, (c) allowances for uncollectible notes and accounts receivable, (d) judgments and estimates used in determining the need for an accrual, and the amount, of our asbestos liability, and (e) evaluation and estimates of our probable insurance coverage for asbestos-related claims. Revenue recognition for fixed price insulation installation and asbestos abatement contracts are accounted for by the percentage-of-completion method, wherein costs and estimated earnings are included in revenues as the work is performed. If a loss on a fixed price contract is indicated, the entire amount of the estimated loss is accrued when known. Revenue recognition on time and material contracts is recognized based upon the amount of work performed. We have made investments in privately-held companies, which can still be considered to be in the startup or development stages. The investments at less than 20% of ownership are initially recorded at cost and the carrying value is evaluated quarterly. We monitor these investments for impairment and make appropriate reductions in carrying values if we determine an impairment charge is required based primarily on the financial condition and near-term prospects of these companies. These investments are inherently risky, as the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. Notes and accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance for uncollectible amounts is based primarily on our evaluation of the financial condition of the noteholder or customer. Future changes in the financial condition of a note payee or customer may require an adjustment to the allowance for uncollectible notes and accounts receivable. We have estimated the probable amount of future claims related to our asbestos liability and the probable amount of insurance coverage related to those claims. We offset proceeds received from our insurance carriers resulting from claims of personal injury allegedly related to asbestos exposure against the payment issued to the plaintiff. The cash from the insurance company goes directly to the plaintiff, so we never have access to this cash. We never have control over any of the funds the insurance company issues to the plaintiff. Once a claim is settled, payment of the claim is normally made by the insurance carrier or carriers within 30 to 60 days. Changes in any of the judgments and estimates could have a material impact on our financial condition and results.

### **Recent Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157 (SFAS No. 157), *Fair Value Measurements*, to eliminate the diversity in practice that exists due to the different definitions of fair value and the limited guidance for applying those definitions in GAAP that are dispersed among the many accounting pronouncements that require fair value measurements. SFAS No. 157 retains the exchange price notion in earlier definitions of fair value, but clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or liability in the principal or most advantageous market for the asset or liability. Moreover, the SFAS states that the transaction is hypothetical at the measurement date, considered from the perspective of the market participant who holds the asset or liability. Consequently, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price), as opposed to the price that would be paid to acquire the asset or received to assume the liability at the measurement date (an entry price).

SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). Finally, SFAS No. 157 expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. Entities are encouraged to combine the fair value information disclosed under SFAS No. 157 with the fair value information disclosed under other accounting pronouncements, including SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, where practicable. The guidance in this Statement applies for derivatives and other financial instruments measured at fair value under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, at initial recognition and in all subsequent periods.

SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application is encouraged. Additionally, prospective application of the provisions of SFAS No. 157 is required as of the beginning of the fiscal year in which it is initially applied, except when certain circumstances require retrospective application.

The Company is currently evaluating the effect of adopting SFAS No. 157 on their consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158 (SFAS No. 158), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, to require an employer to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare, and other postretirement plans in their financial statements. Previous standards required an employer to disclose the complete funded status of its plan only in the notes to the financial statements. Moreover, because those standards allowed an employer to delay recognition of certain changes in plan assets and obligations that affected the costs of providing benefits, employers reported an asset or liability that almost always differed from the plan's funded status. Under SFAS No. 158, a defined benefit postretirement plan sponsor that is a public or private company or a nongovernmental not-for-profit organization must (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for the plan's underfunded status, (b) measure the plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions), and (c) recognize, as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87, *Employers' Accounting for Pensions*, or SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. SFAS No. 158 also requires an employer to disclose in the notes to financial statements additional information on how delayed recognition of certain changes in the funded status of a defined benefit postretirement plan affects net periodic benefit cost for the next fiscal year. SFAS No. 158

is effective for fiscal years ending after December 15, 2006. The Company is evaluating the effect of adopting SFAS No. 158 on their consolidated financial statements.

### **Item 3. Controls and Procedures**

We carried out an evaluation, with the participation of our chief executive and chief financial officers, of the effectiveness, as of September 30, 2006, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based upon that evaluation, made at the end of the period, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure, and that there has been no change in such internal control, or other factors which could significantly affect such controls including any corrective actions with regard to significant deficiencies or material weaknesses, since our evaluation.

The Company has a limited number of employees and is not able to have proper segregation of duties based on the cost benefit of hiring additional employees solely to address the segregation of duties issue. We determined the risks associated with the lack of segregation of duties are insignificant based on the close involvement of management in day-to-day operations (i.e. tone at the top, corporate governance, officer oversight and involvement with daily activities, and other company level controls). The Company has limited resources available and the limited amount of transactions and activities allow for compensating controls.

In addition, our management with the participation of our principal executive officer and principal financial officer or persons performing similar functions has determined that no change in our internal control over financing reporting occurred during the quarter ended September 30, 2006 that has materially affected, or is (as that term is defined in Rules 13(a)-15(f) and 15(d)-15(f) of the Securities Exchange Act of 1934) reasonably likely to materially affect, our internal control over financial reporting.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. 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. To date all of our asbestos-related injury claims have been paid and defended by our insurance carriers.

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. There were 179 new claims made in the first nine months of 2006, compared to 154 in the first nine months of 2005. There were 458 cases pending at September 30, 2006. These claims are currently defended and covered by insurance.





Set forth below is a table for the years ended December 31, 2002, 2003, 2004 and 2005 and the nine months ended September 30, 2006, 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:

	2002	2003	2004	2005 <sup>(2)</sup>	Nine Months Ended September 30, 2006
New cases filed	590	351	265	199	179
Defense Judgments and dismissals	382	311	311	294	150
Settled cases	229	175	97	108	78
Total resolved cases <sup>(1)</sup>	611	486	408	402 <sup>(2)</sup>	228
Pending cases <sup>(1)</sup>	988	853	710	507 <sup>(3)</sup>	458
Total indemnity payments	\$ 9,244,000	\$ 10,618,700	\$ 6,366,750	\$ 8,513,750	\$ 3,945,750
Average indemnity paid on settled cases	\$ 40,366	\$ 60,678	\$ 65,637	\$ 78,831	\$ 50,587
Average indemnity paid on all resolved cases	\$ 15,129	\$ 21,849	\$ 15,605	\$ 21,178 <sup>(2)</sup>	\$ 17,306

<sup>(1)</sup> 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.

<sup>(2)</sup> 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.

<sup>(3)</sup> 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, particularly in view of what appears will be an increase in the claims which will be made in 2006 as compared to 2005. 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. Factoring in the average indemnity of \$11,679 for the first six months of 2006, we have adjusted our projected average future indemnity per claim to be \$19,300. 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 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 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 calendar years, we projected in our Form 10-KSB filed with the Securities and Exchange Commission for the year ended December 31, 2005 that approximately 533 asbestos-related injury claims would be made against the Company after December 31, 2005. These claims, in addition to the 507 claims existing as of December 31, 2005, totaled 1,040 current and future claims. Multiplying the average indemnity per resolved claim over the past five years of \$20,056, times 1,040, we previously projected 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 projected the probable future defense costs to equal approximately \$14 million. Accordingly, our total estimated future asbestos-related liability at December 31, 2005 was \$35 million. These estimated liabilities are included as liabilities on our December 31, 2005 balance sheet.

As of December 31, 2005, we projected that approximately 145 new asbestos-related claims would be commenced, and approximately 245 cases would be resolved, in 2006, resulting in an estimated 407 cases pending at December 31, 2006. Since we projected that an aggregate of 533 new cases would be commenced after December 31, 2005, and that 145 of these cases would be commenced in 2006, we estimated that an aggregate of 388 new cases would be commenced after December 31, 2006. Accordingly, the cases pending and projected to be commenced in the future at December 31, 2006, would be 795 cases. Multiplying 795 claims times the approximate average indemnity paid and defense costs incurred per resolved claim from 2002 through 2005 of \$33,500, we had previously estimated our liability for current and future asbestos-related claims at December 31, 2006 to be approximately \$27,000,000. This amounted to an \$8,000,000 reduction from the \$35,000,000 liability we estimated as of December 31, 2005, or a \$2,000,000 reduction per quarter.

As of June 30, 2006, we re-evaluated our estimates, based upon the fact that we previously estimated that there would be 145 asbestos-related claims made in 2006, and that 123 claims had already been made in the first half of 2006 and that we previously estimated that 245 claims would be resolved in 2006, and that 145 claims had already been resolved in the first six months of 2006. We now estimate that there will be 889 asbestos-related injury claims made against the Company after December 31, 2005. The 889, in addition to the 507 claims existing as of December 31, 2005, totaled 1,396 current and future claims. There were 145 resolved claims in the first six months of 2006, which means that as of June 30, 2006, the Company estimated that there were 1,251 current and future claims. Multiplying the average indemnity per resolved claim over the past five and one half years of \$19,300, times 1,251, we projected the probable future indemnity to be paid on those claims after June 30, 2006 to be equal to approximately \$24 million. In addition, multiplying an estimated cost of defense per resolved claim of approximately \$13,500 times 1,251, we projected the probable future defense costs to equal approximately \$17 million. Accordingly, our total estimated future asbestos-related liability at June 30, 2006 was \$41 million.

As of June 30, 2006, we projected that approximately 196 new asbestos-related claims would be commenced, and approximately 277 cases would be resolved, in 2006, resulting in an estimated 426 cases pending at December 31, 2006. Based upon these new estimates, we projected that an aggregate of 889 new cases would be commenced after December 31, 2005, and that 196 of these cases would be commenced in 2006, we estimated that an aggregate of 693 new cases would be commenced after December 31, 2006. Accordingly, the cases pending and projected to be commenced in the future at December 31, 2006, would be 1,119 cases. Multiplying 1,119 claims times the approximate average indemnity paid and defense costs incurred per resolved claim from 2002 through June 2006 of \$32,800, we estimated our liability for current and future asbestos-related claims at December 31, 2006 to be approximately \$37,000,000. This amounts to a \$4,000,000 reduction from the \$41,000,000 liability we estimated as of June 30, 2006, or a \$2,000,000 reduction per quarter. Accordingly, we reduced our asbestos-related liability at the quarter ended September 30, 2006, by \$2,000,000.

We intend to re-evaluate our estimate of future liability for asbestos claims at the end of each fiscal year, or whenever actual results are materially different from our estimates, integrating our actual experience in that fiscal year with that of prior fiscal years since 2002. 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 our future liability based upon 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.

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, and \$28,000 and \$170,000 for the three and nine months ended September 30, 2006, 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.

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 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 does not believe that it has any legal obligation to assume or pay for such defense.

In 2003 and 2004 the Judiciary Committee of the United States Senate considered legislation to create a privately funded, publicly administered fund to provide the necessary resources for an asbestos injury claims resolution program, and is commonly referred to as the "FAIR" Act. In 2005, a draft of the "FAIR" Act was approved by the Judiciary Committee, but the bill was rejected by the full Senate in February 2006, when a cloture motion on the bill was withdrawn. An amended version of the 2006 "FAIR" Act (S 3274) was introduced in the Senate in May 2006, but has not been scheduled for a vote. A similar bill was introduced in the House (HR 1360) in March 2005, but was referred to a subcommittee in May 2005. The latest draft of the "FAIR" Act calls for the fund to be funded partially by asbestos defendant companies, of which the Company is one, and partially by insurance companies. The bill could be voted on by the Senate or the House at any time in the future. The impact, if any, the "FAIR" Act will have on us if passed 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.

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. The Mexican Federal Labor Arbitration Board rendered a recommendation on December 13, 2004, to the effect that the former employee was entitled to an award of \$350,000 from Entrx in connection with the termination of his employment. The award is in the form of a recommendation which has been affirmed by the Mexican Federal Court, but is only exercisable against assets of the Company located in Mexico. The Company has no assets in Mexico. The award does not represent a collectible judgment against the Company in the United States. Since the Company has no assets in Mexico, the likelihood of any liability based upon this award is remote, and we therefore believe that there is no potential liability to the Company at June 30, 2006 or December 31, 2005. The Company intends to continue to pursue its claims against the same employee for breach of contract, fraud, collusion and other causes of action in connection with the 1999 sale of one of the Company's operating businesses in Mexico.

On May 31, 2006, we entered into a Settlement Agreement with Ventana Global Environmental Organizational Partnership, L.P. and North America Environmental Fund, L.P. (collectively referred to as “Ventana”) whereby Ventana agreed to pay Entrx Corporation \$1,250,000 in exchange for the dismissal with prejudice by Entrx Corporation of the law suit (the “Ventana Action”) filed by Entrx Corporation against Ventana and others in Orange County, California Superior Court in November 2000. Entrx Corporation and Ventana also entered into a mutual release of all claims each may have had against the other. In addition, Entrx Corporation released Carlos Alberto de Rivas Oest and Geologic de Mexico S.A. de C.V., which were parties related to Ventana, and against whom Entrx Corporation had claims pending in Mexico. The Settlement Agreement does not limit claims that Entrx had or currently has against Javier Guerra Cisneros and Promotora Industrial Galeana, S.A. de C.V., which Entrx Corporation continues to pursue in Mexico. Javier Guerra Cisneros and Promotora Industrial Galeana, S.A. de C.V. were involved with the transactions which were the subject of the Ventana Action. Entrx Corporation received approximately \$925,000 net after payment of legal fees and expenses associated with the Ventana Action and the Settlement Agreement.

### **Claim Against Insurer**

In August of 2001, Metalclad Insulation Corporation purchased a workers’ compensation policy from American Home Assurance Company (“American Home”), an American International Group (“AIG”) company, for the period of September 1, 2001 to September 1, 2002. The premium for the workers’ compensation policy was to be calculated retrospectively. The American Home policy required Metalclad to pay an initial estimated premium, but Metalclad’s premium is recalculated periodically, through March 1, 2006, based on actual workers’ compensation losses incurred. Metalclad also provided American Home with collateralized security for future premium adjustments in the form of a letter of credit and cash.

In November 2003, a dispute arose between Metalclad, on the one hand, and American Home and Metalclad’s insurance broker, Meyers-Reynolds & Associates, on the other hand regarding calculation of the first periodic premium adjustment. Specifically, American Home employed the use of a loss development factor and estimated payroll figure in its premium calculation which substantially increased the premium it charged Metalclad. As a result of that dispute, another AIG company, National Union Fire Insurance Company of Pittsburgh drew down on the above mentioned letter of credit. Metalclad believes that American Home’s calculations were inconsistent with the terms of the American Home policy and representations made by American Home and Meyers-Reynolds regarding how the premium would be calculated. Metalclad also believes that National Union was in breach of the American Home policy when it drew down on the letter of credit.

On February 27, 2004, we filed an action in Orange County Superior Court against American Home, National Union and Meyers-Reynolds for breach of contract, breach of the covenant of good faith and fair dealing, declaratory relief, reformation, injunctive relief, negligent and intentional misrepresentation and breach of fiduciary duty. During the three months ended March 31, 2005, the Company recorded an accrual of \$75,000 related to this dispute. On May 2, 2005, we reached a settlement in principal with American Home and National Union which resulted in the payment by the Company to American Home of approximately \$39,000 in the three months ended December 31, 2005 and resulted in the Company paying an additional \$45,000 in the three months ended June 30, 2006 which had been accrued at December 31, 2005. During the three months ended September 30, 2006 the Company reached a settlement with Meyers-Reynolds which resulted in the payment to the Company by Meyers-Reynolds of \$100,000.

### **Item 6. Exhibits**

Exhibits

31.1 Rule 13a-14(a) Certification of Chief  
Executive Officer.

31.2 Rule 13a-14(a) Certification of Chief  
Financial Officer.

32 Section 1350 Certification.

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**SIGNATURES**

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

**ENTRX CORPORATION**

Date: November 9, 2006

By: /s/ Peter L. Hauser

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Peter L. Hauser  
Chief Executive Officer

Date: November 9, 2006

By: /s/ Brian D. Niebur

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