FORM 10-QSB
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended August 28, 1998

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 No. 1-10655

ENVIRONMENTAL TECTONICS CORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Pennsylvania | 23-1714256 |
| (State or other jurisdiction of incorporation or organization | (IRS Employer Identification No.) |

COUNTY LINE INDUSTRIAL PARK
SOUTHAMPTON, PENNSYLVANIA 18966
(Address of principal executive offices
(Zip Code)

(215) 355-9100
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.

Yes x No

The number of shares outstanding of the registrant's common stock as of August 8, 1998 is: [_________]



Environmental Tectonics Corporation
Consolidated Income Statements
(unaudited)

| | Three months ended: Aug 28, 1998 | Aug 29, 1997 | Six Months ended: Aug 28, 1998 | Aug 29, 1997 |
|---|---|---|---|---|
| | (thousands, except share and per share information) | | | |
| Net sales | $5,996 | $7,181 | $13,456 | $13,825 |
| Cost of goods sold | 3,713 | 4,823 | 8,424 | 9,507 |
| Gross profit | 2,283 | 2,358 | 5,032 | 4,318 |
| Operating expenses: | | | | |
| Selling and administrative | 1,319 | 1,244 | 2,981 | 2,374 |
| Research and development | 135 | 19 | 223 | 59 |

| | | | | |
|---|---|---|---|---|
| | 1,454 | 1,263 | 3,204 | 2,433 |
| Operating income | 829 | 1,095 | 1,828 | 1,885 |
| Other expenses: | | | | |
| Interest expense | 333 | 384 | 598 | 601 |
| Other, net | 55 | 80 | 77 | 107 |
| | 388 | 464 | 675 | 708 |
| Income before income taxes | 441 | 631 | 1,153 | 1,177 |
| Provision for income taxes | 146 | 225 | 395 | 411 |
| Income before minority interest | 295 | 406 | 758 | 766 |
| Income attributable to minority interest | 61 | 0 | 61 | 0 |
| Net income | $ 234 | $ 406 | $ 697 | $ 766 |
| Per share information: | | | | |
| Income available to common shareholders | $ 154 | $ 320 | $ 538 | $ 654 |
| Income per share: basic | $ 0.05 | $ 0.11 | $ 0.17 | $ 0.21 |
| Income per share: diluted | $ 0.05 | $ 0.10 | $ 0.16 | $ 0.20 |
| Number of shares: basic | 3,071,000 | 2,987,000 | 3,053,000 | 2,977,000 |
| Number of shares: diluted | 3,316,000 | 3,196,000 | 3,286,000 | 3,169,000 |

The accompanying notes are an integral part of the consolidated financial statements.



Environmental Tectonics Corporation
Consolidated Balance Sheets
(unaudited)

| | August 28, 1998 | February 27, 1998 |
|---|---|---|
| | (amounts in thousands) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 396 | $ 225 |
| Cash equivalents restricted for letters of credit | 25 | 15 |
| Accounts receivable, net | 11,716 | 8,448 |
| Costs and estimated earnings in excess of billings on uncompleted long-term contracts | 8,506 | 5,651 |
| Inventories | 2,689 | 3,058 |
| Deferred tax asset | 770 | 770 |
| Prepaid expenses and other current assets | 463 | 283 |
| | 24,565 | 18,450 |
| Property, plant and equipment, at cost, net of accumulated depreciation of $6,954 at Aug 28, 1998 and $6,729 at Feb 27, 1998 | 3,028 | 2,837 |
| Software development costs, net of accumulated amortization of $4,229 at Aug 28, 1998 and $3,914 at February 27, 1998 | 1,094 | 1,155 |
| Goodwill | 654 | - |
| Other assets | 463 | 513 |
| Total assets | $29,804 | $22,955 |

The accompanying notes are an integral part of the consolidated financial statements.

Environmental Tectonics Corporation
Consolidated Balance Sheets
(unaudited)

| | Aug. 28, 1998 | Feb. 27 1998 |
|---|---|---|
| | (amounts in thousands) | |
| Liabilities and Stockholders' Equity | | |
| Liabilities | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ 186 | $ 148 |
| Convertible notes payable - related parties | 300 | 800 |
| Accounts payable - trade | 817 | 1,424 |
| Billings in excess of costs and estimated earnings on uncompleted long-term contracts | 2,083 | 1,145 |
| Customer deposits | 637 | 1,373 |
| Accrued income taxes | 541 | 984 |
| Accrued liabilities | 1,393 | 1,114 |
| Total current liabilities | 5,958 | 6,988 |
| Long-term debt, less current portion: | | |
| Credit facility payable to banks | 6,549 | 467 |
| Subordinated debt | 3,752 | 3,730 |
| Other | 448 | 159 |
| | 10,749 | 4,356 |
| Deferred income taxes | 702 | 702 |
| Total liabilities | 17,094 | 12,046 |
| Redeemable cumulative preferred stock, $100 par and redemption value; 25,000 shares authorized, issued and outstanding | 2,351 | 2,330 |
| Minority interest | 361 | - |
| Stockholders' Equity | | |
| Common stock; $.10 par value; 10,000,000 shares authorized; 3,076,331 and 3,006,596 issued and outstanding at August 28, 1998 and February 27,1998, respectively | 308 | 300 |
| Capital contributed in excess of par value of common stock | 3,210 | 2,671 |
| Foreign currency exchange adjustment | 18 | - |
| Retained earnings | 6,147 | 5,608 |
| Total stockholders' equity | 9,683 | 8,579 |
| Total liabilities and stockholders' equity | $29,804 | $22,955 |

The accompanying notes are an integral part of the consolidated financial statements.



Environmental Tectonics Corporation
Consolidated Statements of Cash Flows
(unaudited)

| | Six months ended Aug. 28, 1998 | Aug. 29, 1997 |
|---|---|---|
| | (amounts in thousands) | |
| Cash flows from operating activities: | | |
| Net income | $ 697 | $ 766 |
| Adjustments to reconcile net income to net cash (used) provided by operating | | |

| | | |
|---|---|---|
| activities: | | |
| Depreciation and amortization | 724 | 635 |
| Provision for losses on accounts receivable and inventories | (164) | 193 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (3,224) | (108) |
| Costs and estimated earnings in excess of billings on uncompleted long-term contracts | (2,855) | (2,228) |
| Inventories | 489 | 77 |
| Prepaid expenses and other current assets | (784) | (413) |
| Accounts payable | (607) | (442) |
| Billings in excess of costs and estimated earnings on uncompleted long-term contracts | 938 | (702) |
| Customer deposits | (736) | (500) |
| Accrued income taxes | (443) | 203 |
| Other accrued liabilities | 340 | 262 |
| Payments under settlement agreements | (60) | (60) |
| Net cash used in operating activities | (5,685) | (2,317) |
| Cash flows from investing activities: | | |
| Acquisition of equipment | (428) | (218) |
| Capitalized software development costs | (254) | (240) |
| Net cash used in investing activities | (682) | (458) |
| Cash flows from financing activities: | | |
| Net borrowings (payments) under credit facility | 6,082 | (3,280) |
| Proceeds from subordinated debt, net | 0 | 3,227 |
| Proceeds from preferred stock, net | 0 | 2,293 |
| Payment of dividends on preferred stock | (138) | (95) |
| Decrease in cash equivalents restricted for letters of credit | (10) | 406 |
| Decrease in notes payable - related party | (500) | (500) |
| Net increase of other long-term debt | 327 | 6 |

<PAGE 5>

| | | |
|---|---|---|
| Proceeds from issuance of common stock/warrants | 416 | 621 |
| Minority interest | 361 | - |
| Net cash provided by financing activities | 6,538 | 2,678 |
| Net increase (decrease) in cash and cash equivalents | 171 | (97) |
| Cash and cash equivalents at beginning of period | 225 | 189 |
| Cash and cash equivalents at end of period | $ 396 | $ 92 |
| Supplemental schedule of cash flow information: | | |
| Interest paid | 369 | 517 |
| Income taxes paid | 756 | 230 |

Supplemental information on noncash operating and investing activities:
During the six month period ended August 28, 1998, the company transferred $36 of other assets to property, plant and equipment.
Also, in connection with an acquisition,

the company issued 55,000 shares of its common stock and a three-year interest-only note for $375.
During the six month period ended August 29, 1997, the company transferred $158,000 of inventory to property, plant and equipment and $637,000 of customer deposits to billings in excess of cost and estimated earnings on uncompleted long-term contracts

The accompanying notes are an integral part of the consolidated financial statements.



Environmental Tectonics Corporation
Notes to Consolidated Financial Statements

1. Basis of Presentation

The accompanying consolidated financial statements include the accounts of Environmental Tectonics Corporation ("ETC" or the "Company"), its wholly-owned subsidiary ETC International Corporation and its majority-owned subsidiary ETC-PZL Aerospace Industries, Ltd. ("ETC-PZL").

The accompanying consolidated financial statements have been prepared by Environmental Tectonics Corporation, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature.

Certain information in footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles has been condensed or omitted pursuant to such rules and regulations, although the Company believes the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended February 27, 1998.

Certain reclassifications have been made to the 1997 financial statements to conform with the 1998 presentation.

2. Earnings per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The following table demonstrates the components of basic and diluted earning per share for the three and six month periods ended August 28, 1998 and August 29, 1997.



(amounts in thousands, except share and per share information)

| | Three months ended: | | Six months ended: | |
|---|---|---|---|---|
| | Aug 28, 1998 | Aug 29, 1997 | Aug 28, 1998 | Aug 29, 1997 |

| | | | | |
|---|---|---|---|---|
| Net income | $234 | $406 | $697 | $766 |
| Less preferred stock dividends | (69) | (69) | (138) | (95) |
| Less accretion of preferred stock | (11) | (17) | (21) | (17) |
| Income available to common stockholders | $154 | $320 | $538 | $654 |
| Basic earnings per share: | | | | |
| Weighted average shares | 3,070,969 | 2,986,810 | 3,053,410 | 2,977,176 |
| Per share amount | $0.05 | $0.11 | $0.21 | $0.19 |
| Diluted earnings per share: | | | | |
| Weighted average shares | | | | |
| Effect of dilative securities: | 3,070,969 | 2,986,810 | 3,053,410 | 2,977,176 |
| Stock options | 56,879 | 33,506 | 40,898 | 38,050 |
| Stock warrants | 187,741 | 175,625 | 191,791 | 153,746 |
| | 3,315,589 | 3,195,941 | 3,286,099 | 3,168,972 |
| Per share amount | $0.05 | $0.10 | $0.16 | $0.20 |

Common stock issuable pursuant to conversion provisions of convertible subordinated debt and preferred stock totaling 360,611 shares of common stock were not included in the computation of diluted earnings per share because the effect of the assumed conversion was anti-dilutive.

3. Accounts Receivable

The components of accounts receivable are as follows:

| | August 28, 1998 | February 27, 1998 |
|---|---|---|
| | (amounts in thousands) | |
| U.S. Government receivables billed and unbilled contract costs subject to negotiation | $4,824 | $4,563 |
| U.S. commercial receivables billed | 1,341 | 1,071 |
| International receivables billed | 5,886 | 3,193 |
| | 12,051 | 8,827 |
| Less allowance for doubtful accounts | (335) | (379) |
| | $11,716 | $8,448 |

U.S. Government receivables billed and unbilled contract costs subject to negotiation:

Unbilled contract costs subject to negotiation represent claims made or to be made against the U.S. Government under a contract for a centrifuge. Theses costs were recorded during fiscal years 1994, 1995 and 1998. The Company has recorded  claims, amounting to $2.75 million, to the extent of contract costs incurred, and accounts receivable of $1.7 million, representing the balance due under the contract. Claim costs have been incurred in connection with U.S. Government caused delays, errors in specifications and designs, and other unanticipated causes and may not be received in full during fiscal 1999. In accordance with generally accepted accounting principles, revenue recorded by the Company from a claim does not exceed the incurred contract costs related to the claim. The Company currently has approximately $10.3 million in claims filed with the U.S. Government (including the aforementioned recorded claim and accounts receivable balances), which are subject to negotiation and audit by the U.S. Government. The U.S. Government has responded to the claims with either denials or deemed denials that the Company has appealed. As of August, 1998, the company was involved in discovery document review and preparing for depositions of key government personnel. Also, additional amounts are under review for the period November 1995 through October 1996 to determine what, if any, additional amounts can be filed as supplemental claims.

International receivables billed:

International receivables billed includes $1.8 million related to a certain contract with the Royal Thai Air Force.

In October 1993, the Company was notified by the Royal Thai Air Force ("RTAF") that the RTAF was terminating a certain $4.6 million simulator contract with the Company. Although the Company had performed in excess of 90% of the contract, the RTAF alleged a failure to completely perform. In connection with this termination, the RTAF made a call on a $229,000 performance bond, as well as a draw on an approximately $1.1 million advance payment letter of credit. Work under this contract had stopped while under arbitration, but on October 1, 1996, the Thai Trade Arbitration Counsel rendered its decision under which the contract was reinstated in full and the Company was given a period of nine months to complete the remainder of the work. Except as noted in the award, the rights and obligations of the parties remain as per the original contract including the potential invoking of penalties or termination of the contract for delay. On December 22, 1997, the Company successfully performed acceptance testing and the unit passed with no discrepancy reports. Although the contract was not completed in the time allotted, the Company has requested an extension on the completion time due to various extenuating circumstances, including allowable "force majeure" events.

4. Inventories

Inventories are valued at the lower of cost or market using the first-in, first out (FIFO) method and consist of the following (net of reserves):



| | August 28, 1998 | February 27, 1998 |
|---|---|---|
| | (amounts in thousands) | |
| Raw materials | $ 557 | $ 404 |
| Work in Process | 2,132 | 2,654 |
| | $2,689 | $3,058 |

5. Subordinated Debt and Preferred Stock

The components of the subordinated debt and preferred stock at August 28, 1998 and February 27,1998, were as follows:

| | (amounts in thousands) | | | |
|---|---|---|---|---|
| | August 28, 1998 | | February 27, 1998 | |
| | Subordinated Debt | Preferred Stock | Subordinated Debt | Preferred Stock |
| Face value | $4,000 | $2,500 | $4,000 | $2,500 |
| Deferred financing costs | (311) | (208) | (311) | (208) |
| Amortization of financing costs | 63 | - | 41 | |
| Accretion of preferred stock | - | 59 | - | 38 |
| Total | $3,752 | $2,351 | $3,730 | $2,330 |

6. Stockholders' Equity

The components of stockholders' equity at August 28, 1998 and February 27, 1998 were as follows:

(amounts in thousands, except share information)

| | Common stock Shares | Common stock Amount | Additional Capital | Foreign Currency | Retained Earnings | Total |
|---|---|---|---|---|---|---|
| Balance, February 28, 1997 | 3,006,596 | $300 | $2,671 | $ 0 | $5,608 | $8,579 |
| Net income for six month period ended August 28, 1998 | - | - | - | - | 697 | 697 |
| Stock issued in connection with acquisition | 55,000 | 6 | 490 | - | - | 496 |
| Dividend on preferred stock | - | - | - | - | (138) | (138) |
| Accretion of preferred stock | - | - | - | - | (20) | (20) |
| Shares issued in connection with employee stock purchase and stock option plans | 14,735 | 2 | 49 | - | - | 51 |
| Foreign currency exchange adjustments | - | - | - | 18 | - | 18 |
| Balance at August 28, 1998 | 3,076,331 | $308 | $3,210 | $18 | $6,147 | $9,683 |

7. Acquisition of ETC-PZL Aerospace Industries, Ltd.

On April 21, 1998, ETC acquired 65% ownership of MP-PZL Aerospace Industries, Ltd. ("MP-PZL"), a simulation and advanced training device manufacturing company located in Warsaw, Poland. <PAGE 10> The purchase price was $375,000 in cash, a $350,000 three-year promissory note bearing interest at a rate of 10% per annum and payable as to principal at maturity and 55,000 shares of ETC's common stock. MP-PZL was subsequently renamed ETC-PZL Aerospace Industries, Ltd. ("ETC-PZL"). ETC's cost for this acquisition was $1,220,000 and has been recorded in the accompanying balance sheet under the purchase method of accounting for business combinations. In connection with the acquisition, the Company has recorded goodwill of approximately $662,000 and a minority interest of approximately $300,000.

ETC-PZL's fiscal period ends December 31, 1998. The results of ETC-PZL for the period May 1,1998 through June 30, 1998, have been included in ETC's results of operation for the three and six month periods ended August 28, 1998. On a pro forma basis had the Company consolidated the results of ETC-PZL in the prior fiscal periods, the following comparisons would result:

Three months ended:

(amounts in thousands except share and per share data)

| | August 28, 1998 | August 29, 1997 (as reported) | August 29, 1997 (pro forma) |
|---|---|---|---|
| Net sales | $ 5,996 | $ 7,181 | $ 7,412 |
| Gross profit | 2,283 | 2,358 | 2,377 |
| Operating Income | 829 | 1,095 | 982 |
| Net income | 234 | 406 | 337 |
| Per share information: | | | |
| Income available to common shareholders | 154 | 320 | $251 |
| Income per share: basic | 0.05 | 0.11 | 0.08 |
| Income per share: diluted | 0.05 | 0.10 | 0.08 |
| Number of shares: basic | 3,071,000 | 2,987,000 | 2,987,000 |

| | | | |
|---|---|---|---|
| Number of shares: diluted | 3,316,000 | 3,196,000 | 3,196,000 |

| | Six months ended: August 28, 1998 | August 29, 1997 (as reported) | August 29, 1997 (pro forma) |
|---|---|---|---|
| | (amounts in thousands except share and per share data) | | |
| Net sales | $ 13,456 | $ 13,825 | $ 14,056 |
| Gross profit | 5,032 | 4,318 | 4,337 |
| Operating income | 1,828 | 1,885 | 1,772 |
| Net income | 697 | 766 | 697 |



| | | | |
|---|---|---|---|
| Per share information: | | | |
| Income available to common shareholders | $538 | $654 | $585 |
| Income per share: basic | $0.17 | $0.21 | $0.20 |
| Income per share: diluted | $0.16 | $0.20 | $0.18 |
| Number of shares: basic | 3,053,000 | 2,977,000 | 2,977,000 |
| Number of shares: diluted | 3,286,000 | 3,169,000 | 3,169,000 |

8. Computer Software Costs

The American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The SOP was issued to provide authoritative guidance on the subject of accounting for the costs associated with the purchase or development of computer software for internal use. The statement is effective for fiscal years beginning after December 15, 1998. This statement is not expected to have a material impact on the Company's financial position or results of operation.

9. Reporting Comprehensive Income

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards to provide prominent disclosure of comprehensive income items. Comprehensive income is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. SFAS No. 130 is effective for all periods beginning after December 15, 1997. Effective February 28, 1998, the Company adopted SFAS No. 130 which had no material impact on the Company's consolidated financial position or results of operation.

10. Business Segment Presentation:

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 requires that public business enterprises report certain financial information about operating segments in the complete sets of financial statements of the enterprise and in condensed financial statements of interim periods issued to shareholders. It also requires that public business enterprises report certain information about their products and services, the geographic areas in which they operate and their major customers. SFAS No. 131 is effective for all periods beginning after December 15, 1997. Effective February 28, 1998, the Company adopted SFAS

 No. 131 which had no impact on the Company's consolidated financial position or results of operation.

11. Year 2000 Issue

Many existing computer programs use only two digits to identify a year in the date field. These programs were designed and developed without considering the impact of the upcoming change in the century. If not corrected, many computer applications could fail or create erroneous results by or at the year 2000. The Year 2000 issue affects virtually all companies and organizations. The Company is currently utilizing internal resources to identify, convert or replace its systems for Year 2000 compliance. The Company estimates that costs associated with the Year 2000 issue, which are currently being expensed as incurred, will not have a material impact on its financial position or results of operations.

Managements Discussion and Analysis of Financial Condition and Results of Operations

Three months ended August 28, 1998 compared to August 29, 1997.

The Company had net income of $234,000, or $.05 per share (diluted) for the second quarter of fiscal 1998. Sales were $5,996,000, a decrease of $1,185,000 or 17% from the corresponding prior period. Decreases were evident across most product segments. An offset came from consolidating the operations of the Company's Poland subsidiary, acquired in April, 1998.

Gross profit decreased $75,000, or 3%, on the lower sales volume but as a percentage of revenues increased to 38% versus 33% for the prior period. This increase primarily reflected a higher mix of higher margin Aeromedical Training System Sales coupled with gross profit from the Company's Poland subsidiary.

Selling and administrative expenses increased $75,000, or 6%, reflecting the addition of local expenses for the Company's Poland subsidiary in the current period. Research and development expenses increased $116,000 over the prior period, reflecting heightened development in the hyperbaric and aeromedical product areas.

Interest and other fees were down from the prior period because the prior period included additional fees associated with the Company's March, 1997, refinancing.

The Company's tax rate approximates the statutory rate.

Six months ended August 28, 1998 compared to August 29, 1997.



For the six month period ended August 28, 1998, the Company had net income of $697,000, or $.16 per share (diluted), versus $766,000, or $.20 per share (diluted) in the first six months of fiscal 1998. Sales were $13,456,000, slightly down from $13,825,000 for the prior period. As a percentage of the total, sales in the current period of the Aeromedical Training Systems group approximated 78% of total sales. Revenue recognized under contracts with the United Kingdom Royal Air Force accounted for $2.8 million or 21% of total sales. Sales to international customers (including sales of the Polish subsidiary), principally government agencies, accounted for $9.9 million or 73% of total sales, up from $9.0 million or 65% of total sales for the same period a year ago.

Gross profit increased $714,000, or 17%, despite the reduced sales level, reflecting a higher mix of higher margin Aeromedical Training Systems sales coupled with gross profit from the Company's Poland subsidiary. As a percentage of revenue, gross profit was 37% versus 31% in the prior period.

Selling and administrative expenses were up $607,000, or 26% from the prior period due, in part, to higher travel expenses related to increased selling efforts and proposal development, additional legal costs for claim activity, and the addition of local expenses for the Company's Poland subsidiary.

Interest and other expenses were down slightly from the prior period because the prior period included additional fees associated with the Company's March, 1997, refinancing.

The Company's tax rate approximates the statutory rate.

Liquidity and Capital Resources

During the six month period ended August 28, 1998, the Company used $5,685,000 for operating activities. This was primarily a result of a net increase in costs and estimated earnings in excess of billings, increased receivables, and a reduction in current liability accounts including accounts payable, customer deposits and accrued income taxes. Partial offset came from net income and non-cash changes of depreciation and amortization. Generally speaking, the use of cash reflected increased production on certain large contracts combined with end of period customer billings. The Company expects to increase its billings for long-term contracts in the second half of fiscal 1999.

Investment activities included capital expenditures ($428,000) and capitalized software costs (254,000). On April 21,1998, the Company acquired 65 % ownership of MP-PZL Aerospace Industries, Ltd. ("MP-PZL), a simulation and advanced training device manufacturer located in Warsaw, Poland, for $375,000 in cash, a $350,000 three-year promissory note bearing interest at 10% per annum and payable as to principal at maturity  and 55,000 shares of ETC's common stock. MP-PZL was subsequently renamed ETC-PZL Aerospace Industries, Ltd.

Funds to support the Company's operating and investing activities primarily came from the Company's credit facility. The Company believes that cash generated from operating activities as well as available borrowings under its credit facility will be sufficient to meet its obligations. On October 2, 1998, the Company had approximately $1 million available under its credit facility.

The Company's sales backlog at September 30, 1998 and February 27, 1998 for work to be performed and revenue to be recognized under written agreements after such dates was approximately $25.2 million and $30.4 million respectively.

This report contains certain 'forward-looking statements' including, without limitation, statements containing the words "believes," "anticipates," "intends," "expects" and words of similar import relating to the Company's operations. There are important factors that could cause actual results to differ materially from those indicated by such forward-looking statements including contract cancellations, political unrest in customer countries, general economic conditions and the risk factors detailed from time to time in ETC's periodic reports and registration statements filed with the Securities and Exchange Commission, including, without limitation, ETC's Annual Report on form 10-KSB for the fiscal year ended February 27, 1998.

## Part II

### Item 1. Legal Proceedings

There were no material developments in the litigation previously described in the Company's Annual Report on Form 10-KSB for the fiscal year ended February 27, 1998.

### Item 2. Changes in Securities

The constituent instruments defining the rights of the holders of any class of securities were not modified nor were the rights evidenced by any class of registered securities materially limited or qualified during the period covered by this report.

### Item 3. Defaults Upon Senior Securities

No defaults occurred during the period covered in this report.

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

None

### Item 5. Other Information

None

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

(a) Exhibits:

Exhibit 27 - Financial Data Schedule

(b) Reports on Form 8-K

None



## 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.

ENVIRONMENTAL TECTONICS CORPORATION
(Registrant)

By:/s/ Duane Deaner
Duane Deaner,
Chief Financial Officer (authorized officer, principal financial officer and principal accounting officer)

Date: October 12, 1998



## EXHIBIT INDEX

| Exhibit No. | Description |
|---|---|
| 27 | Financial Data Schedule. |

<ARTICLE> 5
<MULTIPLIER> 1,000

| | |
|---|---|
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| <OTHER-SE> | 0 |
| <TOTAL-LIABILITY-AND-EQUITY> | 29,804 |
| <SALES> | 13,456 |
| <TOTAL-REVENUES> | 13,456 |
| <CGS> | 8,424 |
| <TOTAL-COSTS> | 3,204 |
| <OTHER-EXPENSES> | 77 |
| <LOSS-PROVISION> | 0 |
| <INTEREST-EXPENSE> | 598 |
| <INCOME-PRETAX> | 1,153 |
| <INCOME-TAX> | 395 |
| <INCOME-CONTINUING> | 758 |
| <DISCONTINUED> | 0 |
| <EXTRAORDINARY> | 0 |
| <CHANGES> | 61 |
| <NET-INCOME> | 697 |
| <EPS-PRIMARY> | 0.17 |
| <EPS-DILUTED> | 0.16 |