ENVIRONMENTAL TECTONICS CORP
Form 10-Q
October 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended August 24, 2012

Commission file no: 1-10655

ENVIRONMENTAL TECTONICS CORPORATION

Pennsylvania	23-1714256
(State of incorporation)	(I.R.S. Employer Identification No.)

County Line Industrial Park
125 James Way
Southampton, Pennsylvania
18966
(Address of principal
executive offices)

Registrant’s telephone number: (215) 355-9100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	¨	Accelerated Filer	¨
Non-Accelerated Filer	¨ (Do not check if a smaller reporting company)	Smaller Reporting Company	x

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

As of October 4, 2012, there were 9,148,010 shares of the registrant’s Common Stock issued and outstanding.

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When used in this Quarterly Report on Form 10-Q, except where the context otherwise requires, the terms “we”, “us”, “our”, “ETC”, and the “Company” refer to Environmental Tectonics Corporation and its subsidiaries.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

Environmental Tectonics Corporation
Consolidated Statements of Income and Comprehensive Income
(unaudited)
(in thousands, except per share information)

	Thirteen weeks ended		Twenty-six weeks ended	
	August 24, 2012	August 26, 2011	August 24, 2012	August 26, 2011
Net sales	$16,502	$ 15,851	$32,572	$ 32,125
Cost of goods sold	10,405	9,932	20,027	19,708
Gross profit	6,097	5,919	12,545	12,417
Operating expenses:				
Selling and marketing	1,277	1,336	2,617	2,627
General and administrative	2,022	1,788	3,905	3,875
Research and development	337	136	647	381
	3,636	3,260	7,169	6,883
Operating income	2,461	2,659	5,376	5,534
Other expenses:				
Interest expense, net	231	207	445	357
Other (income) expense, net	(61)	(24)	(64)	84
	170	183	381	441
Income before income taxes	2,291	2,476	4,995	5,093
Provision for income taxes	994	952	2,008	1,944
Net income	1,297	1,524	2,987	3,149
Loss (gain) attributable to non-controlling interest	1	(2)	6	(18)
Net income attributable to Environmental Tectonics Corporation	$1,298	$ 1,522	$2,993	$ 3,131
Foreign currency translation adjustment	(101)	137	55	(80)
Comprehensive income	$1,197	$ 1,659	$3,048	$ 3,051
Preferred Stock dividend	(552)	(552)	(1,104)	(1,104)
Income attributable to common and participating shareholders	$746	$ 970	$1,889	$ 2,027
Per share information:				

Basic earnings per common and participating share:				
Distributed earnings per share:				
Common	$-	$ -	$-	$ -
Preferred	$0.05	$ 0.05	$0.10	$ 0.10
Undistributed earnings per share:				
Common	$0.04	$ 0.05	$0.09	$ 0.10
Preferred	$0.04	$ 0.05	$0.09	$ 0.10
Diluted earnings per share	$0.04	$ 0.05	$0.09	$ 0.10
Basic weighted average common and participating shares:				
Common weighted average number of shares	9,142	9,106	9,139	9,106
Participating preferred shares	11,095	11,095	11,095	11,095
Total basic weighted average common and participating shares	20,237	20,201	20,234	20,201
Diluted weighted average shares:				
Basic weighted average common and participating shares	20,237	20,201	20,234	20,201
Dilutive effect of stock warrants and options	154	294	152	305
Total diluted weighted average shares	20,391	20,495	20,386	20,506

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

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Environmental Tectonics Corporation

Consolidated Balance Sheets
(in thousands, except share information)

	August 24, 2012 (unaudited)	February 24, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$3,096	$3,425
Restricted cash	6,159	6,000
Accounts receivable, net	6,427	10,695
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	21,633	18,766
Inventories, net	4,227	4,145
Deferred tax assets, current	3,961	4,170
Prepaid expenses and other current assets	1,079	830
Total current assets	46,582	48,031
Property, plant, and equipment, net	14,870	14,860
Capitalized software development costs, net	533	666
Deferred tax assets, non-current, net	2,560	4,190
Other assets	4	39
Total assets	$64,549	$67,786
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt obligations	$-	$8
Accounts payable, trade	4,656	5,639
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	4,815	6,519
Customer deposits	3,610	3,425
Accrued taxes	339	148
Accrued interest and dividends	1,016	941
Other accrued liabilities	3,235	3,565
Total current liabilities	17,671	20,245
Long-term debt obligations, less current portion:		
Credit facility payable to bank	14,043	16,716
Total long-term debt obligations, less current portion	14,043	16,716
Total liabilities	31,714	36,961
Commitments and contingencies		
Shareholders' equity:		
Cumulative convertible participating Preferred Stock, Series D, $0.05 par value, 11,000 shares authorized; 386 shares outstanding at August 24, 2012 and February 24, 2012	386	386
Cumulative convertible participating Preferred Stock, Series E, $0.05 par value, 25,000 shares authorized; 21,741 shares outstanding at August 24, 2012 and February 24, 2012	21,741	21,741

Common Stock, $0.05 par value, 50,000,000 shares authorized; 9,148,010 and 9,134,403 shares issued and outstanding at August 24, 2012 and February 24, 2012, respectively	457	456
Additional paid-in capital	9,963	9,892
Retained earnings (Accumulated deficit)	703	(1,186)
Accumulated other comprehensive loss	(450)	(505)
Total shareholders’ equity before non-controlling interest	32,800	30,784
Non-controlling interest	35	41
Total shareholders’ equity	32,835	30,825
Total liabilities and shareholders’ equity	$64,549	$67,786

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

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Environmental Tectonics Corporation
Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Twenty-six weeks ended August 24, 2012	August 26, 2011
Cash flows from operating activities:		
Net income	$2,987	$3,149
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	914	770
Deferred tax assets	1,839	1,348
Increase in allowances for accounts receivable and inventories, net	2	156
Accretion of loan origination deferred charge	50	105
Stock compensation expense	51	49
Changes in operating assets and liabilities:		
Accounts receivable	4,268	(1,817)
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	(2,867)	(6,387)
Inventories	(84)	(2,613)
Prepaid expenses and other assets	(264)	(607)
Accounts payable, trade	(983)	468
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(1,704)	207
Customer deposits	185	61
Accrued taxes	191	813
Accrued interest and dividends	75	94
Other accrued liabilities	(330)	402
Net cash provided by (used in) operating activities	4,330	(3,802)
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(766)	(944)
Capitalized software development costs	(25)	(146)
Net cash used in investing activities	(791)	(1,090)
Cash flows from financing activities:		
(Repayments) borrowings under line of credit	(2,673)	9,389
Payment of Preferred Stock dividends	(1,104)	(1,104)
Increase in restricted cash	(159)	(18)
Payments of other debt obligations	(8)	(61)
Issuance of Common Stock	21	28
Net cash (used in) provided by financing activities	(3,923)	8,234
Effect of exchange rate changes on cash	55	(80)
Net (decrease) increase in cash	(329)	3,262
Cash at beginning of period	3,425	1,423
Cash at end of period	$3,096	$4,685
Supplemental schedule of cash flow information:		

Interest paid	$310	$153
Income taxes paid	$69	$-
Supplemental information on non-cash operating and investing activities:		
Accrued dividends on Preferred Stock	$552	$552

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

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ENVIRONMENTAL TECTONICS CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share information)

Description of Business

ETC is principally engaged in the design, manufacture, and sale of software driven products and services used to recreate and monitor the physiological effects of motion on humans, and the design, manufacture, and sale of equipment to control, modify, simulate, and measure environmental conditions. These products and services include; (1) software driven products and services used to create and monitor the physiological effects of flight, including high performance jet tactical flight simulation, upset recovery and spatial disorientation, and both suborbital and orbital commercial human spaceflight; (2) altitude (hypobaric) chambers; (3) the Advanced Disaster Management Simulator ("ADMS"); (4) steam and gas sterilizers; (5) environmental testing and simulation devices; and (6) hyperbaric (100% oxygen) chambers. ETC focuses on software enhancements, product extensions, new product development, and new marketplace applications.

We operate in two primary business segments, Aerospace Solutions ("Aerospace") and Commercial/Industrial Systems ("CIS"). Aerospace encompasses the design, manufacture, and sale of; (1) software driven products and services used to create and monitor the physiological effects of flight, including high performance jet tactical flight simulation, upset recovery and spatial disorientation, and both suborbital and orbital commercial human spaceflight; collectively, Aircrew Training Systems ("ATS"); (2) altitude (hypobaric) chambers; (3) hyperbaric chambers for multiple persons (multiplace chambers); and (4) ADMS, as well as integrated logistics support for customers who purchase these products. These products and services provide customers with an offering of comprehensive solutions for improved readiness and reduced operational costs. Sales of our Aerospace products are made principally to U.S. and foreign government agencies. The CIS segment encompasses the design, manufacture, and sale of; (1) steam and gas (ethylene oxide) sterilizers; (2) environmental testing and simulation devices; (3) hyperbaric chambers for one person (monoplace chambers); and (4) parts and service support. Sales of our CIS products are made principally to the healthcare, pharmaceutical, and automotive industries.

The Company's fiscal year is the 52- or 53-week annual accounting period ending the last Friday in February. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2013.

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying interim consolidated financial statements include the accounts of ETC, our 95%-owned subsidiary, ETC-PZL Aerospace Industries SP. Z 0.0, ("ETC-PZL"), and our 99%-owned subsidiary, Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"). The Company's corporate headquarters and main production plant are located in Southampton, Pennsylvania, USA. ETC-PZL manufactures simulators and provides software to support our domestic products. ETC-Europe functions as a sales office in the United Kingdom. All significant inter-company accounts and transactions have been eliminated in consolidation.

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

In accordance with industry practices, costs and estimated earnings in excess of billings on uncompleted long-term contracts are classified as current even though a portion of these amounts may not be realized within one year.

Certain information in footnote disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America has been condensed or omitted pursuant to such rules and regulations and the financial results for the periods presented may not be indicative of the full year's results; however, the Company believes that 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-K for the 2012 fiscal year.

References to 2013 second quarter are references to the thirteen week period ended August 24, 2012. References to 2012 second quarter are references to the thirteen week period ended August 26, 2011. References to 2013 first half are references to the twenty-six week period ended August 24, 2012. References to 2012 first half are references to the twenty-six week period ended August 26, 2011. References to fiscal 2013 or the 2013 fiscal year are references to the fifty-two week period ending February 22, 2013. References to fiscal 2012 or the 2012 fiscal year are references to the fifty-two week period ended February 24, 2012.

Significant Accounting Policies

There have been no material changes in the Company's significant accounting policies during fiscal 2013 as compared to what was previously disclosed in the Company's Annual Report on Form 10-K for the 2012 fiscal year.

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Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued
(Dollars in thousands, except per share information)

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 amends the FASB Accounting Standards Codification (Codification) to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. The amendments to the Codification in ASU 2011-05 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income.

In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. Among the new provisions in ASU 2011-05 was a requirement for entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented (for both interim and annual financial statements); accordingly, this requirement is indefinitely deferred by ASU 2011-12 and will be further deliberated by the FASB at a future date.

The Company adopted this guidance during the thirteen week period ended February 24, 2012, and chose to present other comprehensive income within the accompanying Consolidated Statements of Income and Comprehensive Income. The effect of this amended guidance has been retrospectively applied to all periods presented.

In July 2012, the FASB issued ASU No. 2012-02, Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment, which amends the guidance in ASC 350-30 on testing indefinite-lived intangible assets, other than goodwill, for impairment. Under ASU 2012-02, an entity testing an indefinite-lived intangible asset for impairment has the option of performing a qualitative assessment before calculating the fair value of the asset. If the entity determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is not more likely than not (i.e., a likelihood of more than 50 percent) impaired, the entity would not need to calculate the fair value of the asset. ASU 2012-02 does not revise the requirement to test indefinite-lived intangible assets annually for impairment. In addition, ASU 2012-02 does not amend the requirement to test these assets for impairment between annual tests if there is a change in events or circumstances; however, it does revise the examples of events and circumstances that an entity should consider in interim periods. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012; early adoption is permitted. The effect of this amended guidance is not expected to have a significant impact on the consolidated financial statements.

2. Earnings per Share

The Company utilizes the two-class method for computing and presenting earnings per share. The Company currently has one class of common stock (the "Common Stock") and two classes of cumulative participating preferred stock, Series D and Series E (the "Preferred Stock"). Under its terms, the Preferred Stock is entitled to participate in any cash dividends on a one-for-one basis for the equivalent converted common shares if the Preferred Stock were to be converted by the holder by the dividend record date. Therefore, the Preferred Stock is considered a participating security requiring the two-class method for the computation and presentation of net income per share – basic.

The two-class computation method for each period segregates basic earnings per common and participating share into two categories: distributed earnings per share (i.e., the Preferred Stock stated dividend) and undistributed earnings per share, which allocates earnings after subtracting the Preferred Stock dividend to the total of weighted average common shares outstanding plus equivalent converted common shares related to the Preferred Stock. Basic earnings per common and participating share excludes the effect of Common Stock equivalents, and is computed using the two-class computation method.

Diluted earnings per share reflects the potential dilution that could result if securities or other contracts to issue Common Stock were exercised or converted into Common Stock. Diluted earnings per share continues to be computed using the if-converted method. Diluted earnings per share assumes the exercise of stock options and warrants using the treasury stock method. If the effect of the conversion of any financial instruments would be anti-dilutive, it is excluded from the diluted earnings per share calculation.

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Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued
(Dollars in thousands, except per share information)

At August 24, 2012 and February 24, 2012, there was $22,127 of cumulative convertible participating Preferred Stock. These instruments were convertible at exercise prices of:

- Series D Preferred Stock of $55 at $0.94 per share, equating to 58,511 shares of Common Stock, issued in April 2009;
- Series D Preferred Stock of $100 at $1.11 per share, equating to 90,090 shares of Common Stock, issued in July 2009;
- Series D Preferred Stock of $231 at $3.02 per share, equating to 76,490 shares of Common Stock, issued in October 2010; and
- Series E Preferred Stock of $21,741 at $2.00 per share, equating to 10,870,321 shares of Common Stock, issued in July 2009.

On February 20, 2009, in connection with the issuance of a $2,000 promissory note, the Company issued 200,000 warrants to purchase 143,885 shares of the Company's Common Stock at $1.39 per share. Additionally, on July 2, 2009, in consideration of an increase of the guarantee on the line of credit with PNC Bank, National Association ("PNC Bank"), the Company issued 500,000 warrants to purchase 450,450 shares of the Company's Common Stock at $1.11 per share. On January 4, 2011, the Company entered into amendments to these warrants to remove a provision in each of the warrants that provided anti-dilution protection in the event the Company issued securities at a price below the exercise price set forth in the warrants.

At August 24, 2012 and August 26, 2011, there were outstanding options to purchase the Company's Common Stock totaling 240,921 and 260,921 shares at an average price of $4.26 and $4.44 per share, respectively. Due to the conversion price of the Common Stock options, all 240,921 shares were excluded from the calculation of diluted earnings per share as of August 24, 2012 because the effect of their conversion would be antidulutive; likewise, all 260,921 shares were also excluded from the calculation of diluted earnings per share as of August 26, 2011.

3. Accounts Receivable

The components of accounts receivable are as follows:

	August 24, 2012 (unaudited)	February 24, 2012
U.S. Government	$ 3,045	$ 4,305
U.S. Commercial	1,123	2,994
International	2,659	3,797
	6,827	11,095
Less: allowance for doubtful accounts	(400)	(400)
	$ 6,427	$ 10,695

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:

August 24, 2012	Fe