FORM 10-Q/A

Quarterly report pursuant to sections 13 or 15(d) [amend]

Filing Date: **1998-07-22** | Period of Report: **1997-06-30**
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FILER

AMERICAN PACIFIC CORP

CIK:**350832**| IRS No.: **596490478** | State of Incorp.:**DE** | Fiscal Year End: **0930**
Type: **10-Q/A** | Act: **34** | File No.: **000-21046** | Film No.: **98669424**
SIC: **2810** Industrial inorganic chemicals

Mailing Address
3770 HOWARD HUGHES PKWY STE 300
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7027352200

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A
(Amendment No. 2)

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

FOR QUARTERLY PERIOD ENDED JUNE 30, 1997

COMMISSION FILE NUMBER 1-8137

OR

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

AMERICAN PACIFIC CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	59-6490478
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

3770 HOWARD HUGHES PARKWAY, SUITE 300 LAS VEGAS, NV	89109
(Address of principal executive offices)	(Zip Code)

(702) 735-2200
(Registrant's telephone number, including area code)

NOT APPLICABLE
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant has filed all reports required to be filed by Sections 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

Applicable Only to Corporate Issuers

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 8,098,537 AS OF JULY 31, 1997.

PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

The information required by Rule 10-01 of Regulation S-X is provided on pages 4 through 12 of this Report on Form 10-Q.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information required by Item 303 of Regulation S-K is provided on pages 13 through 17 of this Report on Form 10-Q.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

The information required by Item 103 of Regulation S-K is provided on pages 8 through 9 of this Report on Form 10-Q.

ITEM 2. Changes in Securities

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits and Reports on Form 8 -K

(a) The following Exhibit was filed in connection with the Registrant's original electronic filing:

27. Financial Statement Schedules.

(b) 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.

AMERICAN PACIFIC CORPORATION

Date: July 21, 1998

/s/ John R. Gibson

John R. Gibson
President and Chief Executive Officer

Date: July 21, 1998

/s/ David N. Keys

David N. Keys
Vice President,
Chief Financial Officer and Treasurer; Principal Financial and Accounting Officer

AMERICAN PACIFIC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

<TABLE>
<CAPTION>

	FOR THE THREE-MONTHS ENDED JUNE 30,		FOR THE NINE-MONTHS ENDED JUNE 30,	
	1997	1996	1997	1996
<S>	<C>	<C>	<C>	<C>
Sales and Operating Revenues	$12,767,000	$10,617,000	$30,545,000	$31,373,000
Cost of Sales	10,434,000	8,293,000	25,542,000	24,346,000
Gross Profit	2,333,000	2,324,000	5,003,000	7,027,000
Operating Expenses	2,304,000	2,035,000	6,936,000	6,941,000
Operating Income (Loss)	29,000	289,000	(1,933,000)	86,000
Equity in Earnings of Real Estate Venture		600,000	100,000	600,000
Net Interest and Other Expense	202,000	357,000	735,000	1,215,000

Income (Loss) Before Provision (Credit) for Income Taxes	(173,000)	532,000	(2,568,000)	(529,000)
Provision (Credit) for Income Taxes	(59,000)	181,000	(875,000)	(180,000)
Net Income (Loss)	$ (114,000)	$ 351,000	$(1,693,000)	$ (349,000)
Net Income (Loss) Per Common Share	$ (.02)	$ .04	$ (.21)	$ (.04)
Weighted Average Common and Common Equivalent Shares Outstanding	8,098,000	8,142,000	8,098,000	8,105,000

</TABLE>

See the accompanying Notes to Condensed Consolidated Financial Statements.

AMERICAN PACIFIC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

<TABLE>
<CAPTION>

	JUNE 30, 1997	SEPTEMBER 30, 1996
ASSETS		
CURRENT ASSETS:		
<S>	<C>	<C>
Cash and Cash Equivalents	$ 14,568,000	$ 18,501,000
Short-term Investments		2,000,000
Accounts and Notes Receivable	5,851,000	4,165,000
Related Party Notes Receivable	664,000	737,000
Inventories	12,837,000	11,297,000
Prepaid Expenses and Other Assets	1,214,000	946,000
TOTAL CURRENT ASSETS	35,134,000	37,646,000
Property, Plant and Equipment, Net	73,725,000	77,217,000
Development Property	7,295,000	8,631,000
Real Estate Equity Investments	19,992,000	18,698,000
Other Assets	2,638,000	2,858,000
Restricted Cash	4,618,000	4,969,000
TOTAL ASSETS	$ 143,402,000	$ 150,019,000

</TABLE>

See the accompanying Notes to Condensed Consolidated Financial Statements.

AMERICAN PACIFIC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

<TABLE>
<CAPTION>

	JUNE 30, 1997	SEPTEMBER 30, 1996
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
<S>	<C>	<C>
Accounts Payable and Accrued Liabilities	$ 7,277,000	$ 5,407,000
Current Portion of Long-Term Debt	6,166,000	7,334,000
TOTAL CURRENT LIABILITIES	13,443,000	12,741,000

Long-Term Debt	24,787,000	29,452,000
Deferred Income Taxes	9,226,000	10,101,000
TOTAL LIABILITIES	47,456,000	52,294,000
Commitments and Contingencies		
Warrants to Purchase Common Stock	3,569,000	3,569,000
SHAREHOLDERS' EQUITY:		
Common Stock	825,000	823,000
Capital in Excess of Par Value	78,399,000	78,331,000
Retained Earnings	14,285,000	15,978,000
Treasury Stock	(1,035,000)	(879,000)
Receivable from the Sale of Stock	(97,000)	(97,000)
TOTAL SHAREHOLDERS' EQUITY	92,377,000	94,156,000
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$143,402,000	$150,019,000

</TABLE>

See the accompanying Notes to Condensed Consolidated Financial Statements.

AMERICAN PACIFIC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

<TABLE>
<CAPTION>

	FOR THE THREE-MONTHS ENDED JUNE 30, 1997	1996	FOR THE NINE-MONTHS ENDED JUNE 30, 1997	1996
Cash Provided by (Used for)				
<S>	<C>	<C>	<C>	<C>
Operating Activities	$(1,045,000)	$ (288,000)	$ 5,252,000	$ 4,727,000
Cash Flows Used for Investing Activities: Capital Expenditures, Development Property Additions and Real Estate Equity Investments	(1,156,000)	(405,000)	(2,931,000)	(5,027,000)
Net Cash Used For Investing Activities	(1,156,000)	(405,000)	(2,931,000)	(5,027,000)
Cash Flows From Financing Activities:				
Principal Payments on Debt			(6,168,000)	(5,000,000)
Issuance of Common Stock			70,000	39,000
Treasury Stock Acquired			(156,000)	(29,000)
Net Cash Used For Financing Activities			(6,254,000)	(4,990,000)
Net Decrease in Cash and Cash Equivalents	(2,201,000)	(693,000)	(3,933,000)	(5,290,000)
Cash and Cash Equivalents, Beginning of Period	16,769,000	19,943,000	18,501,000	24,540,000
Cash and Cash Equivalents, End of Period	$14,568,000	$19,250,000	$14,568,000	$19,250,000
Supplemental Disclosure of Cash Flow Information: Interest Paid (net of amounts capitalized)	$ 851,000	$ 1,230,000	$ 851,000	$ 1,230,000

</TABLE>

See the accompanying Notes to Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS:

1. BASIS OF REPORTING

The accompanying Condensed Consolidated Financial Statements are unaudited and do not include certain information and disclosures included in the Annual Report on Form 10-K of American Pacific Corporation (the "Company"). The Condensed Consolidated Balance Sheet as of September 30, 1996 was derived from the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended September 30, 1996. The Condensed Consolidated Financial Statements for the three-month and nine-month periods ended June 30, 1997 and 1996 are unaudited. Such statements should therefore be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the year ended September 30, 1996. In the opinion of Management, however, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation have been included.

The Financial Accounting Standards Board ("FASB") recently issued Statement of Financial Accounting Standards ("SFAS") No. 128 "Earnings per Share." This statement establishes standards for computing and presenting earnings per share and is effective for financial statements issued for periods ending after December 15, 1997. Earlier application of this statement is not permitted and upon adoption requires restatement (as applicable) of all prior-period earnings per share data presented. Management believes that the implementation of this standard will not have a significant impact on earnings per share.

In February 1997 the FASB issued SFAS No. 129, "Disclosure of Information about Capital Structure." This statement establishes standards for disclosing information about an entity's capital structure. Management intends to comply with the disclosure requirements of this statement which are effective for periods ending after December 15, 1997.

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." This statement requires companies to classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position, and is effective for financial statements issued for fiscal years beginning after December 15, 1997. Management does not believe this statement will have material impact on the Company's financial statements.

In June 1997, the FASB issued SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information." This statement establishes additional standards for segment reporting in the financial statements and is effective for fiscal years beginning after December 15, 1997. Management has not determined the effect of this statement on the Company's financial statement disclosure.

2. NET LOSS PER COMMON SHARE

Net loss per common share for the three-month and nine-month periods ended June 30, 1997 and 1996 is determined based upon the weighted average number of common shares outstanding. Common share equivalents, although not considered during net loss periods, consist of outstanding stock options and warrants.

3. INVENTORIES

Inventories consist of the following:

	June 30, 1997	September 30, 1996
Work-in-process	$ 8,619,000	$ 5,011,000
Raw materials and supplies	4,218,000	6,286,000
Total	$12,837,000	$11,297,000

4. COMMITMENTS AND CONTINGENCIES

In fiscal 1993, three shareholder lawsuits were filed in the United States District Court for the District of Nevada against the Company and certain of its directors and officers (the "Company Defendants"). The complaints, which were consolidated, alleged that the Company's public statements violated Federal securities laws by inadequately disclosing information concerning its agreements with Thiokol Corporation ("Thiokol") and the Company's operations. On November 27, 1995, the U.S. District Court granted in part the Company's motion for summary judgment, ruling that the Company had not violated the Federal securities laws in relation to disclosures concerning the Company's agreements with Thiokol. The remaining claims, which related to allegedly misleading or inadequate disclosures regarding Halotron, were the subject of a jury trial that ended on January 17, 1996. The jury reached a unanimous verdict that none of the Company Defendants made misleading or inadequate statements regarding Halotron. The District Court thereafter entered judgment in favor of the Company Defendants on the Halotron claims. The plaintiffs appealed the summary judgment ruling and the judgment on the jury verdict to the Ninth Circuit of the United States District Court of Appeals. On June 5, 1997, the Court of Appeals affirmed the judgments of the United States District Court in favor of the Company Defendants. On June 19, 1997, the plaintiffs filed an Appellants Petition for Rehearing and Suggestion of Rehearing En Banc with the Court of Appeals.

As a result of the above-described shareholder lawsuits, the Company has incurred legal and other costs and may incur material legal and other costs associated with the ultimate resolution of the shareholder lawsuits in future periods. Certain of these costs may be reimbursable under policies providing for insurance coverage. The Company has adopted certain policies in its Charter and Bylaws as a result of which the Company may have the obligation to indemnify its affected officers and directors to the extent, if at all, the existing insurance coverages are insufficient. The Company's insurance carriers have reserved the right to exclude or disclaim coverage under certain circumstances. The Company is currently unable to predict or quantify the amount or the range of such costs, if any, or the period of time during which such costs will be incurred.

During the third quarter of fiscal 1996, the Company settled certain matters with its insurance carrier relating to legal fees and other costs associated with the successful defense of the shareholder lawsuits. Under this settlement, the Company was reimbursed for approximately $450,000 in costs that had previously been expensed and incurred in connection with the defense. Such amount was recognized as a reduction in operating expenses in the third quarter of fiscal 1996. The insurance

carrier has agreed to pay attorneys fees and other defense costs related to the plaintiffs' appeals referred to above.

The Company was served with a complaint on December 10, 1993 in a lawsuit brought by limited partners in a partnership of which one of the Company's former subsidiaries, divested in 1985, was a general partner. The plaintiffs allege that the Company is liable to them in the amount of approximately $5.9 million, plus interest, on a guarantee executed in 1982. In August 1996, the Company's cross-motion for summary judgment was granted, although the plaintiffs filed an appeal in January 1997. The Company believes that the claim against it is wholly without merit.

The Company and its subsidiaries are also involved in other lawsuits. The Company believes that these other lawsuits, individually or in the aggregate, will not have a material adverse effect on the Company or any of its subsidiaries.

5. SODIUM AZIDE

In July 1990, the Company entered into agreements (the "Azide Agreements") pursuant to which Dynamit Nobel licensed to the Company on an exclusive basis for the North American market its most advanced technology and know-how for the production of sodium azide, the principal component of the gas generant used in automotive airbag safety systems. In addition, Dynamit Nobel has provided technical support for the design, construction and start-up of the facility. The facility was constructed and is being operated by American Azide Corporation ("AAC"), a wholly-owned subsidiary of the Company.

Under the Azide Agreements, Dynamit Nobel was to receive, for the use of its technology and know-how relating to its batch production process of manufacturing sodium azide, quarterly royalty payments of 5% of the quarterly net sales of sodium azide by AAC for a period of 15 years from the date the Company began to produce sodium azide in commercial quantities. In July 1996, the Company and Dynamit Nobel agreed to suspend the royalty payment effective as of July 1, 1995. As a result, in the third quarter of fiscal 1996, the Company recognized an increase in sodium azide sales of approximately $600,000. This amount had previously been recognized as a reduction of net sodium azide sales during the period July 1, 1995 through June 30, 1996.

In May, 1997 the Company entered into a three-year contract with Autoliv ASP, Inc. (formerly Morton International Automotive Safety Products). The contract provides for the Company to supply sodium azide used by Autoliv in the manufacture of automotive airbags. Deliveries under the contract commenced in July 1997.

The estimated sales value of the contract is approximately $45 - $55 million over the three-year period. This actual sales value, however, will depend upon many factors beyond the control of the Company, such as the number of automobiles and light trucks manufactured and competitive conditions in the airbag market, that will influence the actual magnitude of Autoliv's sodium azide requirements, and there can therefore be no assurance as to the actual sales value of the contract. Management believes that the Autoliv contract will result in improved performance of the Company's sodium azide operations, although there can be no assurance in that regard.

In accordance with the provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed Of," Management periodically reviews whether the anticipated net cash flows from sodium azide operations will be sufficient to recover the Company's fixed asset investment in the facility. Sales and related variable operating margins have historically not been at a level sufficient to absorb fixed costs, including depreciation. Such operating history was partially expected by the Company as a result of the generally lengthy process of qualification for use of new material in automotive safety equipment. As indicated above, Management believes that the Autoliv agreement will result in improved performance of the sodium azide operations. Capacity utilization rates are expected to increase as a result of deliveries under this agreement. Management is cautiously optimistic that sodium azide sales will continue to increase owing principally to the expectation of continued market share gains and additional positive developments resulting from the anti-dumping petition referred to below.

The Company's future success in the sodium azide market will be dependent upon, among other things:

- Sales of sodium azide to major users other than Autoliv;
- The rapidity of the pace of penetration of airbag inflation technology that does not use sodium azide;
- The continued effects of the antidumping petition;
- Actions of other manufacturers of sodium azide;
- The relationship of the U.S. dollar to the home country currency of other manufacturers of sodium azide.

As of June 30, 1997, Management believes that the Company's investment in sodium azide fixed assets is recoverable under the requirements of SFAS No. 121. In light of the factors and uncertainties discussed above, however, there can be no assurance that the results of the evaluation of recoverability will remain the same in the future.

The Company previously believed that the demand for sodium azide in North America and the world would substantially exceed existing manufacturing capacity and announced expansions or new facilities (including the AAC plant) by the 1994 model year (which for sodium azide sales purposes is the period June 1993 through May 1994). Currently, demand for sodium azide is substantially less than supply on a worldwide basis. The Company believes this is the result of capacity expansions by existing producers and a declining market for sodium azide as a result of competing airbag inflation technology and methods, although the Company's information with respect to competitors' existing and planned capacity is limited. There can be no assurance that other manufacturing capacities not now known to the Company will not be established. By reason of this highly competitive market environment, and other factors discussed below, there exists considerable pressure on the price of sodium azide.

The Company believes that the price erosion of sodium azide over the past few years is due to unlawful pricing procedures of Japanese sodium azide producers. In response to such practices, in January 1996, the Company filed an antidumping petition with the

International Trade Commission ("ITC") and the Department of Commerce ("Commerce"). In August 1996, Commerce issued a preliminary determination that Japanese imports of sodium azide have been sold in the United States at prices that are significantly below fair value. Commerce's preliminary dumping determination applied to all Japanese imports of sodium azide, regardless of end-use. Commerce's preliminary determination followed a March 1996 preliminary determination by ITC that dumped Japanese imports have cause material injury to the U.S. sodium azide industry.

On January 7, 1997 the anti-dumping investigation initiated by Commerce, based upon the Company's petition, against the three Japanese producers of sodium azide was suspended by agreement.

It is the Company's understanding that, by reason of the Suspension Agreement, two of the three Japanese sodium azide producers have ceased their exports of sodium azide to the United States for the time being. As to the third and largest Japanese sodium adize producer, which has not admitted any prior unlawful conduct, the

Suspension Agreement requires that it make all necessary price revisions to eliminate all United States sales at below "Normal Value," and that it conform to the requirements of sections 732 and 733 of the Tariff Act of 1930, as amended (the Act), in connection with its future sales of sodium azide in the United States.

The Suspension Agreement contemplates a cost-based determination of "Normal Value" and establishes reporting and verification procedures to assure compliance. Accordingly, the minimum pricing for sodium azide sold in the United States by the remaining Japanese producer will be based primarily on its actual costs, and may be affected by changes in the relevant exchange rates.

Finally, the Suspension Agreement provides that it may be terminated by any party on 60 days notice, in which event the anti-dumping proceeding would be re-instituted at the stage to which it had advanced at the time the Suspension Agreement became effective.

6. RESTRUCTURING UNDER CONSIDERATION

The Company is currently undergoing a planning process respecting its structure, strategic direction and operational focus. This process may result in the consolidation and/or relocation of operations and/or the abandonment of operations or productive assets (including impairment issues discussed in the Notes to Condensed Consolidated Financial Statements and the Results of Operations section of Management's Discussion and Analysis of Financial Condition and Results of Operations). The Company expects this process to be completed in the fourth quarter of fiscal 1997. The implementation of any plan may result in events that trigger, among other things, the recognition of provisions for restructuring charges relating to the termination and/or relocation of operations and employees.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

SALES AND OPERATING REVENUES AND GROSS PROFIT

Sales and operating revenues were $12,767,000 and $10,617,000 during the three-month periods ended June 30, 1997 and 1996, and $30,545,000 and $31,373,000 during the nine-month periods ended June 30, 1997 and 1996. Gross profit as a percentage of sales and operating revenues was 16 percent in the first nine months of fiscal 1997 compared to 22 percent during the same period in fiscal 1996. A discussion of sales and operating revenues and gross profit percentages relating to the Company's principal operating activities is provided below.

PERCHLORATE CHEMICAL OPERATIONS

Sales of all perchlorate chemicals amounted to approximately $4,450,000 and $5,410,000 during the three-month periods ended June 30, 1997 and 1996, and $14,709,000 and $15,899,000 during the nine-month periods ended June 30, 1997 and 1996. In September 1996, Western Electrochemical Company ("WECCO") an indirect wholly-owned subsidiary of the Company, received a purchase order for deliveries of AP to Thiokol during the fiscal year ending September 30, 1997. The purchase order amounts to approximately $13.3 million. In October 1995, the Company received a purchase order for the delivery of AP to another customer from October 1996 through 1999 having a value in the range of $8 million to $10 million. This contract includes options that could increase the order during the 1997-1999 period, and that could extend the contract to the year 2000. Based upon this backlog and negotiations currently in process, the Company estimates that total perchlorate revenues, including sodium perchlorate and potassium perchlorate, will range between $21 and $22 million during the fiscal year ended September 30, 1997.

SODIUM AZIDE OPERATIONS

Sodium azide sales were $3,252,000 and $3,325,000 during the three-month periods ended June 30, 1997 and 1996, and $8,370,000 and $9,355,000 during the nine-month periods ended June 30, 1997 and 1996. Commercial shipments of sodium azide began in April 1994. Sales and related variable operating margins have historically not been at a level sufficient to absorb fixed costs. The operation has however, been generating positive cash flow and earnings before interest, taxes, depreciation and amortization ("EBITDA"). Management believes that the Autoliv contract referred to in Note 5 of Notes to Condensed Consolidated Financial Statements will result in improved performance of the Company's sodium azide operations, although there can be no assurance thereof. See Note 5 of Notes to Condensed Consolidated Financial Statements for a discussion of the sodium azide market, the status of an antidumping petition the Company filed against certain Japanese producers of sodium azide and a description of the Autoliv contract.

REAL ESTATE OPERATIONS

The Company's real estate development properties consist of approximately 4,700 acres in Iron County, Utah near Cedar City, Utah and improved land in Clark County, Nevada. The Iron County site is primarily dedicated to the Company's growth and diversification. Substantially all of the Clark County land is pledged as collateral for certain debt (the "Azide Notes"). In 1994, approximately 240 acres of its Clark County land was transferred to Gibson Ranch Limited Liability Company ("GRLLC") for the purpose of residential development, construction, and sale. In addition to this project, the Company has

approximately 120 net acres of land in Clark County available for sale and/or development.

Real estate and related sales amounted to $3,229,000 and $1,678,000 during the three-month periods ended June 30, 1997 and 1996, and $3,582,000 and $4,565,000 during the nine-month periods ended June 30, 1997 and 1996. The nature of real estate development and sales is such that the Company is unable reliably to predict any pattern of future real estate sales or the recognition of equity in earnings of GRLLC.

ENVIRONMENTAL PROTECTION EQUIPMENT OPERATIONS

Environmental protection equipment sales were approximately $1,103,000 and $174,000 during the third quarter of fiscal 1997 and 1996, and $2,082,000 and $1,138,000 during the nine-month periods ended June 30, 1997 and 1996. As of June 30, 1997, this segment had a backlog of approximately $135,000. Two equipment purchase orders, totaling approximately $750,000, were received in July, 1997. The Company has submitted a number of bids on significant projects, although there can be no assurance that any of these bids will result in future orders.

HALOTRON OPERATIONS

Sales of Halotron amounted to approximately $703,000 and $48,000 during the third quarter of fiscal 1997 and 1996, and $1,627,000 and $321,000 during the first nine months of fiscal 1997 and 1996. In December 1995, the Company, in concert with Buckeye Fire Equipment Company, successfully completed Underwriters Laboratories (UL) fire tests of a line of portable fire extinguishers using Halotron I. Domestic distribution of the Buckeye Halotron extinguisher line began in February, 1996.

OPERATING EXPENSES

Operating expenses were $2,304,000 and $2,035,000 during the three-month periods ended June 30, 1997 and 1996, and $6,936,000 and $6,941,000 during the nine-month periods ended June 30, 1997 and 1996. As discussed in Note 4 of Notes to Condensed Consolidated Financial Statements, during the third quarter of fiscal 1996, the Company settled certain matters with its insurance carrier relating to legal fees and other costs associated with the successful defense of the shareholder lawsuits. Under this settlement, the Company was reimbursed for approximately $450,000 in costs that had previously been expensed and incurred in connection with the defense. Such amount was recognized as a reduction in operating expenses in the third quarter of fiscal 1996. The insurance carrier has agreed to pay attorneys fees and other defense costs related to the plaintiffs' appeal of the case referred to above.

NET INTEREST AND OTHER EXPENSE

The decrease in net interest and other expense in the first three and nine months of fiscal 1997 compared to the same periods in fiscal 1996 is primarily due to the reduction in debt balances.

CREDIT FOR INCOME TAXES

The Company's effective income tax rates were approximately 34% during the three-month and nine-month periods ended June 30, 1997 and 1996.

OPERATING RESULTS

Although the Company's net income (loss) and net income (loss) per common share have not been subject to seasonal fluctuations, they have been and are expected to continue to be subject to variations from quarter to quarter and year to year due to the following factors, among others; (i) as discussed in Note 4 of Notes to Condensed Consolidated Financial Statements, the Company may incur material legal and other costs associated with certain litigation; (ii) the timing of real estate and related sales and equity in earnings of real estate ventures is not predictable; (iii) the recognition of revenues from environmental protection equipment orders not accounted for as long-term contracts depends upon orders generated and the timing of shipment of the equipment; (iv) weighted average common and common equivalent shares for purposes of calculating net income (loss) per common share are subject to significant fluctuations based upon changes in the market price of the Company's Common Stock due to outstanding warrants and options; and (v) the magnitude, pricing and timing of AP, sodium azide, Halotron, and environmental protection equipment sales in the future is uncertain.

The Company's efforts to produce, market and sell Halotron I and Halotron II are, among other factors, dependent upon the political climate and environmental regulations that exist and may vary from country to country. Although the Company is satisfied with the progress and performance characteristics of Halotron I and Halotron II, the magnitude of additional orders received, if any, in the future will be dependent to a large degree upon political issues and environmental regulations that are not within the Company's control, as well as additional testing and qualification in certain jurisdictions and the ultimate extent of market acceptance.

As a result of the uncertainties with respect to the sodium azide business referred to above, the Company may experience significant variations in sodium azide sales and related operating results from quarter to quarter.

In accordance with the provisions of SFAS No. 121, Management periodically reviews whether the anticipated net cash flows from Halotron and sodium azide operations will be sufficient to recover the Company's investment in each of such facilities/projects. At June 30, 1997, the Company had approximately $65 million and $6 million in recorded net long-lived assets associated with sodium azide and Halotron, respectively. A number of factors are considered in the evaluation of recoverability, including, but not limited to, anticipated pricing and volume and the duration thereof, and expected costs associated with production. Management believes that such net asset balances are recoverable under the requirements of SFAS No. 121, although, in light of the uncertainties discussed above, there can be no assurance that the results of the evaluation of recoverability will remain the same in the future. (See Note 5 of Notes to Condensed Consolidated Financial Statements.)

As discussed in Note 6 to Notes to Condensed Consolidated Financial Statements, the Company is engaged in a planning process that may, upon implementation of the plan, result in the recognition of restructuring charges.

LITIGATION

See Note 4 of Notes to Condensed Consolidated Financial Statements for a discussion of litigation.

INFLATION

Inflation did not have a significant effect on the Company's sales and operating revenues or costs during the six-month periods ended June 30, 1997 or 1996. The Company does not expect inflation to have a material effect on gross profit in the future, because any increases in production costs should be recovered through increases in product prices, although there can be no assurance in that regard.

LIQUIDITY AND CAPITAL RESOURCES

On July 29, 1994, the Board of Directors of the Company authorized the repurchase of up to 1.5 million shares of the Company's common stock through open market purchases and private transactions. Such authorization was briefly suspended. As of June 30, 1997, the Company had repurchased approximately 140,000 shares through this program.

As a result of the litigation described in Note 4 of Notes to Condensed Consolidated Financial Statements, the Company has incurred legal and other costs and may incur material legal and other costs associated with the resolution of these matters in future periods. Certain of the costs, if any, may be reimbursable under policies providing for insurance coverage. The Company has adopted certain policies in its Charter and Bylaws as a result of which the Company may be required to indemnify its affected officers and directors to the extent, if at all, that existing insurance coverages relating to the shareholder lawsuits are insufficient. The Company has in force substantial insurance covering this risk. The Company's insurance carriers have reserved the right to exclude or disclaim coverage under certain circumstances. Defense costs and any potential settlement or judgment costs associated with litigation, to the extent borne by the Company and not recovered through insurance, would adversely affect the Company's liquidity. The Company is currently unable to predict or quantify the amount or range of such costs, if any, or the period of time that litigation related costs will be incurred.

Cash flows from operating activities were $5,252,000 and $4,727,000 during the nine-month periods ended June 30, 1997 and 1996, respectively. The increase in cash flows from operating activities is principally due to changes in working capital balances.

The Company believes that its cash flows from operations and existing cash balances will be adequate for the foreseeable future to satisfy the needs of its operations. However, the satisfactory resolution of litigation, and the timing, pricing and magnitude of orders for AP, sodium azide and Halotron, may have an effect on the use and availability of cash.

FORWARD-LOOKING STATEMENTS/RISK FACTORS

Certain matters discussed in this Report may be forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include, but are not limited to, the risk factors set forth below. The following important risk factors, among others, may cause the Company's operating results and/or financial position to be adversely affected from time to time:

1. Declining demand or downward pricing pressure for the Company's products as a result of general or specific economic conditions, further governmental budget decreases affecting the Department of Defense or NASA which would cause a continued decrease in demand for AP, the results achieved by the Suspension Agreement resulting from the Company's anti-dumping petition and the possible termination of such agreement, technological advances and improvements or new competitive products causing a reduction or elimination

of demand of AP, sodium azide or Halotron, the ability and desire of purchasers to change existing products or substitute other products for the Company's products based upon perceived quality and pricing, and the fact that perchlorate chemicals, sodium azide, Halotron and the Company's environmental products have limited applications and highly concentrated customer bases. Reference is also made to Notes 5 and 6 of Notes to Condensed Consolidated Financial Statements.

2. Competitive factors including, but not limited to, the Company's limitations respecting financial resources and its ability to compete against companies with substantially greater resources, significant excess market supply in the AP and sodium azide markets and the development or penetration of competing new products, particularly in the propulsion, airbag inflation and fire suppression businesses.

3. Underutilization of the Company's manufacturing facilities resulting in production inefficiencies and increased costs, the inability to recover facility costs and reductions in margins.

4. Difficulties in procuring raw materials, supplies, power and natural gas used in the production of perchlorates, sodium azide and Halotron products and used in the engineering and assembly process for environmental protection equipment products.

5. The Company's ability to control the amount of operating expenses and/or the impact of any non-recurring or unusual items resulting from the Company's continuing evaluation of its strategies, plans, organizational structure and asset valuations.

6. Risks associated with the Company's real estate activities, including, but not limited to, dependence upon the Las Vegas commercial, industrial and residential real estate markets, changes in general or local, economic conditions, interest rate fluctuations affecting the availability and the cost of financing, the performance of the managing partner of the GRLLC (Ventana Canyon Joint Venture) and regulatory and environmental matters that may have a negative impact on sales.

7. The effects of, and changes in, trade, monetary and fiscal policies,

laws and regulations and other activities of governments, agencies or similar organizations, including, but not limited to, environmental, safety and transportation issues.

8. The cost and effects of legal and administrative proceedings, settlements and investigations, particularly those described in Note 4 of Notes to Condensed Consolidated Financial Statements contained in this report and Note 10 in the Report on Form 10-K, and claims made by or against the Company relative to patents or property rights.

9. The adoption of new, or changes in existing, accounting policies and practices.