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ENVIRONMENTAL TREATMENT AND TECHNOLOGIES CORP.

ANNUAL REPORT

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Environmental Treatment and Technologies Corp.

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Financial Highlights

(In Thousands, Except Per Share Data)

	1987	1986	1985	1984	1983
Gross Revenues	**$137,027**	$101,420	$82,790	$55,786	$35,462
Net Revenues	**98,432**	76,289	67,062	45,804	29,775
Operating Income	**5,637**	9,367	10,441	6,564	2,530
Income Before Extraordinary Credit	**2,418**	2,509	5,401	3,251	931
Net Income	**2,418**	2,785	7,014	3,411	931
Earnings Per Share	**0.20**	0.23	0.61	0.36	0.10
Total Assets	**122,181**	114,394	58,312	32,279	25,422
Stockholders' Equity	**36,970**	34,677	28,933	12,001	10,358

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To Our Shareholders

With passage of the $8.5 billion reauthorization of Superfund in October 1986, management made a substantial commitment to the aggressive expansion of our business. While the risks of expansion in anticipation of substantially increased demand for analytical and remediation services were great, we believed that the risks of losing market share by not being properly positioned were even greater. Accordingly, we proceeded with our commitment to maintain the Company's leadership position in the segments of the environmental services industry in which we serve.

The Company made capital investments of $25 million to increase our fixed asset base by over 60 percent. Our laboratory network was expanded with the acquisition of Multi-Tech Laboratories, Inc. of Santa Rosa, California in July of 1987. By mid-year, our staff of operational, technical, administrative and support personnel had been increased by over 200 employees, or approximately 25 percent, compared to the beginning of the year. We completed the development of a mobile infrared incinerator that has been successfully applied to the incineration of PCBs at a National Priorities List site in Florida. Our geographical presence was extended by establishing remediation service centers in Toronto and Los Angeles, and we initiated the expansion of our new Gulf Coast service center in Baton Rouge.

The Company also received the unprecedented award of two Emergency Response Cleanup Services (ERCS) contracts from the Environmental Protection Agency with a potential value of $179.5 million over four years. New systems were put into place to enhance management of projects and the utilization of people and equipment. Additional financial flexibility was obtained with the execution of a $30 million revolving line of credit, and we increased liquidity for our shareholders through the listing of our common stock on the New York Stock Exchange.

The Company experienced a 39 percent increase in net revenues for the first nine months of 1987 and a 56 percent increase in operating income for the same period. However, net revenues for the fourth quarter were $5.8 million less than the third quarter level of $29.9 million, resulting in operating performance for the year below our expectations. The market for remediation services did not expand as rapidly as we had initially anticipated. Losses were also experienced due to production delays encountered at the Company's Edison, New Jersey laboratory. In addition, nonrecurring expenses of approximately four cents per share were incurred in connection with acquisition activities frustrated by the stock market decline in October.

In responding to production delays at the Edison facility, new operating systems have been put in place which will enable the laboratory to accommodate substantial growth, while providing enhanced quality and improved efficiency. At the same time, we are expanding production at our five other laboratories. The Company's expertise in systems development and management of geographically dispersed laboratories has enabled it to integrate its network and transfer data between laboratories electronically, creating central data bases for its clients regardless of where the samples are taken or the analyses performed.

We also took action on a Company-wide basis to control costs and more effectively manage the profitability of the Company. Our efforts included a reduction in administrative and support positions not directly involved in operations, expanded programs to reduce and control variable cost items, and the implementation of improvements already underway to consolidate and augment our insurance programs. These and other efforts have resulted in a reduction in overhead expenses of approximately 15 percent during January of 1988 compared to fourth quarter levels.

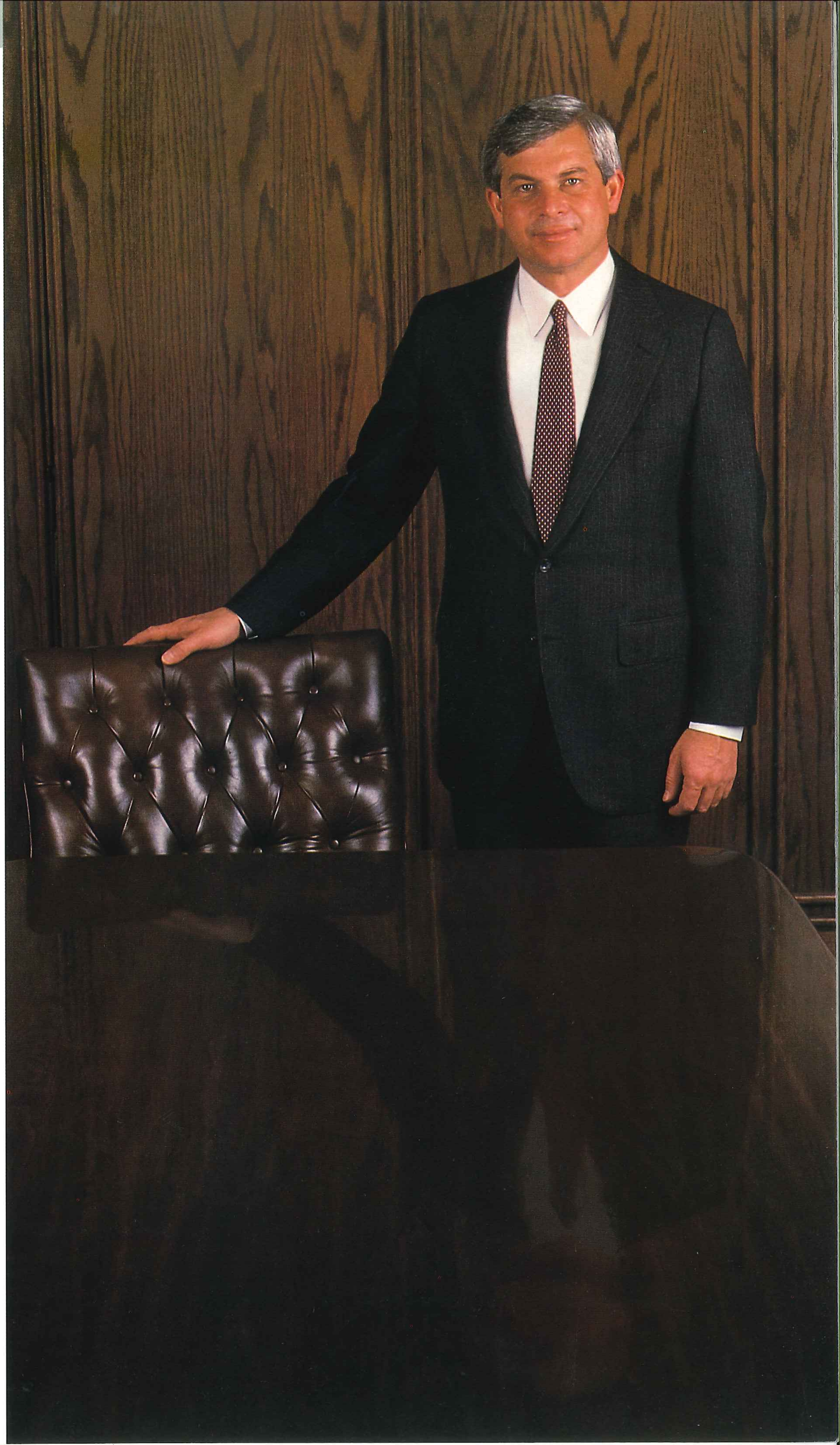
Nevertheless, fourth quarter performance resulted in a net loss of $3.0 million. For the year, net revenues reached $98.4 million. However, net income equaled $2.4 million compared to $2.8 million in 1986. Earnings per share were $0.20 compared to $0.23 in 1986.

While the year's results fell short of our expectations, we continue to believe in the fundamental strengths of the environmental services industry and its prospects for long-term growth. Growth in the analytical and remediation sectors of the market will continue to be driven by the enforcement and future enactment of state and federal laws and regulations, by limitations on the land disposal of many hazardous wastes, and by clients' desires to avoid future liabilities for current waste management and disposal practices. While we are more sensitive to the complexities of managing our Company within the context of an emerging and dynamic industry, we continue to believe, as strongly as ever, that the environmental problems faced by this nation require the technically advanced services which we are committed to providing.

Our investment in technology and capacity positions us to capitalize on the opportunities emerging in our industry. The quality of our analytical and remediation services continues to be enhanced as we develop and perfect technologies which increase our efficiency and productivity. Our expanding portfolio of treatment services is being developed with the specific objective of bringing permanent solutions to a constantly increasing array of environmental problems. These advantages, coupled with the solid foundation Environmental Treatment and Technologies Corp. has already established, positions us to aggressively pursue and achieve our objectives for long-term growth.

James L Kirk

James L. Kirk
Chairman, President and
Chief Executive Officer



The ETTC Philosophy

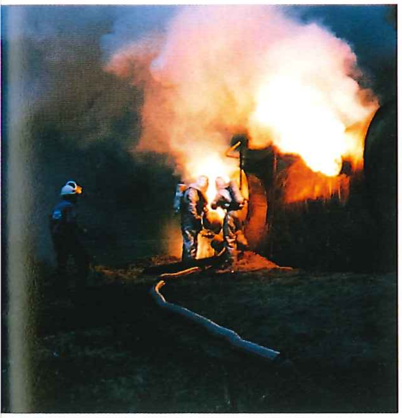
The fundamental concepts upon which Environmental Treatment and Technologies Corp. has been built date back to the very beginnings of the environmental services industry. In 1969, long before the enactment of environmental legislation including TSCA, RCRA, CERCLA, and SARA, the founders of ETTC's Remediation Services Group determined that the only viable long-term solution to environmental contamination is the permanent elimination of toxic materials or their reduction to acceptable levels. Accordingly, they established a business dedicated to developing and applying innovative mobile on-site treatment technologies.

During the initial years of the Company's development, its business primarily consisted of emergency response services. The laws and regulations, governmental funding and enforcement, and the evolving corporate social responsibility which drive the planned remediation services of today, as well as the future, did not begin to develop significantly until the late 1970s. In those early years, each emergency response project presented unique challenges, requiring the Company to be a pioneer in environmental technology.

Today, ETTC has changed dramatically. The Company has grown from a handful of employees to over 1,200. Its operations have spread from coast to coast and into Canada. ETTC's services now combine sophisticated analytical and data management capabilities to identify and assess environmental problems with the engineering and operational expertise to develop and apply a vast array of mobile treatment and remediation technologies to solve those problems. Emergency response, while still important, represents less than 20 percent of gross revenues. Today the Company's business is driven by an aggressive regulatory climate and corporate recognition of the liabilities, past, present and future, associated with the improper management of hazardous waste.

Despite its growth and the changes in the marketplace, ETTC remains committed to its original concepts of developing and applying innovative approaches to solve environmental problems. Most important, many of the services developed by the Company years ago are now becoming the preferred approaches to our nation's environmental problems. In the past several years, federal and state laws and regulations increasingly have expressed a preference for the treatment and permanent destruction of hazardous and toxic materials and are discouraging landfilling and other temporary solutions. While full development and enforcement of such laws and regulations may take several more years, the Company believes their evolution confirms the validity of the concepts upon which ETTC has been founded.

ETTC's Technical Center provides modern equipment and a productive work environment for the development of remediation and treatment technologies. The Company's expertise is based on nearly 20 years experience in providing planned and emergency response services including site-specific treatment systems.



Above: Technical Center-Findlay, Ohio
Upper Left: ETTC Emergency Response
Left: Custom Designed and Fabricated Treatment System

Assessment, Evaluation and Data Management

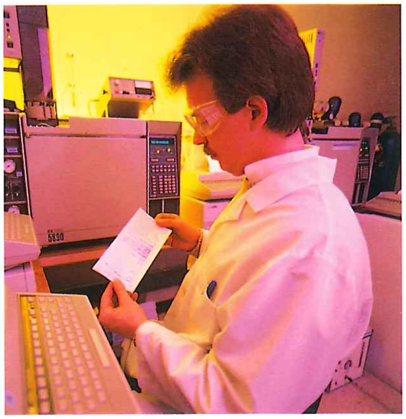
The federal environmental legislation enacted in the late 1970s and early 1980s did not result in an immediate increase in the demand for treatment services. Rather, their passage initially fostered a significant demand for the investigation and evaluation of environmental problems. While cleanup activity has begun to increase, a significant portion of today's environmental expenditures continue to be spent on assessment activities.

ETTC believes that in the long-term the highest growth segment of the environmental services industry will be the remediation and treatment of toxic materials. The Company participates in the evaluation phase through its analytical and data management services for the identification and assessment of environmental problems. However, ETTC's services have been designed to provide continuous value both during and after the initial evaluation phase. ETTC-developed data management services are capable of evaluating hundreds of analytical results taken from one or more samples and combining them with similar data from hundreds of other samples taken over many years and translating the results into valuable management information concerning contamination levels and migration. This information can then be used to determine appropriate treatment processes, gauge their effectiveness and continue to monitor the environment after remediation is completed.

ETTC's Analytical Services Group consists of six laboratories across the country. These include its primary laboratory in Edison, New Jersey as well as facilities in Florida, Ohio, Louisiana, Minnesota and its recent acquisition of Multi-Tech Laboratories, Inc. in Santa Rosa, California. The Analytical Services Group, on average, processes 4,000 samples a month, conducting between 5 and 400 analyses per sample. Often, this work is done under continuing service agreements and programs established years ago.

From its inception, the Group has made a significant investment in the continual development of its data management capabilities. Many competitors are only now attempting to develop capabilities which clients of the Analytical Services Group have benefitted from for years. ETTC continued to expand its competitive edge in 1987 with enhanced remote data entry flexibility, on-line interactive client access, extensive modeling and projection capabilities, and innovative data acquisition and interpretation programs.

Analysis at ETTC's fixed laboratories begins with computer log-in of samples to ensure accurate tracking and to maintain chain of custody. Analysis is preceded by sample preparation involving complex extraction techniques. Internally developed software allows specialists to interpret analytical results.



Above: Computerized Sample Scheduling and Tracking
Upper Left: Sample Extraction
Left: Gas Chromatography Analysis

One long-term client currently utilizes the Group's services to manage its groundwater monitoring program involving 3,000 sampling wells at 165 facilities throughout the United States. In this case, the ability of the client's personnel to access this data from their respective locations is particularly important in meeting regulatory deadlines.

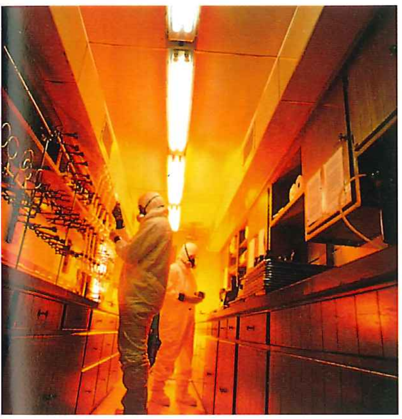
In another case, the Group developed and designed an analytical and data management program for a major petroleum company's distribution and marketing units. The ability of the Group's laboratory network to provide timely analyses of samples from 72 geographically dispersed sites will enable the client to comply with Environmental Protection Agency (EPA) and state underground tank regulatory programs. Additionally, ETTC offers the advantage of providing client-specific data management reports and a secured data base compatible with the client's existing computer system.

Remediation and Treatment

ETTC's Remediation Services Group has completed more than 6,000 private and public sector environmental projects in its nearly two decades of existence; over 1,300 were completed during 1987. The services provided by this Group can be segmented into five major categories:

- Facilities Decontamination: nondestructive decontamination of industrial, institutional and commercial facilities
- Waste-Site Remediation: surface and subsurface remediation and restoration of operating or abandoned hazardous waste sites
- Surface Impoundments: dewatering, reconstruction and closure services for hazardous waste pits, ponds and lagoons
- Groundwater: product recovery and restoration of quality standards for groundwater supplies
- Emergency Response: all of the above services but substantially differentiated by the emergency nature and timing of the response

ETTC's laboratory network transforms analytical results obtained from mobile and fixed laboratories as well as client facilities into comprehensive environmental data bases. Data management services provide clients with analysis and assessment of their unique environmental situations within the context of the most current regulations.



Above: Analytical Services Group Data Management Center
Upper Left: On-Site Analysis in Mobile Laboratory
Left: Project Manager and Client Review Site Plans

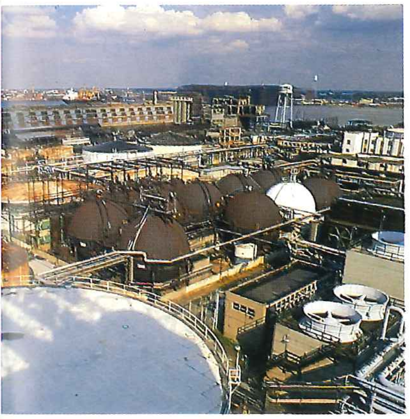
Nondestructive Decontamination

The facilities decontamination market has grown into a separate segment from its origins in emergency response. Initially, the Group developed its unique skills in nondestructive decontamination in response to fires, explosions, spills or other unplanned incidents where the release of hazardous materials disrupted the normal use of industrial or commercial facilities. The Company has pioneered many decontamination technologies to cost effectively return such facilities to productive use. Solvent application and extraction, high-pressure surfactant cleaning, hydroblasting, thermal cleaning and various other chemical detoxification procedures are examples of technologies developed specifically for this market.

Currently, the facilities decontamination market is also being driven by a trend begun in New Jersey where the Environmental Cleanup Responsibility Act (ECRA) has been enacted. Similar legislation has also been enacted in Connecticut and Massachusetts with other states expected to follow. Under ECRA-type legislation, the sale or transfer of potentially contaminated property is prohibited until analysis is done and, if contamination is confirmed, a remediation plan is developed and approved. The potential financial and legal liabilities for corporations and lending institutions are so substantial that many of them are requiring certification that no environmental problem exists or cleanup of the hazard has been completed before the property changes hands—even in the absence of a state law requiring these steps.

In late 1985, PCB contamination was discovered during the initial stages of the multi-million dollar renovation of an old manufacturing facility into luxury condominiums. ETTC became involved at that time and has, to date, decontaminated over one million square feet of surface area and, utilizing a unique PCB debris-washing system developed by ETTC, removed over 40,000 tons of contaminated material from this full city block facility. On-site analyses in the Company's field analytical units of over 9,000 samples confirmed the effectiveness and quality of the cleanup. Key to this project has been ETTC's ability to decontaminate the facility while preserving the architectural integrity of the multi-building complex, now designated an historical landmark.

ETTC's resources, combined with its extensive experience, are applied to the design and implementation of environmental solutions at industrial complexes across the country. At all work sites, safety, efficiency and effectiveness are the crews' primary goals.



Above: Sampling and Overpacking of Unknown Chemicals
Upper Left: Major Remediation Project Site
Left: Hydroblasting PCB-Contaminated Facility

Mobile On-Site Treatment

ETTC has always been a leader in the development of technologies, process systems and support equipment for the waste-site remediation market. Initial industry actions in this area focused on traditional construction methods to excavate, load-out and transport contaminated material from the waste site being remediated to a different landfill. ETTC, recognizing the long-term inappropriateness of this approach, was one of the earliest developers of mobile systems to treat contaminated soils and materials on site and has consistently maintained its commitment to the development of new technology. Where complete destruction or decontamination is not technically or economically feasible, the Company concentrates on the development of volume reduction methods to reduce the cost and long-term liabilities associated with landfill disposal.

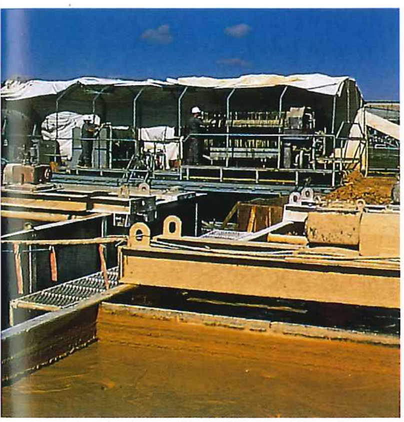
The waste-site remediation market is expected to be driven by the transition of identified sites from the investigation and study phase to actual remediation, by expanding regulatory enforcement, and by voluntary actions of private industry to preempt regulatory agency involvement. As a result, we believe that the demand for treatment services such as those developed and refined by ETTC since 1969 will grow substantially.

Thermal Technologies

Significant achievements were made in 1987 within ETTC's newly created Thermal Technologies Group, which was established in large part to support waste-site remediation efforts. In the broadest definition, thermal technology involves the application of heat to chemically alter hazardous and toxic materials, rendering them environmentally safe. Critical to this process is the application of this technology in controlled environments where associated volatiles can be destroyed or detoxified.

In its first year, the Thermal Technologies Group significantly enhanced the operating design, efficiency and mobility of an infrared incinerator system and successfully applied the unit to one of the first commercial scale projects to burn PCB-contaminated soils in the United States. A Superfund 106 order issued by Region IV of the EPA allows ETTC to operate the unit on a National Priorities List site involving the incineration of approximately 17,000 tons of PCB-contaminated soils.

In 1987, ETTC invested $25 million to increase its assets 60 percent. Among the Company's achievements were the successful, commercial application of its mobile incineration technology at a PCB-contaminated NPL site and the tripling of dewatering capacity.



Above: Mobile Incinerator at NPL Site
Upper Left: High Efficiency Plate and Frame Filter Press
Left: Mobile Incinerator Control Center

An EPA summary estimates that within the next five years 450,000 underground storage tanks could be leaking into the environment, contaminating soil and, in some cases, groundwater supplies. During 1987, the Company designed and built a unique mobile system to treat hydrocarbon-contaminated soils. ETTC's thermal volatilizer provides an economic solution to remediate soil contaminated by petrochemical products. The volatilizer offers an alternative to lengthy recovery processes or landfilling of these soils since they can be treated to remove the contamination and returned to their original location, thus eliminating liability and reducing cleanup expense.

Dewatering and Volume Reduction

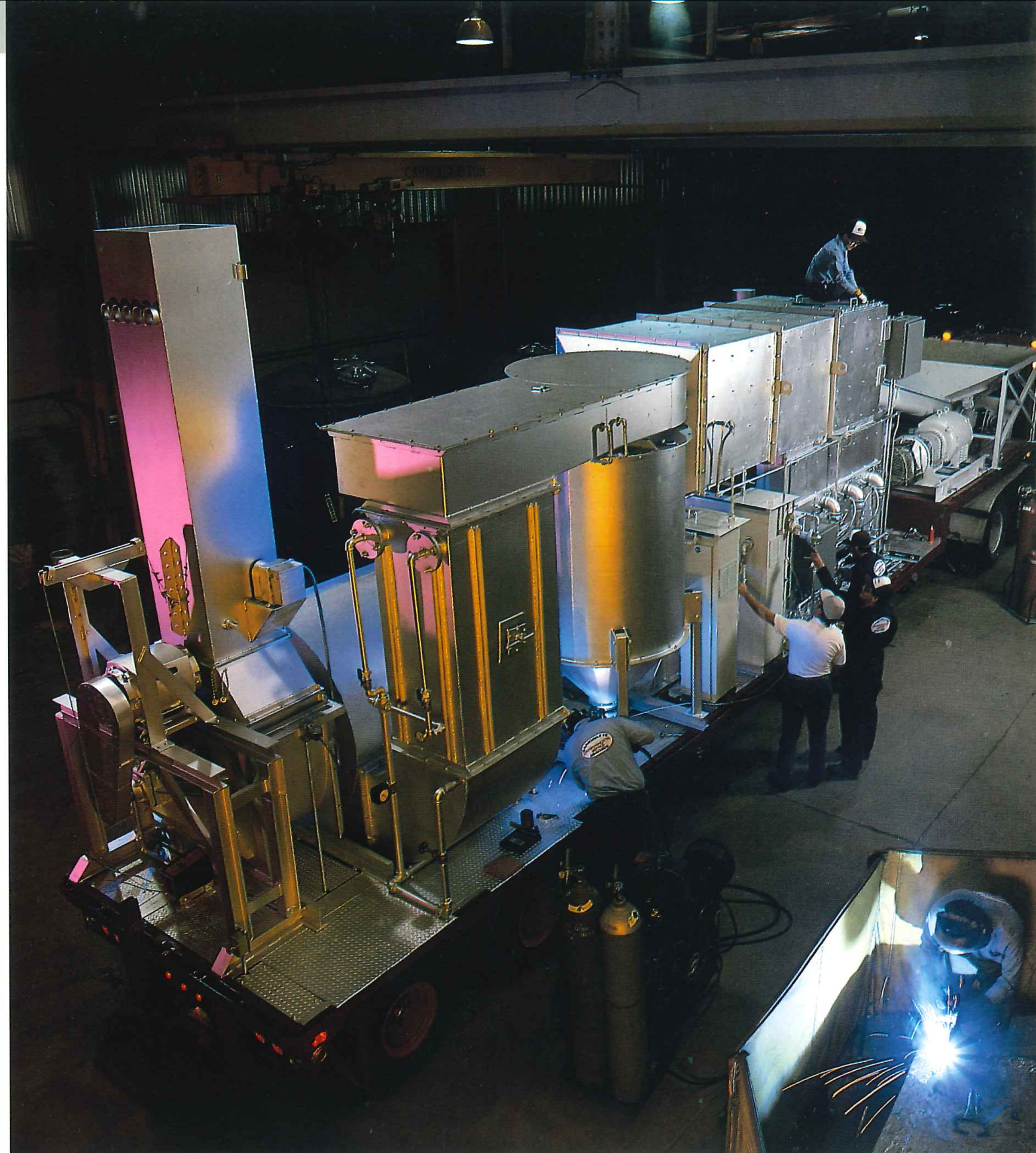
Growth in the surface impoundment market is expected in response to RCRA deadlines imposing more stringent requirements on hazardous waste disposal in pits, ponds and lagoons. Investments in equipment for ETTC's dewatering and volume reduction service tripled the Company's capacity during the year. This service provides its clients with the financial advantages associated with volume reduction technology and can provide additional economic benefits through unique resource recovery and recycling applications.

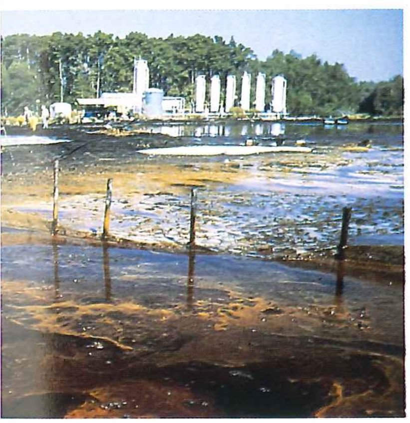
ETTC has established an enviable reputation for expert response to environmental crises earned through its nearly 20 years of experience. Each year the Company receives hundreds of requests for emergency services to recover and treat hazardous and toxic materials spilled or released as a result of transportation, industrial and other accidents.

Overall, ETTC is well positioned to maintain and enhance its leadership status in the environmental services industry. More than 1,200 employees at offices, laboratories and project sites across the country and in Canada support the Company's commitment to excellence. ETTC believes that lasting, long-term success in the enviromental services industry will belong to those who can deliver complete integrated solutions to their clients. These solutions will rely on the use of carefully gathered, processed and interpreted data, and the development of site-specific remedies based upon such data and the implementation and operation of those remedies utilizing innovative treatment technologies.

Environmental Treatment and Technologies Corp., The Environmental Services Company . . . Providing Tomorrow's Solutions Today.

Mobile treatment technology is the cornerstone of ETTC's Remediation Services Group. The ability to design and custom-fabricate mobile treatment equipment complements ETTC's expertise in applying the most appropriate technology. The Company's primary emphasis since its inception nearly 20 years ago has been directed toward the permanent destruction or detoxification of hazardous and toxic wastes.





Above: ETTC's Unique Thermal Volatilizer
Upper Left and Left: Contaminated Surface Impoundment
Before and After Biological Treatment

Quarterly Financial Data

(In Thousands, Except Per Share Data) (Unaudited)

1987	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Gross revenues	**$29,895**	**$29,460**	**$43,726**	**$33,946**
Net revenues	**20,881**	**23,630**	**29,874**	**24,047**
Gross profit	**8,410**	**9,928**	**12,789**	**5,053**
Operating income (loss)	**1,432**	**2,500**	**5,394**	**(3,689)**
Net income (loss)	**590**	**1,697**	**3,137**	**(3,006)**
Earnings (loss) per share	**0.05**	**0.14**	**0.26**	**(0.25)**

1986	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Gross revenues	$15,187	$22,481	$33,349	$30,403
Net revenues	12,190	17,589	23,785	22,725
Gross profit	4,088	7,959	11,554	9,917
Operating income (loss)	(1,044)	2,084	4,949	3,378
Net income (loss)	(2,470)	826	2,665	1,764
Earnings (loss) per share before extraordinary credit	(0.23)	0.07	0.23	0.15
Earnings (loss) per share	(0.21)	0.07	0.23	0.15

Quarterly Stock Prices

1987	High	Low
Fourth Quarter	**34**	**8 1/2**
Third Quarter	**36**	**26 3/4**
Second Quarter	**32**	**25 1/2**
First Quarter	**33 1/4**	**27 1/2**

1986	High	Low
Fourth Quarter	31 1/4	18 1/2
Third Quarter	29 3/4	19
Second Quarter	32 1/2	29 1/2
First Quarter	30 1/2	24 1/2

Note: The above table reflects, for the periods indicated, the high and low closing sales prices for ETC as reported by NASDAQ through June 30, 1986. Prices after June 30, 1986, reflect the high and low closing sales prices of the common stock of the Company as reported by NASDAQ from July 1, 1986, through August 24, 1987. On August 25, 1987, the Company's common stock was listed and commenced trading on the New York Stock Exchange under the symbol ETT. The prices after this date reflect the high and low sale prices of common stock of the Company as reported by The Wall Street Journal. As of December 31, 1987, the Company had approximately 626 stockholders of record.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

1987 Versus 1986

Gross revenues for the year ended December 31, 1987 increased 35.1 % to $137,027,000 from $101,420,000 in 1986. Net revenues for the year ended December 31, 1987 increased 29.0 % to $98,432,000 from $76,289,000 in 1986. The increase in net revenues resulted from greater demand by both industrial and governmental customers for the Company's remediation and analytical services. Net revenues for the first three quarters of 1987 increased 38.9 % while net revenues for the fourth quarter of 1987 increased 5.8 % over the comparable periods in 1986. Fourth quarter 1987 growth was affected by a slowdown in planned industrial remediation activity, part of which was attributable to seasonal conditions, and nonrecurring production delays experienced at the Company's Edison, New Jersey laboratory. Gross revenues from industrial customers decreased to 73.0 % of gross revenues in 1987 compared to 81.2 % in 1986. Revenues from the Company's Emergency Response Cleanup Services (ERCS) contracts with the Environmental Protection Agency (EPA) increased to 19.1 % of gross revenues in 1987 compared to 11.6 % in 1986 as a result of an increase in delivery orders under the previous ERCS contract as well as under the two new ERCS contracts awarded to the Company in June and July 1987.

The Company incurs a substantial amount of direct subcontract costs which are passed through to its clients. These costs result from the use of subcontractors on projects principally for the transportation and disposal of hazardous wastes and, in some cases, for analytical and remediation services where contracts or other business conditions require the use of subcontractors. The Company believes that net revenues, excluding subcontract costs, more accurately reflect the amounts earned for activities performed by the Company. The increase in subcontract costs of $13,464,000 during 1987 reflects a larger proportion of activities which the Company does not traditionally perform but were required on projects awarded in 1987.

Cost of services as a percentage of net revenues was 63.2 % for the year ended December 31, 1987 compared with 56.1 % in 1986. This increase is a result of the Company's efforts to increase its capacity throughout 1987 at a greater rate than required to support revenue levels, as well as, a greater proportion of ERCS revenues which have lower margins and costs incurred as a result of production delays at the Edison laboratory. Cost of services as a percentage of net revenues for the first three quarters and fourth quarter of 1987 were 58.2 % and 79.0 %, respectively, reflecting the slowdown in industrial remediation activity in the fourth quarter and the other factors discussed above.

Selling, general and administrative expenses for the year ended December 31, 1987 increased $6,392,000 or 26.5 % from 1986. However, such expenses declined to 31.0 % of net revenues in 1987 compared to 31.7 % in 1986. The increase in these expenses is associated with additions to sales, marketing and technical personnel and increases in administrative support functions in anticipation of the Company's growth. However, during the fourth quarter the Company initiated cost control measures as a result of the slowdown in revenues, including the layoff of approximately 6 % of its work force, in an effort to reduce its overhead expenses.

Other (income) expenses decreased 45.8 % to $1,829,000 for the year ended December 31, 1987 compared to $3,375,000 in 1986. Investment income increased 49.4 % to $1,657,000. Included in investment income in 1987 was a write-down of $548,000 for investments held at December 31, 1987 stemming from the October 1987 stock market decline. Interest expense increased 108.9 % to $4,637,000 as a result of the issuance of the Company's 8 % Convertible Subordinated Debentures in October 1986. In 1986, the Company incurred $2,239,000 of nonrecurring costs associated with the combination of ETC and OHM. In 1987, the Company recorded $1,151,000 of other income which is primarily from the sale of certain property and equipment.

Net income for the year ended December 31, 1987 amounted to $2,418,000 or $0.20 per share compared to $2,785,000 or $0.23 per share for 1986. An extraordinary credit from net operating loss carryforwards of $276,000 was included in 1986 net income. The effective tax rate for 1987 declined to 36.5 % from 58.1 % for 1986. The 1986 rate was primarily a result of the nonrecurring costs in 1986 from the combination of ETC and OHM. In the fourth quarter of 1987, the weighted average number of common and equivalent shares outstanding declined to 11,951,000 as a result of the Company's program to repurchase its shares in the stock market initiated in November 1987. As of December 31, 1987, 167,000 shares had been repurchased under this program.

1986 versus 1985

Gross revenues for the year ended December 31, 1986 increased 22.5 % to $101,420,000 from $82,790,000 in 1985. Net revenues for the year ended December 31, 1986 increased 13.8 % to $76,289,000 from $67,062,000 in 1985. Net revenues during the first quarter of 1986 declined by $3,750,000 from the comparable period in 1985 due primarily to a significant decline in net revenues from the ERCS program and other government contracts. However, net revenues in the three succeeding quarters of 1986 increased 25.4 % over the comparable period in 1985. The significant increases in net revenues in the last three quarters of 1986 were primarily attributable to increases in net revenues derived from industrial companies, reflecting the benefits of the Company's efforts to market its services to this sector. Gross revenues from industrial clients comprised 81 % of total gross revenues, an increase from 66 % in 1985 and 59 % in 1984.

Cost of services as a percentage of net revenues was 56.1 % for the year ended December 31, 1986 compared with 52.1 % in 1985. The increase in cost of services in 1986 is primarily attributable to the decrease in first quarter 1986 net revenues compared to the same period in 1985 combined with a corresponding increase in the Company's capacity and fixed cost structure during that period. Cost of services as a percentage of net revenues was 66.5% for the first quarter of 1986 compared to 47.0% for 1985. For the last three quarters of 1986, cost of services as a percentage of net revenues was 54.1% compared to 53.7% for the same period in 1985.

Selling, general and administrative expenses for the year ended December 31, 1986 increased by $2,472,000 or 11.4% from 1985. However, such expenses decreased to 31.7% of net revenues in 1986 from 32.3% of net revenues in 1985. The increase in these expenses is attributable to a significant increase in insurance costs, additions to sales and marketing personnel as the Company continued to expand its efforts in marketing to industrial customers, and increases in other administrative support functions necessary to accommodate the Company's growth.

Other (income) expenses increased to $3,375,000 for the year ended December 31, 1986 from $355,000 in 1985. This increase is primarily attributable to $2,239,000 of nonrecurring expenses relating to the 1986 combination of ETC and OHM. In addition, interest expense increased $658,000 in 1986 from 1985 primarily as a result of the issuance of the Company's 8% Convertible Subordinated Debentures due October 1, 2006.

Net income amounted to $2,785,000 or $0.23 per share for 1986 versus $7,014,000 or $0.61 per share in 1985. The decrease for the year was primarily attributable to the net loss of $2,470,000 in the first quarter of 1986 and the nonrecurring expenses of combining ETC and OHM. Extraordinary credits from net operating loss carryforwards of $276,000 and $1,613,000, respectively, are included in 1986 and 1985 net income.

The effective tax rate increased in 1986 to 58.1% as compared to 46.4% for 1985 due primarily to the nonrecurring expenses from the 1986 combination of ETC and OHM.

Liquidity and Capital Resources

Working capital at December 31, 1987 was $43,122,000 compared to $52,807,000 at December 31, 1986. The decrease in working capital of $9,685,000 is primarily attributable to capital expenditures of $24,563,000 in 1987 for additional remediation and analytical equipment and facilities as well as for acquisitions that occurred during the year. Working capital provided by operations was $8,342,000 in 1987 compared to $6,975,000 in 1986.

The Company's remediation and analytical businesses are capital intensive. For 1988, the Company believes significant capital expenditures will be needed to acquire or improve existing equipment and facilities to enhance the Company's technical capabilities in on-site remediation and analytical services and to meet the demands of planned growth. The Company believes that its current cash reserves and cash flow from operations combined with the Company's $30,000,000 revolving credit agreement executed in November 1987 will be sufficient throughout the next twelve months to finance its capital expenditures and working capital needs of its existing operations.

In assessing the Company's liquidity and capital resources, the impact of the Tax Reform Act of 1986 has been considered, particularly the repeal of the investment tax credit, changes to the alternative minimum tax, changes to depreciation methods, and the lower overall corporate income tax rates. In 1987, the benefit of the lower federal income tax rates in effect was more than offset by the loss of investment tax credits. In future years, the Company expects that the effects of the Tax Reform Act of 1986 should generally have a favorable impact on the Company, provided that earnings increase and capital expenditures stabilize such that the Company realizes the benefit of the reduced corporate income tax rates. In addition, the Company has assessed the impact of Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes," as of December 31, 1987. Although the standard has not been implemented and may be implemented in 1988 or 1989, the Company believes that implementation will have a favorable, but not material, impact on results of operations.

Inflation

Historically, inflation has not been a significant factor to the Company or to the cost of its operations. The Company has been able to raise prices in the past to compensate for cost increases.

Consolidated Balance Sheets

(In Thousands)

December 31	1987	1986	1985
Assets			
Current assets			
Cash and short-term investments	$ 19,290	$ 38,169	$13,109
Accounts receivable	39,338	27,580	22,324
Inventories	3,574	2,318	1,524
Prepaid expenses and other assets	2,556	3,392	1,062
Refundable income taxes	1,461	—	—
	66,219	71,459	38,019
Property and equipment, net	49,180	30,523	19,257
Other noncurrent assets			
Investments	—	6,839	—
Debt issuance costs	2,020	2,127	—
Other assets	4,762	3,446	1,036
	6,782	12,412	1,036
Total Assets	$122,181	$114,394	$58,312
Liabilities and Stockholders' Equity			
Current liabilities			
Notes payable	$ —	$ —	$ 6,879
Accounts payable	16,701	9,306	5,551
Accrued compensation and related taxes	2,307	2,101	1,518
Federal, state and local income taxes	—	759	511
Deferred income taxes	694	1,457	741
Other accrued liabilities	2,369	3,833	1,527
Current portion of noncurrent liabilities	1,026	1,196	1,749
	23,097	18,652	18,476
Noncurrent liabilities			
Long-term debt	58,345	58,510	7,358
Capital leases	463	783	646
Noncompetition and pension agreements	300	300	2,575
	59,108	59,593	10,579
Deferred income taxes	3,006	1,472	324
Stockholders' equity			
Preferred stock	—	—	—
Common stock, $.10 par value	1,188	1,182	1,164
Additional paid-in capital	23,962	22,773	19,445
Retained earnings	13,548	11,074	8,324
Valuation allowance on investments	—	(352)	—
	38,698	34,677	28,933
Treasury stock at cost	(1,728)	—	—
	36,970	34,677	28,933
Total Liabilities and Stockholders' Equity	$122,181	$114,394	$58,312

The accompanying notes are an integral part of these financial statements.

Environmental Treatment and Technologies Corp.

Consolidated Statements of Income

(In Thousands, Except Per Share Data)

Years Ended December 31	1987	1986	1985
Gross revenues	**$137,027**	$101,420	$82,790
Less: direct subcontract costs	**38,595**	25,131	15,728
Net revenues	**98,432**	76,289	67,062
Cost of services	**62,252**	42,771	34,942
Gross Profit	**36,180**	33,518	32,120
Selling, general and administrative expenses	**30,543**	24,151	21,679
Operating Income	**5,637**	9,367	10,441
Other (income) expenses:			
Investment income	**(1,657)**	(1,109)	(1,241)
Interest expense	**4,637**	2,220	1,562
Nonrecurring affiliation costs	**—**	2,239	—
Miscellaneous, net	**(1,151)**	25	34
	1,829	3,375	355
Income Before Income Taxes And Extraordinary Credit	**3,808**	5,992	10,086
Income taxes	**1,390**	3,483	4,685
Income Before Extraordinary Credit	**2,418**	2,509	5,401
Extraordinary credit — utilization of net operating loss carryforward	**—**	276	1,613
Net Income	**$ 2,418**	$ 2,785	$ 7,014
Net income per share:			
Before extraordinary credit	**$ 0.20**	$ 0.21	$ 0.47
Extraordinary credit	**—**	0.02	0.14
	$ 0.20	$ 0.23	$ 0.61
Weighted average number of common and common equivalent shares outstanding	**12,021**	11,891	11,448

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Changes in Stockholders' Equity

(In Thousands, Except Share Data)

	Preferred Stock		Common Stock		Additional			
	Number of Shares	Amount	Number of Shares	Amount	Paid-In Capital	Retained Earnings	Treasury Stock	Other Changes
Balance at December 31, 1984	6,000	$600	6,319,106	$ 632	$ 8,153	$ 2,616	$ —	$ —
Stock options exercised			12,946	1	12			
Issuance of common stock			2,137,021	214	11,597			
Three-for-two stock split			3,166,026	317	(317)			
Net income						7,014		
Pro forma adjustment for income taxes						509		
Purchase and retirement of shares	(6,000)	(600)						
Basis adjustment						(400)		
Distribution of earnings						(1,415)		
Balance at December 31, 1985	-0-	-0-	11,635,099	1,164	19,445	8,324	—	—
Stock options exercised			44,500	4	272			
Issuance of common stock			58,960	14	3,056			
Net income						2,785		
Pro forma adjustment for income taxes						30		
Distribution of earnings						(65)		
Valuation allowance on investments								(352)
Balance at December 31, 1986	-0-	-0-	11,824,098	1,182	22,773	11,074	—	(352)
Stock options exercised			58,960	6	1,189			
Net income						2,418		
Recovery of valuation allowance on investments								352
Deferred translation adjustments						56		
Purchase of 167,000 shares of treasury stock							(1,728)	
Balance at December 31, 1987	-0-	$-0-	11,883,058	$1,188	$23,962	$13,548	$(1,728)	$-0-

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Changes in Financial Position

(In Thousands)

Years Ended December 31	1987	1986	1985
Sources of working capital			
Net income before extraordinary credit	$ 2,418	$ 2,509	$ 5,401
Items which do not use (provide) working capital:			
Depreciation and amortization	5,366	3,645	2,736
Amortization of other assets	610	261	467
Pro forma adjustment for income taxes	—	30	509
Noncurrent deferred income taxes	1,389	517	85
Gain on sale of property and equipment	(1,441)	—	—
Other	—	13	(13)
Working capital provided by operations	8,342	6,975	9,185
Extraordinary credit	—	276	1,613
Proceeds from sale of property and equipment	1,981	—	—
Issuance of long-term debt and capital leases	918	61,871	3,822
Decrease in receivables from stockholders and related entities	—	—	4,496
Reclassification of investments	7,210	—	—
Reclassification of deferred income taxes	145	631	—
Proceeds from issuance of common stock	1,195	3,346	11,824
	19,791	73,099	30,940
Uses of working capital			
Net additions to property and equipment	24,563	14,924	13,368
Increase in investments	19	7,191	—
Increase in debt issuance costs	—	2,154	—
Increase in other assets	1,819	2,644	446
Reduction of long-term debt	740	9,887	2,176
Reduction of capital leases	663	695	627
Payments on noncompetition and pension agreements	—	2,275	380
Distribution of earnings	—	65	1,415
Purchase of treasury stock	1,728	—	—
Purchase of preferred stock and other equity adjustments	(56)	—	1,000
	29,476	39,835	19,412
Increase (decrease) in working capital	$ (9,685)	$33,264	$11,528
Changes in components of working capital			
Increase (decrease) in current assets:			
Cash and short-term investments	$(18,879)	$25,060	$10,900
Accounts receivable	11,758	5,256	7,659
Inventories	1,256	794	774
Prepaid expenses and other assets	(836)	2,330	572
Refundable income taxes	1,461	—	—
	(5,240)	33,440	19,905
Increase (decrease) in current liabilities:			
Notes payable	—	(6,879)	6,879
Accounts payable	7,395	3,755	471
Accrued compensation and related taxes	206	583	582
Federal, state and local income taxes	(759)	248	(363)
Deferred income taxes	(763)	716	(335)
Other accrued liabilities	(1,464)	2,306	652
Current portion of noncurrent liabilities	(170)	(553)	491
	4,445	176	8,377
Increase (decrease) in working capital	$ (9,685)	$33,264	$11,528

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

December 31, 1987

Description of the Company

Environmental Treatment and Technologies Corp. (the Company) provides a comprehensive range of analytical, technical and on-site remediation services to manage the risks of actual or threatened chemical releases into the environment. These services are provided primarily to large chemical, petroleum, transportation, industrial and waste disposal companies, and government agencies.

The Company provides its services through its wholly-owned operating subsidiaries, O.H. Materials Corp. (OHM) and Environmental Testing and Certification Corp. (ETC). The Company was organized in 1986 when ETC and OHM agreed to combine the two companies in order to serve more effectively the market for environmental services. On July 1, 1986, all of the issued and outstanding stock of ETC and OHM were exchanged for 5,644,099 and 6,000,000 shares, respectively, of the Company. The transaction was accounted for as a pooling of interests and accordingly, the accompanying financial statements for the periods ended December 31, 1986 and 1985, including the calculations of earnings per share, have been restated to include the results of operations and the accounts of ETC and OHM as if the combination of the companies had occurred at the beginning of these periods.

Revenues from federal government agencies accounted for 25 %, 14 %, and 25 % of gross revenues for the years ended December 31, 1987, 1986, and 1985, respectively. The Company derived 12 % of its gross revenues for the year ended December 31, 1987 from one customer, a major petroleum company and its affiliates. There were no state or local government agencies or other industrial customers which accounted for more than 10 % of gross revenues in any of these years.

Note 1 – Significant Accounting Policies

Principles of Consolidation The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. Significant intercompany transactions and balances have been eliminated in consolidation.

Revenue Recognition The Company primarily derives its revenue from providing environmental services under time and materials, fixed price and unit price contracts. The Company records revenues and related income from its fixed and unit price contracts in process using the percentage-of-completion method of accounting. Anticipated losses on these contracts are recorded when identified. Revenue from time and materials type contracts are recorded based on performance and efforts expended.

Direct Subcontract Costs The Company incurs a substantial amount of direct subcontract costs which are passed through to its clients. These costs result from the use of subcontractors on projects principally for transportation and disposal of hazardous wastes and in some cases, for analytical and remediation services where contracts or other business conditions require the use of subcontractors. The Company believes that net revenues, excluding direct subcontract costs, more accurately reflect the amounts earned for activities performed by the Company. Accordingly, the Company reports direct subcontract costs as a reduction of gross revenues to arrive at net revenues.

Inventories Inventories are comprised primarily of operating supplies and are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method.

Property and Equipment Property and equipment are carried at cost and include expenditures which substantially increase the useful lives of the assets. Maintenance, repairs and minor renewals are expensed as incurred. Depreciation and amortization, including amortization of capital leases, are provided over the estimated useful lives of the respective assets, using primarily the straight-line method. In 1987, the Company recognized gains from the sale of certain property and equipment of $1,441,000, which is included in miscellaneous income.

Goodwill Goodwill, which represents the net cost in excess of the assets of companies acquired, is amortized over forty years using the straight-line method. Amortization was $17,300 for 1987 and $3,300 for 1986. The remaining unamortized cost, which is included in other assets, was $695,000 and $1,820,000 at 1987 and 1986, respectively. During 1987, $1,163,000 of goodwill was reclassified to property and equipment and other noncurrent assets to reflect the appraised fair values of the assets of companies acquired in late 1986.

Investments Marketable equity securities are carried at the lower of cost or market at the balance sheet date. To reduce the carrying amount of short-term investments to market at December 31, 1987, $548,000 was charged to results of operations at that date. Subsequent to December 31, 1987, the aggregate amount of this unrealized loss has been substantially reversed. At December 31, 1986, the cost of short-term investments approximated market, and long-term investments had a cost of $7,191,000, which was $352,000 above market. A valuation allowance of $352,000 was charged to stockholders' equity at that date. A net realized gain of $659,000 on the sale of marketable equity securities was included in the determination of net income in 1987. The cost of the securities sold was based on the average cost of all the shares of each security held at the time of sale.

Capital Leases Certain lease transactions are accounted for as installment purchases. Such costs are amortized over the asset's economic life, using the straight-line method and are included in depreciation and amortization expense.

Federal Income Taxes Deferred income taxes are recognized for income and expense items that are reported for financial reporting purposes in different years than for income tax purposes. The Company accounts for investment tax credits by the flow-through method. The Company has not implemented the provisions of Financial Accounting Standards Board Statement No. 96, "Accounting for Income Taxes." When implemented in 1988 or 1989, the Company believes that this pronouncement will have a favorable, but not material, impact on results of operations.

Earnings Per Share Earnings per share amounts are based on the weighted average common and equivalent shares outstanding during the respective periods, after giving effect to the three-for-two split effective July 15, 1985 and adjusted for an additional 6,000,000 shares of equivalent ETC common stock (or 1.065 shares for each share of the ETC common stock outstanding for periods prior to July 1, 1986) that would have been issued had the 1986 combination occurred at the beginning of such periods.

Basis of Presentation The consolidated statements of income for the years ended December 31, 1987, 1986, and 1985 include the results of operations of the Company and all subsidiaries on a common financial reporting year.

The consolidated statements of income for the years ended December 31, 1986 and 1985 include the results of operations of a previously affiliated S corporation. The consolidated statements of stockholders' equity reflect the distribution of accumulated earnings related to this S corporation.

Reclassification Certain amounts presented for the years ended December 31, 1986 and 1985 have been reclassified to conform to the 1987 presentation.

Note 2 – Acquisitions

On July 1, 1987, the Company acquired substantially all of the assets and assumed certain liabilities of Multi-Tech Laboratories, Inc. which provides analytical and data management services. The purchase price, including assumed liabilities of $693,000, was approximately $1,410,000. On November 1, 1986, the Company acquired substantially all of the assets and assumed certain liabilities of Toxicon Laboratories, Inc. which provides analytical and data management services. On December 29, 1986, the Company acquired substantially all of the assets and assumed certain liabilities of IFAD International, Inc. which provides dewatering and waste filtration services. The purchase price, including assumed liabilities of $2,989,000, approximated $5,500,000 for the acquisitions in 1986 for which $1,250,000 was paid with 44,499 shares of common stock. These acquisitions were recorded using the purchase method of accounting.

Note 3 – Accounts Receivable

Accounts receivable are summarized as follows:

December 31	1987	1986	1985
		(In Thousands)	
Accounts billed and due currently	**$28,927**	$18,674	$17,776
Unbilled receivables	**10,655**	9,333	5,225
Retained	**1,383**	713	194
	40,965	28,720	23,195
Allowance for doubtful accounts	**(1,627)**	(1,140)	(871)
	$39,338	$27,580	$22,324

Unbilled receivables represent costs incurred and estimated earnings on contracts for which billings have not been presented to customers.

Note 4 – Property and Equipment

Property and equipment is summarized as follows:

December 31	1987	1986	1985
		(In Thousands)	
Land	**$ 254**	$ 236	$ 239
Buildings and improvements	**14,481**	12,029	6,783
Machinery and equipment	**45,480**	31,603	23,659
Construction-in-progress	**4,591**	1,512	945
	64,806	45,380	31,626
Accumulated depreciation and amortization	**(15,626)**	(14,857)	(12,369)
	$49,180	$30,523	$19,257

Note 5 – Other Accrued Liabilities

Other accrued liabilities are summarized as follows:

December 31	1987	1986	1985
		(In Thousands)	
Customer deposits	**$ —**	$1,143	$ —
Accrued interest	**1,151**	1,104	119
Accrued benefits	**223**	454	695
Miscellaneous	**995**	1,132	713
	$2,369	$3,833	$1,527

Note 6 – Long-Term and Short-Term Debt

The long-term debt of the Company is summarized as follows:

December 31	1987	1986	1985
		(In Thousands)	
8% Convertible Subordinated Debentures, due October 1, 2006, convertible into common stock at $24.00 per share, with interest payable semi-annually on April 1 and October 1 and redeemable at the option of the Company anytime after October 1, 1989, or earlier, under certain conditions as discussed below.	**$57,500**	$57,500	$ —
New Jersey Economic Development Authority Bond, payable $89,000 quarterly with interest at 80% of the prime rate.	**446**	804	1,160
Installment purchase contract, payable $6,700 per month including interest.	**125**	186	242
Non-interest bearing note due June 30, 1989.	**537**	—	—
Other	**315**	649	6,926
	58,923	59,139	8,328
Current portion	**(578)**	(629)	(970)
	$58,345	$58,510	$7,358

The convertible subordinated debentures require annual mandatory sinking fund payments of 7.5% of the principal amount which commence on October 1, 1996, and continue through October 1, 2005. The debentures are redeemable at the Company's option, prior to October 1, 1989, if the market price of the Company's common stock equals or exceeds 150% of the conversion price for a specified period. Debt issuance costs incurred in 1986, relating to the convertible subordinated debentures, were $2,154,000. The related amortization was $107,000 and $27,000 for the years ended December 31, 1987 and 1986, respectively.

The non-interest bearing note is related to the purchase of the assets of Multi-Tech Laboratories, Inc. and is convertible at seller's option into approximately 21,338 shares of the Company's common stock.

The aggregate maturities of long-term debt for the five years ending December 31 are: 1988, $578,600; 1989, $828,100; 1990, $15,200; 1991, $1,600; 1992, $0; 1993 and thereafter $57,500,000.

The short-term notes payable to bank for the year ended December 31, 1985, consisted of a demand note under a line of credit agreement. In November 1987, the Company executed a $30,000,000 Revolving Credit and Term Loan Agreement with several banks. The facility provides for a two-year revolving loan which converts to a three-year term loan. The loan carries interest at the prime rate or at the Company's option, other rates which would not exceed the prime rate. No amounts were borrowed under the agreement at December 31, 1987. However, the Company had $1,870,000 of standby letters of credit outstanding under the facility at December 31, 1987. In addition, the Company has lines of credit with several banks amounting to $15,000,000 for the purpose of issuing standby letters of credit. The Company had $3,250,000 of letters of credit outstanding under these facilities at December 31, 1987. At December 31, 1986, the Company had a short-term line of credit available of $10,000,000 with interest at ½% over prime. No amounts were borrowed under this agreement at December 31, 1986. However, the Company had $3,566,000 of letters of credit outstanding at December 31, 1986.

Note 7 — Leases

The Company leases data processing and certain office equipment under captial lease agreements. Included in property and equipment are the following amounts for equipment leases that have been capitalized.

December 31	1987	1986	1985
		(In Thousands)	
Equipment	**$1,841**	$1,710	$1,241
Accumulated depreciation	**(513)**	(284)	(129)
	$1,328	$1,426	$1,112

Future minimum lease payments under noncancellable operating leases and the present value of future minimum capital lease payments are as follows:

	Capital Leases	Operating Leases
	(In Thousands)	
Years ending December 31:		
1988	**$ 524**	$1,291
1989	**441**	1,029
1990	**31**	891
1991	**24**	625
1992	**4**	185
Total minimum lease payments	**$1,024**	$4,021
Amount representing interest	**(113)**	
Present value of minimum lease payments	**911**	
Current portion	**(448)**	
	$ 463	

Rental expense under operating leases totaled $1,533,000, $977,000, and $1,110,000 for the years ended December 31, 1987, 1986, and 1985, respectively.

Note 8 — Income Taxes

The provision for income taxes consists of the following:

Years Ended December 31	1987	1986	1985
		(In Thousands)	
Federal			
Current	**$ 788**	$1,406	$2,220
Deferred	**537**	1,102	(250)
Charge in lieu of income taxes	**—**	276	1,613
Pro forma adjustment	**—**	30	509
	1,325	2,814	4,092
State and local			
Current	**(24)**	538	593
Deferred	**89**	131	—
	65	699	593
	$1,390	$3,483	$4,685

The Company's tax provisions for the years ended December 31, 1986 and 1985, contained a charge in lieu of federal income taxes which would have been required in the absence of a net operating loss carryforward. The 1986 and 1985 tax provisions also include pro forma adjustments to reflect the additional income taxes the Company would have incurred if the income of a former S corporation had not been directly taxed to its stockholders. For the year ended December 31, 1987, the Company charged $215,000 to additional paid-in capital for tax deductions associated with the exercise of stock options by employees of the Company.

The reasons for differences between total federal income tax expense and the amount computed by applying the statutory federal income tax rate (40% in 1987, 46% in 1986 and 1985) to income before income taxes and extraordinary credit are as follows:

Years Ended December 31	1987	1986	1985
		(In Thousands)	
Statutory rate times pretax income	$1,523	$2,756	$4,640
Add (deduct)			
Federal income tax benefit of state and local income taxes	(26)	(308)	(273)
Investment tax credit — net	(24)	(670)	(359)
Nonrecurring affiliation costs	—	972	—
Corporate dividend exclusion	(268)	—	—
Other	120	64	84
	$1,325	$2,814	$4,092

Deferred income tax expense (benefit), resulting from timing differences in reporting revenue and expense for income tax and financial reporting purposes, is summarized as follows:

Years Ended December 31	1987	1986	1985
		(In Thousands)	
Restoration of deferred taxes	$ 237	$ 291	$ —
Unbilled receivables	(285)	633	(93)
Depreciation	1,250	511	109
Noncompetition agreements	—	(156)	34
Equipment leases	154	263	97
Allowance for doubtful accounts and other allowances	(238)	(256)	(265)
Pension expenses	—	—	(138)
Alternative minimum tax credit	(211)	—	—
Other	(281)	(53)	6
	$ 626	$1,233	$(250)

At December 31, 1987, for tax reporting purposes, the Company had unused investment tax credits and net operating loss carryforwards available to be used against ETC's income of approximately $533,000 and $3,432,000, respectively, which will expire in 1996 through 2000.

Note 9 — Related Party Transactions

The Company has a policy whereby transactions with directors, executive officers, and related parties require the approval of a disinterested majority of the Board of Directors.

The Company had various long-term notes and accounts receivable due from certain stockholders amounting to $4,685,000 which were repaid in September, 1985. The Company earned interest income of $170,000 from these agreements for the year ended December 31, 1985.

On September 30, 1985, the Company purchased certain land and buildings from an affiliated partnership, owned by certain of the Company's principal stockholders, for $4,700,000. The purchase price was based on an independent appraisal. The land and buildings were recorded in an amount equal to the affiliated partnership's basis which resulted in a $400,000 charge to retained earnings.

During 1986, the Company entered into a contract with a company to act as general contractor with respect to the construction of additions to certain facilities. The principal stockholder of this company is a former stockholder-officer of the Company and is directly related to certain directors of the Company. The price paid by the Company for the construction was the actual cost of construction plus 10 percent which approximated $4,780,000.

The Company rented land, buildings, laboratory facilities and aircraft from an affiliated partnership. Rental expense for these facilities and aircraft totaled $131,000, $142,000, and $430,000 for the years ended December 31, 1987, 1986, and 1985, respectively.

An investment banking firm, of which a former director of the Company is a managing director, provided financial advisory services to ETC in connection with the combination of ETC and OHM in 1986, for which approximately $1,400,000 was paid by ETC. This firm also acted as an underwriter to the Company's offering of common stock and convertible subordinated debentures in 1986. The firm received an underwriting commission of $1.05 per share for the common stock and an underwriting discount of 2.875 % for the convertible subordinated debentures for which the firm was an underwriter. In 1987, the Company paid $330,000 to this firm in connection with the sale of certain marketable securities.

On July 27, 1987, the Company entered into a five-year management consulting services and non-solicitation agreement with a former director of the Company. The Company paid $450,000 in advance, which is being amortized over the term of the agreement. The unamortized cost was $405,000 at December 31, 1987.

Note 10 — Agreement With Former Stockholders

The Company had the following amounts payable to former stockholders under noncompetition and pension agreements:

December 31	1987	1986	1985
		(In Thousands)	
1981 agreement	$ —	$ —	$1,920
1983 agreement	—	—	360
1985 agreement	300	300	636
	300	300	2,916
Current portion	—	—	(341)
	$300	$300	$2,575

In 1981, the Company repurchased shares of its common stock held by a former stockholder-officer for $2,500,000 and entered into a five-year noncompetition agreement which required payments of $960,000 upon execution of the agreement and approximately $38,000 per month from January 15, 1982 through December 15, 1991. On July 1, 1986, the Company prepaid the remaining amounts due under the noncompetition agreement.

In 1983, the Company repurchased shares of its common stock held by a former stockholder-officer for $1,125,000 and entered into a noncompetition agreement for $600,000. The noncompetition agreement was payable $120,000 upon execution of the agreement with the balance payable in eight annual installments of $60,000 commencing January 15, 1984. On July 1, 1986, the Company prepaid the remaining amounts due under such agreement.

On May 31, 1985, the Company redeemed the shares of its preferred stock held by a former stockholder–officer for $600,000 and entered into a five-year noncompetition agreement which requires payments of approximately $8,000 per month commencing on June 1, 1985. On July 1, 1986, the Company prepaid the remaining amounts due under the agreement. In addition, the Company executed a pension agreement with the former stockholder for an annual pension of $80,000 commencing June 1990. The value of this pension agreement of $300,000 was recorded in the year ended December 31, 1985.

The total expense incurred to prepay the noncompetition agreements was $452,000 which was recorded in 1986. The asset which pertains to the 1981 noncompetition agreement was being amortized by the double-declining balance method over its five-year term. The assets related to the 1983 and 1985 agreements are being amortized by the straight-line method over their respective term. These assets, included in other assets, amounted to $421,000, $556,000 and $780,000 at December 31, 1987, 1986, and 1985, respectively.

Note 11 — Capital Stock

The Company has one class of $.10 par value common stock. On May 19, 1987, the stockholders of the Company authorized an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares from 20,000,000 to 50,000,000. The total common shares outstanding at December 31, 1987, 1986, and 1985 were 11,883,058, 11,824,098, and 11,635,099, respectively. During 1987, the Company acquired 167,000 shares of its common stock in the open market.

The Company has authorized 1,000,000 shares of preferred stock at a $10 par value. No shares of this stock have been issued at December 31, 1987. The rights and preferences of the preferred stock will be fixed by the Board of Directors at the time the shares are issued. The stock, when issued, will have dividend and liquidation preferences over those of the common stockholders.

The Company has currently exersiable warrants outstanding to purchase 150,000 common shares at $4.00 per share and have certain other rights. These warrants were issued in connection with ETC's initial public offering, prior to the combination of ETC and OHM in 1986.

Note 12 — Retirement, Profit Sharing and Employee Bonus Plans

The Company operates separate profit sharing and bonus plans for each of its two major subsidiaries. Substantially all full-time employees of OHM are covered under its profit sharing plan. Contributions to the plan are at the discretion of the Board of Directors and no contributions were made for the years ended December 31, 1987, 1986, and 1985. Until February 1, 1988, ETC had a defined contribution retirement plan covering substantially all full-time employees of ETC. The Plan provided for a contribution of three percent of each employee's salary, plus an additional three percent for any fiscal quarter in which ETC recorded net income. ETC's contributions were $308,000, $289,000, and $184,000 for the years ended December 31, 1987, 1986, and 1985, respectively, Effective February 1, 1988, the ETC Plan was amended to allow contributions to be made to the Plan only at the discretion of the Board of Directors.

For the year ended December 31, 1985, ETC had an employee bonus plan covering substantially all its employees. ETC made a contribution to this plan of $365,000 for 1985.

Note 13 — Stock Option Plans

On June 30, 1986, the 1986 Stock Option Plan (1986 Plan) was approved by stockholders to grant options for an aggregate of 1,100,000 of the Company's shares of common stock to directors, officers, and key employees of the Company. On May 19, 1987, the stockholders approved an amendment to the 1986 Plan to increase from 1,100,000 to 1,600,000 the aggregate shares of the Company's common stock available to grant options. The options are granted by a committee of the Board of Directors at prices equal to the fair market value of the shares at the date of grant. To date, the agreements evidencing such options provide that they are exercisable in cumulative annual installments of 20 percent commencing on the date of grant. The options expire ten years after grant. At December 31, 1987, the 1986 Plan had approximately 251,400 shares available for issuance upon the exercise of options granted under the 1986 plan.

The Company has an Incentive Stock Option Plan (ETC Plan) which permits the granting of options to purchase up to an aggregate of 300,000 common shares at prices equal to the fair market value of the shares at the date of grant. The Company does not intend to grant any additional stock options under the ETC Plan. The options currently outstanding are exercisable in cumulative annual installments of 33⅓ percent commencing one year after the date of grant and expiring ten years after grant.

On December 23, 1987, the Stock Option Committee of the Board of Directors authorized the Company to offer to exchange with each holder (who was then an employee, officer or director of the Company) of stock options granted under the 1986 Plan, a new stock option for a number of shares equal to the number of shares remaining unexercised under the old option at the time of exchange subject to certain conditions including those described hereinafter. The option price of each new option is equal to the fair market value of the Company's common stock on the date of authorization, December 23, 1987, or $11.00 per share. Each new option will not be exercisable for a period of six months following the date of the authorization or until June 23, 1988, and thereafter, shall be exercisable in accordance with the schedule of installments provided for in the related old option and shall terminate on the same date as the related old option. With respect to options granted to non-employee directors, the exchange of such stock options for new options is subject to stockholder approval.

Note 14 — Litigation and Contingencies

The Company is the defendant in certain legal actions. In the opinion of management, the outcome of these actions, which is not clearly determinable at the present time, will not have a material adverse impact upon its financial condition.

The Company is self-insured for the initial $1,000,000 for certain general and automobile liability risks through its wholly-owned insurance company subsidiary. The Company is insured through commercial sources for certain environmental impairment risks as well as for certain general and automobile liability umbrella coverages. The present situation does not reflect any record of unfavorable claim experience. The Company provides for losses when identified and evaluated. The Company's historical claim losses have been insignificant.

The following summarizes stock option activity:

	ETC Plan		1986 ETTC Plan	
	Number of Shares	Option Price Per Share	Number of Shares	Option Price Per Share
Outstanding at December 29, 1984	74,936	$.10, $9.00, $9.50	—	—
Exercised	(6,270)	$.10		
Cancelled	(6,000)	$.10 and $9.50		
Granted to give effect to 3-for-2 stock split	31,333			
Outstanding at December 31, 1985	93,999	$6.00 and $6.33	—	—
Granted	—		932,740	$25.25 and $27.00
Exercised	(44,500)	$6.00 and $6.33	—	
Cancelled	(9,000)	$6.00	(44,050)	$25.25 and $27.00
Outstanding at December 31, 1986	40,499	$6.00 and $6.33	888,690	$25.25 and $27.00
Granted	—		751,900	$10.75 and $11.00
Exercised	(27,000)	$6.33	(31,960)	$25.25 and $28.50
Cancelled	(6,500)	$6.00	(291,990)	$10.75 and $11.00
Outstanding at December 31, 1987:	6,999	$6.33	1,316,640	$10.75, $11.00, $25.25
Exercisable at December 31, 1987:	6,999	$6.33	71,400	$10.75, $11.00, $25.25
To become exercisable in 1988:	—		611,560	$10.75 and $11.00
To become exercisable in 1989:	—		250,200	$10.75 and $11.00
To become exercisable in 1990:	—		247,200	$10.75 and $11.00
To become exercisable in 1991:	—		136,280	$10.75 and $11.00
	6,999	$6.33	1,316,640	$10.75, $11.00, $25.25

Report of Independent Accountants

Board of Directors and Stockholders
Environmental Treatment and Technologies Corp.

We have examined the consolidated balance sheets of Environmental Treatment and Technologies Corp. and subsidiaries as of December 31, 1987, 1986, and 1985 and the related consolidated statements of income, changes in stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Environmental Testing and Certification Corporation (ETC) for the year ended December 31, 1985, a consolidated subsidiary combined in a pooling of interest transaction, which statements reflect total assets and total revenues consisting of 40 % and 20 %, respectively, of the related consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us and our opinion expressed in the following paragraph, insofar as it relates to 1985 amounts included for ETC, is based solely on the report of the other auditors.

In our opinion, based upon our examinations and the aforementioned report of other auditors, the financial statements referred to above present fairly the consolidated financial position of Environmental Treatment and Technologies Corp. and subsidiaries at December 31, 1987, 1986, and 1985, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney

Columbus, Ohio
February 5, 1988

Five Year Summary of Results of Operations

(In Thousands, Except Per Share Data)

Years Ended December 31	1987	1986	1985	1984	1983
Gross revenues	$137,027	$101,420	$82,790	$55,786	$35,462
Less: direct subcontract costs	38,595	25,131	15,728	9,982	5,687
Net revenues	98,432	76,289	67,062	45,804	29,775
Cost of services	62,252	42,771	34,942	24,525	16,872
Gross Profit	36,180	33,518	32,120	21,279	12,903
Selling, general and administrative expenses	30,543	24,151	21,679	14,685	10,373
Operating Income	5,637	9,367	10,441	6,594	2,530
Other (income) expenses:					
Investment income	(1,657)	(1,109)	(1,241)	(487)	(657)
Interest expense	4,637	2,220	1,562	1,209	1,238
Nonrecurring affiliation costs	—	2,239	—	—	—
Miscellaneous, net	(1,151)	25	34	(20)	90
	1,829	3,375	355	702	671
Income Before Income Taxes And Extraordinary Credit	3,808	5,992	10,086	5,892	1,859
Income taxes	1,390	3,483	4,685	2,641	928
Income Before Extraordinary Credit	2,418	2,509	5,401	3,251	931
Extraordinary credit	—	276	1,613	160	—
Net Income	$ 2,418	$ 2,785	$ 7,014	$ 3,411	$ 931
Net income per share:					
Before extraordinary credit	$ 0.20	$ 0.21	$ 0.47	$ 0.34	$ 0.10
Extraordinary credit	—	0.02	0.14	0.02	—
	$ 0.20	$ 0.23	$ 0.61	$ 0.36	$ 0.10
Weighted average number of common and common equivalent shares outstanding	12,021	11,891	11,448	9,445	9,379

Five Year Summary of Financial Position

(In Thousands)

December 31	1987	1986	1985	1984	1983
Working Capital	$ 43,122	$ 52,807	$19,543	$ 8,015	$ 6,049
Total Assets	122,181	114,394	58,312	32,279	25,422
Noncurrent Liabilities	59,108	59,593	10,579	9,940	8,496
Stockholders' Equity	36,970	34,677	28,933	12,001	10,358

Officers and Directors of ETTC

OFFICERS

James L. Kirk
Chairman of the Board, President and Chief Executive Officer

Ira O. Kane
Executive Vice President

Gene J. Ostrow
Vice President and Chief Financial Officer

Swep T. Davis
Vice President, Analytical Services

Mark H. Shipps
Vice President, Remediation Services

Randall M. Walters
Vice President, General Counsel and Secretary

Pamela K.M. Beall
Treasurer and Assistant Secretary

Daniel P. Buettin
Controller

Dr. Fred H. Halvorsen
Vice President, Health and Safety

Frank A. McBride, III
Vice President, Northeast Region

DIRECTORS

James L. Kirk
Chairman of the Board, President and Chief Executive Officer

Douglas M. Costle
Dean of the Vermont Law School

Elmer A. Graham
Chairman of Graham & Carey, Inc., Financial Consultants

Ira O. Kane
Executive Vice President, President and Chief Executive Officer of OHM

Joseph R. Kirk
Executive Vice President of OHM

Dan W. Lufkin
Private Investor

Richard W. Pogue
Managing Partner of Jones, Day, Reavis & Pogue

Charles W. Schmidt
Senior Vice President and Group Executive of Raytheon Company

BOARD COMMITTEES

1 Audit Committee
Elmer A. Graham
Chairman
Douglas M. Costle
Charles W. Schmidt

2 Compensation Committee
Richard W. Pogue
Chairman
Elmer A. Graham
Dan W. Lufkin

3 Executive Committee
James L. Kirk
Elmer A. Graham
Dan W. Lufkin

4 Stock Option Committee
Elmer A. Graham
Dan W. Lufkin
Richard W. Pogue

Shareholder Information

Annual Meeting
The Annual Meeting of Shareholders of Environmental Treatment and Technologies Corp., will be held May 11, 1988, at the Company's Headquarters, 16406 U.S. Route 224 East, Findlay, Ohio

Form 10-K
Shareholders may request, without charge, Form 10-K, which the Company submits to the Securities and Exchange Commission, by writing:
Pamela K.M. Beall
Treasurer and Assistant Secretary
Environmental Treatment and Technologies Corp.
16406 U.S. Route 224 East
P.O. Box 551
Findlay, Ohio 45839-0551

Transfer Agent and Registrar
Midlantic National Bank
499 Thornall Street
Edison, New Jersey 08818

Corporate Offices
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Findlay, Ohio 45839-0551
419-423-3529

ETTC Facilities

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Findlay, OH 45839-0551
(419) 423-3529

O.H. Materials Corp.
16406 U.S Route 224 East
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Findlay, OH 45839-0551
(419) 423-3526

Environmental Testing and Certification Corp.
284 Raritan Center Parkway
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Edison, NJ 08818-7808
(201) 225-6700

Laboratories
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Edison, NJ 08818-7808

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Santa Rosa, CA 95401

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Westport Commercial Park
Port Allen, LA 70767

3245 Winpark Drive
New Hope, MN 55427

405 Mohawk Road
Clermont, FL 32711

16406 U.S. Route 224 East
Findlay, OH 45840

Remediation Service Centers

Midwest Region and Ohio Division
16406 U.S. Route 224 East
P.O. Box 551
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(419) 423-3526

Illinois Division
1334 Enterprise Drive
Romeoville, IL 60441

Michigan Division
2615 Taylor Street
Lansing, MI 48906

Minnesota Division
3241 Winpark Drive
New Hope, MN 55427

Missouri Division
291 Indacom Drive
St. Peters, MO 63376

Pennsylvania Division
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West Elizabeth, PA 15088-0657

Northeast Region and New Jersey Division
Windsor Industrial Park
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Massachusetts Division
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Virginia Division
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Southern Region
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Clermont, FL 32711

Georgia Division
90 Almon Road
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Louisiana Division
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