

FORM 10-K
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act Of 1934 For the fiscal year ended February 23, 2001

or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 [no fee required]

For the transition period from _____ to _____.

Commission File Number 1-10655

ENVIRONMENTAL TECTONICS CORPORATION

(Exact name of small business issuer in its charter)

Pennsylvania

23-1714256

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

County Line Industrial Park
Southampton, Pennsylvania

18966

(Address of principal executive offices)

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value \$.05 per share

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: None

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

Yes

No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of May 21, 2001, the aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant was approximately \$28,536,000. As of May 21, 2001, there were 7,133,914 shares of Registrant's common stock, \$0.05 par value per share, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE. Portions of Registrant's 2001 Annual Report to Stockholders (the "Annual Report") are incorporated by reference in Part II, Items 5, 6, 7, and 8. Portions of the Registrant's Proxy Statement to be used in

connection with its 2001 Annual Meeting of Shareholders is incorporated herein by reference in Part III, Item II.

FORWARD-LOOKING STATEMENTS

Except for historical information, this report may be deemed to contain "forward-looking" statements. The Company desires to avail itself of the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995 (the "Act") and is including this cautionary statement for the express purpose of availing itself of the protection afforded by the Act.

These forward-looking statements include statements with respect to the Company's vision, mission, strategies, goals, beliefs, plans, objectives, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business of the Company, including but not limited to, (i) projections of revenues, costs of raw materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, the effect of currency fluctuations, capital structure and other financial items, (ii) statements of plans and objectives of the Company or its management or board of directors, including the introduction of new products, or estimates or predictions of actions by customers, suppliers, competitors or regulating authorities, (iii) statements of future economic performance, (iv) statements of assumptions and other statements about the Company or its business, and (v) statements preceded by, followed by or that include the words, "may," "could," "should," "pro forma," "looking forward," "would," "believe," "expect," "anticipate," "estimate," "intend," "plan," or similar expressions. These forward-looking statements involve risks and uncertainties, which are subject to change based on various important factors (some of which, in whole or in part, are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the goals, plans, objectives, intentions and expectations expressed in such forward-looking statements: (1) the strength of the United States and global economies in general and the strength of the regional and local economies in which the Company conducts operations; (2) the effects of, and changes in, U.S. and foreign governmental trade, monetary and fiscal policies and laws; (3) the import of domestic or foreign military or political conflicts and turmoil; (4) the timely development of competitive new products and services by the Company and the acceptance of such products and services by customers; (5) willingness of customers to substitute competitors' products and services and vice versa; (6) the impact on operations of changes in U.S. and governmental laws and public policy, including environmental regulations; (7) the level of export sales impacted by export controls, changes in legal and regulatory requirements; policy changes affecting the markets, changes in tax laws and tariffs, exchange rate fluctuations, political and economic instability, and accounts receivable collection; (8) technological changes; (9) regulatory or judicial proceedings; (10) the impact of any current or future litigation involving the Company; and (11) the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

PART I

Item 1. Business

(a) Business Development

Environmental Tectonics Corporation ("ETC" or the "Company"), a Pennsylvania corporation, incorporated in 1969, is principally engaged in the design, manufacture and sale of software driven products used to A) create and monitor the physiological effects of motion on humans and equipment and B) control, modify, simulate and measure environmental conditions. These products include aircrew training systems, entertainment products, sterilizers, environmental and hyperbaric chambers, and other products, which involve similar manufacturing techniques and engineering technologies.

Since February 25, 2000, there has been no material change in the Company's mode of conducting business.

(b) Business of the Company

The company operates in two primary business segments, Aircrew Training Systems ("ATS") and Industrial Group.

Aircrew Training Systems. This segment includes three primary product groups.

The Company's aircrew training devices are used for medical research, advanced flight training, and for the indoctrination and testing of military and commercial pilots. The major devices sold in this product area are commercial flight simulators, night vision trainers, water survival training equipment, disorientation training equipment, human centrifuges, ejection seat trainers and vehicle and tank simulators. The Company provides operation and maintenance services for installed equipment it manufactures as well as equipment produced by others.

The Company's entertainment products consist of motion-based simulation rides and other products.

The Company's Disaster Management Systems line includes real-time interactive training programs that allow instruction on various disaster situations.

The aircrew training system class of products as a whole represented 73%, 76% and 84% of consolidated revenues of the Company for the years ended February 23, 2001, February 25, 2000 and February 26, 1999, respectively.

Industrial Group. This segment includes three primary product lines:

Sterilizers. The Company manufactures steam and gas sterilizers used for various industrial and pharmaceutical applications. The Company concentrates on marketing the larger custom-designed sterilizers to the pharmaceutical and medical device industries.

Environmental Systems and Other Products. The Company's environmental systems business consists of the design and fabrication of sampling and analysis systems, and test equipment and systems. The simulation systems generally consist of an enclosed chamber with instrumentation and equipment which enable the customer to control and modify such environmental factors as temperature, pressure, humidity, wind velocity and gas content to produce desired conditions. These products include controlled air systems for automotive companies and environmental chambers

The Company's Hyperbaric line includes monoplace and multiplace chambers for decompression and wound care applications.

Sales in this class of products were 27%, 24% and 16% of consolidated revenues of the Company for the years ended February 23, 2001, February 25, 2000 and February 26, 1999, respectively.

The Company also provides control operator repair and upgrades and maintenance service for its own and other manufacturers' equipment.

Marketing

The Company currently markets its products and services primarily through its sales offices and employees. At February 23, 2001, approximately 20 employees were committed to sales and marketing functions. The Company uses branch offices in the United Kingdom, the Middle East, and Asia as well as the services of approximately 100 independent sales organizations in seeking foreign orders for its products.

Product Development

New products and improvements in existing products are being continually developed in response to inquiries from customers and to management's determination that particular products should be produced or significantly improved. Although the Company does not have a separate research and development group, there are a few technical personnel whose main activity is the development and integration of new technologies into our existing products. These personnel include the Vice-President of Engineering and the Vice-President of New Product Development whose additional activity is the introduction of product extensions and new applications of existing technology.

Within the Aircrew Training Segment, product development emphasizes enhancing control systems and software graphics and exploring commercial possibilities. The Company's product development efforts will be focused on three areas:

- Disaster Management Simulation. The Company is in production of a major contract from the City of Chicago to develop, install and maintain a computer-based Incident Command Simulator. The company will continue to explore product applications and extensions to this Intelligent Virtual Reality product.
- G-force and Disorientation trainers. The Company is introducing a new second generation General Aviation Trainer (GAT II). Aimed at the commercial aviation market, the GAT II simulates the cockpit controls, displays and flight characteristics of general aviation private aircraft, business aircraft and helicopters. The GAT II will integrate portions of the "Pro-Pilot" flight simulation software game.
- Entertainment. The Company is evaluating product extensions to motion based amusement rides.

On April 16, 1999, the Company formed a new wholly owned subsidiary, Entertainment Technology Corporation, to handle all of the Company's future entertainment projects. Product development in this class will emphasize entertainment applications of our proven ATS simulation technology.

The Company reported research and development costs of \$903,000, \$920,000 and \$397,000 for the years ended February 23, 2001, February 25, 2000 and February 26, 1999, respectively. However, most of the cost of the Company's research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates.

Supplies

The components being used in the assembly of systems and the parts used to manufacture the Company's products are purchased from equipment manufacturers, electronics supply firms and others. To date, the Company has had no difficulty in obtaining supplies. Further, all raw materials, parts, components, and other supplies used by the Company in the manufacture of its products can be obtained at competitive prices from alternate sources should existing sources of supply become unavailable.

Patents and Trademarks

The Company has no patents or trademarks which it considers significant to its operations, except a patent on the GYROLAB Spatial Disorientation Trainer, which expires in December 2004.

Customers

In the current year and recent past, it has been the Company's

experience that a substantial portion of sales are made to a small number of customers that vary within any given year. The Company's business does not depend upon repeat orders from these same customers. Sales of aircrew training systems are made principally to U.S. and foreign governmental agencies. Sales of sterilizers and environmental systems are made to commercial and governmental entities worldwide.

In fiscal 2001, the Company's major customers included the United Kingdom Ministry of Defense representing \$5,524,000 and the Walt Disney companies, representing \$8,400,000 of revenues, respectively. These companies do not have any relationship with the Company other than as customers.

Foreign and Domestic Operations and Export Sales

During the years ended February 23, 2001, February 25, 2000 and February 26, 1999, approximately \$916,000 (3%), \$1,587,000 (5%) and \$1,158,000 (4%), respectively, of the Company's net revenues were attributable to contracts with agencies of the U.S. Government or with other customers who had prime contracts with agencies of the U.S. government.

During the years ended February 23, 2001, February 25, 2000 and February 26, 1999, \$16,404,000 (51%), \$23,907,000 (69%) and \$22,876,000 (78%), respectively, of the Company's net revenues were attributable to export sales or sales for export. (See Note 11 to the Company's consolidated financial statements incorporated herein by reference to the Annual Report.) On export sales, customers' obligations to the Company are normally secured by irrevocable letters of credit based on the credit worthiness of the customer.

The Company does not believe that the distribution of its sales for any particular period is necessarily indicative of the distribution expected for any other period.

A large portion of the Company's sales is under long-term contracts requiring more than one year to complete. The Company accounts for sales under long-term contracts on the percentage of completion basis. See Note 1 to consolidated financial statements.

The Company's U.S. Government contracts contain standard terms permitting termination for the convenience of the Government. In the event of termination of such contracts, the Company is entitled to receive reimbursement on the basis of work completed (cost incurred plus a reasonable profit), recording the amounts anticipated to be recovered from termination claims in income as soon as those amounts can be reasonably determined rather than at the time of final settlement. All costs applicable to a termination claim are charged as an offsetting expense concurrently with the recognition of income from the claim.

Backlog

The Company's sales backlog at February 23, 2001, and February 25, 2000, for work to be performed and revenue to be recognized under written agreements after such dates was \$40,439,000 and \$44,146,000, respectively. In addition, the Company's training and maintenance contracts backlog at February 23, 2001 and February 25, 2000, for work to be performed and revenue to be recognized after that date under written agreements was approximately \$1,347,000 and \$1,288,000, respectively. Of the February 23, 2001 backlog, approximately \$32,799,000 is under contracts for aircrew training systems and maintenance support including \$23,627,000 for the Walt Disney companies. Approximately 79% of the February 23, 2001, backlog is expected to be completed prior to February 24, 2002.

Competition

The Company's business strategy in recent years has been to seek niche markets in which there are not numerous competitors. However, in some areas of its business the Company competes with well-established firms, some of which have substantially greater financial and personnel resources.

Some competitor firms have technical expertise and production capabilities in one or more of the areas involved in the design and production of physiological flight training equipment, environmental systems, and other specially designed products, and compete with the Company for this business. The competition for any particular project generally is determined by the technological requirements of the project, with consideration also being given to a bidder's reliability, product performance, past performance, and price.

The Company faces particularly intense competition from a number of firms in the sale of hospital sterilizers but faces less competition in the sale of the larger custom-designed industrial sterilizers.

The Company believes that it is a significant participant in the markets in which it competes, especially in aircrew training systems in which the Company believes it is a principal provider of this type of equipment and training in its market area.

Compliance with Environmental Laws

The Company has not incurred during fiscal 2001 nor does it anticipate incurring during fiscal 2002 any material capital expenditures to maintain compliance with Federal, state and local statutes, rules and regulations concerning the discharge of materials into the environment, nor does the Company anticipate that compliance with these provisions will have a material adverse effect on its earnings or competitive position.

Employees

On February 23, 2001, the Company had 307 full-time employees, of whom 6 were employed in executive positions, 88 were engineers, engineering designers, or draftspeople, 56 were administrative (sales, accounting, etc.) and clerical personnel, and 137 were engaged principally in production and operations.

Item 2. Property

The Company owns its executive offices and principal production facilities located on a 5-acre site in the County Line Industrial Park, Southampton, Pennsylvania in an approximately 100,000 square foot steel and masonry building. Approximately 85,000 square feet are devoted to manufacturing, and 15,000 square feet to office space. The original building was erected in 1969 and additions were made in 1973, 1976, 1985, 1991 and 2000. This property serves as collateral for the Company's revolving credit facility. Additionally, the Company rents office space at various sales and support locations throughout the world and at its Polish subsidiary.

The Company considers its machinery and plant to be in satisfactory operating condition. Increases in the level of operations beyond that expected in the current fiscal year might require the Company to obtain additional facilities and equipment.

Item 3. Legal Proceedings

Certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against the Company. In the opinion of management, all such matters are reserved for or are adequately covered by insurance or, if not so covered, are without merit or are of such kind, or involve such amounts as would not have a material adverse effect on the financial position of the Company if resolved unfavorably.

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

None.

PART II

Item 5. Market for the Registrant's Common Stock and Related Security Holder Matters

See information appearing under the heading "Market for the Registrant's Common Stock and Related Stockholder Matters" in the Annual Report attached hereto as Exhibit 13 and incorporated herein by reference.

Item 6. Selected Financial Data

See information appearing under the heading "Financial Review" in the Annual Report attached hereto as Exhibit 13 and incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

See information appearing under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report attached hereto as Exhibit 13 and incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements

See the information appearing under the headings "Consolidated Financial Statements" and "Notes to Consolidated Financial Statements" in the Annual Report attached hereto as Exhibit 13 and incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

The following table sets forth certain information with respect to the directors and executive officers of the Registrant:

Name	Age	Served as Director or Officer Since (1)	Principal Occupations and Positions and Offices with the Company
William F. Mitchell(2)	59	1969	Chairman of the Board, President and Director
Richard E. McAdams(3)	65	1985	Executive Vice President and Director
Philip L. Wagner, Ph.D.(4)	64	1993	Director
Pete L. Stephens, M.D.(5)	63	1974	Director
David Lazar(6)	44	2000	Director
Duane D. Deaner(7)	53	1996	Chief Financial Officer

- (1) Directors serve one-year terms.
- (2) Mr. Mitchell has been Chairman of the Board, President and Chief Executive Officer of the Company since 1969, except for the period from January 24, 1986 through January 24, 1987, when he was engaged principally in soliciting sales for the Company's products in the overseas markets.
- (3) Mr. McAdams has been with the Company since 1970. He became a Vice President in 1978 with responsibility for contract administration. Mr. McAdams became Executive Vice President of the Company in 1990.
- (4) Dr. Wagner is an organic chemist with over 30 years of diversified experience managing research and development and new business development at E.I. du Pont de Nemours & Company and thereafter founded Chadds Ford Technologies, Inc., a consulting firm. He is currently President of Chadds Ford Technologies, Inc.
- (5) Dr. Stephens has been a physician engaged in the private practice of medicine for 30 years.
- (6) Since February 1, 1993, Mr. Lazar has served as Managing Director of Berwind Financial, L.P., and since June 1999, co-head of Berwind's Investment Bank, specializing in investment banking services to both privately held and publicly-traded companies. He also heads the firm's Financial Services group. Prior to Berwind, Mr. Lazar served as President, Ryan, Beck & Co./Mid-Atlantic, a regional investment banking firm specializing in the financial services industry. Mr. Lazar holds an MBA from the College of William and Mary Graduate School of Business Administration and a B.S. from Duke University. He also serves as an advisory director of First Virtual, Inc., a Florida based internet company that provides financial services.
- (7) Mr. Deaner has served as Chief Financial Officer of the Company since January 1996. Mr. Deaner served as Vice President of Finance for Pennfield Precision Incorporated from September 1988 to December 1995.

Committees of the Board of Directors

During the year ended February 23, 2001, the Company had an Audit Committee consisting of the following directors: Messrs. Lazar, Philip L. Wagner and Dr. Pete L. Stephens. The independent outside directors also served on the Company's Compensation Committee during the year ended February 23, 2001. The Audit Committee is charged with reviewing and overseeing the Company's financial systems and internal control procedures and conferring with the Company's independent accountants with respect thereto. The Compensation Committee is charged with reviewing the compensation and incentive plans of officers and key personnel.

During the year ended February 23, 2001, the Board of Directors held 2 meetings and the Audit Committee and Compensation Committee each held 1 meeting. All members of the Board attended all of the meetings of the Board held while they were members of the Board. All members of the Audit Committee and Compensation Committee attended all meetings of the Committee held while they were members thereof.

Compliance With Section 16(a) of the Exchange Act

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission ("SEC") and the American Stock Exchange. Officers, directors and greater than ten percent shareholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) Forms they file. The rules of the SEC regarding the filing of such statement require that "late filings" of such statements be disclosed in the Company's proxy statement.

Based solely on its review of the copies of such forms received by it, or written representations from certain reporting persons that no Forms 5 were required for those persons, the Company believes that, during the fiscal year ended February 25, 2000, its officers, directors and greater than ten percent beneficial owners complied with all applicable filing requirements.

Item 11. Executive Compensation

REMUNERATION OF DIRECTORS AND OFFICERS

The following table sets forth compensation paid by the Company to the Chief Executive Officer for services rendered during fiscal years 2001, 2000, 1999. There are no other executive officers whose total annual salary and bonus exceeds \$100,000. The footnotes to the table provide additional information concerning the Company's compensation and benefit programs.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Fiscal Year	Salary (\$)	Bonus (\$)	Annual Compensation	
				Other Annual Compensation (\$)(1)	All Other Compensation (\$)(2)
William F. Mitchell, President and Chief Executive Officer	2001	\$225,000	\$ 10,969(1) (4)	--	\$4,000
	2000	225,000	\$ 12,023(1) (4)	--	3,876
	1999	207,085	126,563	--	3,876

(1) The Company's executive officers receive certain perquisites. For fiscal years 2001, 2000 and 1999, the perquisites received by Mr. Mitchell did not exceed the lesser of \$50,000 or 10% of his salary and bonus.

(2) These amounts represent the Company's contribution to the Retirement Savings Plan.

Directors of the Company who are not officers of the Company are paid \$600 for Board of Directors meetings which they attend. Additional compensation is not paid for committee meetings.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth as of May 21, 2001, the number of shares and percentage of the Company's Common Stock owned beneficially by each director, each executive officer named in the Summary Compensation Table, and each person holding, to the Company's knowledge, more than 5% of the outstanding Common Stock. The table also sets forth the holdings of all directors and executive officers as a group.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
William F. Mitchell (1) c/o Environmental Tectonics Corporation County Line Industrial Park Southampton, PA 18966	1,752,998	24.6%
Pete L. Stephens, M.D. (2) 31 Ribaut Drive Hilton Head Island, SC 29926	675,800 (3)	9.5%
Richard E. McAdams (2)	38,992 (4)	*

c/o Environmental Tectonics
 Corporation
 County Line Industrial Park
 Southampton, PA 18966

Philip L. Wagner, Ph.D. (2) 201 Sandfiddler East P.O. Box 4603 Emerald Isle, NC 28594	12,000 (5)	*
David P. Lazar (2) C/o Berwind Financial, L.P. 3000 Centre Square West 1500 Market Street Philadelphia, PA 19102	0	*
FINOVA Mezzanine Capital 500 Church Street, Suite 200 Nashville, TN 37219	832,800 (6)	11.2%
Emerald Advisors, Inc. 1857 William Penn Way P.O. Box 10666 Lancaster, PA 17605-0666	1,051,513 (7)	14.7%
All directors, and executive officers as a group (6 persons)	2,483,540 (8)	34.7%

* less than 1%

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- (1) Chairman of the Board, President and Director of the Corporation. Shares of Common Stock include 192,000 shares held by Mr. Mitchell's wife.
 - (2) Director of the Corporation.
 - (3) Includes 25,500 shares held by or for the benefit of Dr. Stephens' wife and two of his children.
 - (4) Includes options to purchase 21,250 shares of Common Stock held under the Company's Incentive Stock Option Plan which are presently exercisable.
 - (5) Includes 8,000 shares of Common Stock held by or for the benefit of Dr. Wagner's wife.
 - (6) These shares include 332,820 shares of Common Stock underlying a presently exercisable warrant to purchase shares of Common Stock.
 - (7) As reported in a Schedule 13G, dated December 31, 2000, filed by Emerald Advisors, Inc., Emerald has sole voting power with respect to 743,273 shares of Common Stock and sole dispositive power over 308,240 shares of Common Stock.
 - (8) Includes options to purchase 21,250 and 3,750 shares of Common Stock which may be acquired by Director McAdams and Duane Deaner, Chief Financial Officer, respectively, upon the exercise of options granted under the Company's Incentive Stock Option Plan.

Item 13. Certain Relationships and Related Transactions

None

Item 14. Exhibits and Reports on Form 8-K

(a) Exhibits:

Number	Item
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- 3.1 Registrant's Articles of Incorporation, as amended, were filed as Exhibit 3.1. to Registrant's Form 10-K for the year ended February 28, 1997 and are incorporated herein by reference.
- 3.2 Registrant's By-Laws, as amended, were filed as Exhibit 3(ii) to Registrant's Form 10-K for the year ended February 25, 1994 and are incorporated herein by reference.
- 4.1 12% Subordinated Debenture due March 27, 2004 was filed as Exhibit 4.1 to Registrant's Form 10-K for the year ended February 28, 1997 and is incorporated herein by reference.
- 10.1 Registrant's 1988 Incentive Stock Option Plan was filed as Exhibit 10(v) to Registrant's Form 10-K for the year ended February 23, 1990 and is incorporated herein by reference.*
- 10.2 Registrant's Employee Stock Purchase Plan was filed on July 6, 1988 as Exhibit A to the Prospectus included in Registrant's Registration Statement (File No. 33-42219) on Form S-8 and is incorporated herein by reference.*
- 10.3 Registrant's Stock Award Plan adopted April 7, 1993, filed as Exhibit 10(ix) to the Registrant's Form 10-K for the fiscal year ended February 25, 1994 and is incorporated herein by reference.*
- 10.4 Form of 1996 Warrant Agreement between the Registrant and Chase Manhattan Capital Corporation, filed as Exhibit 10(xiv) to the Registrant's Form 10-KSB for the fiscal year ended February 23, 1996 and is incorporated herein by reference.
- 10.5 Revolving Credit Agreement, dated as of March 27, 1997, between the Registrant and First Union National Bank was filed as Exhibit 10.6 to Registrant's Form 10-K for the year ended February 28, 1997 and is incorporated herein by reference.
- 10.6 Amendment to Revolving Credit Agreement dated as of November 28, 1997 and is incorporated herein by reference.
- 10.7 Debenture Purchase Agreement, dated March 27, 1997, between the Registrant and Sirrom Capital Corporation was filed as Exhibit 10.7 to the Registrant's Form 10-KSB for the fiscal year ended February 28, 1997 and is incorporated herein by reference.
- 10.8 Preferred Stock Purchase Agreement, dated March 27, 1997, between the Registrant and Sirrom Capital Corporation was filed as Exhibit 10.8 to the Registrant's Form 10-KSB for the fiscal year ended February 28, 1997 and is incorporated herein by reference.
- 10.9 Stock Purchase Warrant, dated March 27, 1997, issued by the Registrant to Sirrom Capital Corporation was filed as Exhibit 10.9 to the Registrant's Form 10-KSB for the fiscal year ended February 28, 1997 and is incorporated herein by reference.
- 13 Portions of Registrant's 1999 Annual Report to Shareholders which are incorporated by reference into this Form 10-K.
- 21 List of subsidiaries.
- 23 Consent of Grant Thornton L.L.P.
- 27 Financial Data Schedule

* Represents a management contract or a compensatory plan or arrangement.

(b) Reports on Form 8-K:

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ENVIRONMENTAL TECTONICS CORPORATION

By /s/ William F. Mitchell

William F. Mitchell,
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name -----	Position -----	Date ----
/s/ William F. Mitchell ----- William F. Mitchell	Chairman of the Board, Chief Executive Officer, President and Director	May 24, 2001
/s/ Duane D. Deaner ----- Duane D. Deaner	Chief Financial Officer (Principal Accounting Officer)	May 24, 2001
/s/ Richard E. McAdams ----- Richard E. McAdams	Director	May 24, 2001
/s/ David Lazar ----- David Lazar	Director	May 24, 2001
/s/ Pete L. Stephens ----- Pete L. Stephens, M.D.	Director	May 24, 2001
/s/ Philip L. Wagner ----- Philip L. Wagner, Ph.D.	Director	May 24, 2001

ENVIRONMENTAL TECTONICS CORPORATION AND SUBSIDIARIES
SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
(\$ in thousands)

Column A -----	Column B -----	Column C -----	Column D -----	Column E -----
Description -----	Balance at Beginning of Period -----	Charges/ (Credits) to Costs/ Expenses -----	Reductions (A) -----	Balance At End of Period -----
Year ended February 23, 2001:				
Valuation and qualifying accounts related to:				
Accounts receivables	\$ 367	\$ (3)	\$ --	\$ 370
Inventory	\$ 720	\$ 100	\$ 190	\$ 630
Property, plant and equipment	\$8,004	\$ 631	\$ --	\$8,635
Software development costs	\$5,215	\$ 455	\$ --	\$5,670

Other assets	\$ 61	\$ 35	\$ --	\$ 96
Year ended February 25, 2000				
Valuation and qualifying accounts related to:				
Accounts receivable	\$ 385	\$ --	\$ 18	\$ 367
Inventory	\$ 625	\$ 95	\$ --	\$ 720
Property, plant and equipment	\$7,527	\$ 535	\$ 58	\$8,004
Software development costs	\$4,619	\$ 96	\$ --	\$5,215
Other assets	\$ 25	\$ 36	\$ --	\$ 61
Year ended February 26, 1999				
Valuation and qualifying accounts related to:				
Accounts receivables	\$ 379	\$ 83	\$ 77	\$ 385
Inventory	\$1,040	\$(315)	100	625
Property, plant and equipment	\$6,729	\$ 798	\$ --	\$7,527
Software development costs	\$3,914	\$ 705	\$ --	\$4,619
Other assets	\$ --	\$ 25	\$ --	\$ 25

(A) Amounts written off or retired

EXHIBIT INDEX

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4.1	12% Subordinated Debenture due March 27, 2004 was filed as Exhibit 4.1 to Registrant's Form 10-K for the year ended February 28, 1997 and is incorporated herein by reference.
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10.2	Registrant's Employee Stock Purchase Plan was filed on July 6, 1988 as Exhibit A to the Prospectus included in Registrant's Registration Statement (File No. 33-42219) on Form S-8 and is incorporated herein by reference.*
10.3	Registrant's Stock Award Plan adopted April 7, 1993, filed as Exhibit 10(ix) to the Registrant's Form 10-K for the fiscal year ended February 25, 1994 and is incorporated herein by reference.*
10.4	Form of 1996 Warrant Agreement between the Registrant and Chase Manhattan Capital Corporation, filed as Exhibit 10(xiv) to the Registrant's Form 10-KSB for the fiscal year ended February 23, 1996 and is incorporated herein by reference.
10.5	Revolving Credit Agreement, dated as of March 27, 1997, between the Registrant and First Union National Bank was filed as Exhibit 10.6 to Registrant's Form 10-K for the year ended February 28, 1997 and is incorporated herein by reference.
10.6	Amendment to Revolving Credit Agreement dated as of November 28, 1997

and is incorporated herein by reference.

- 10.7 Debenture Purchase Agreement, dated March 27, 1997, between the Registrant and Sirrom Capital Corporation was filed as Exhibit 10.7 to the Registrant's Form 10-KSB for the fiscal year ended February 28, 1997 and is incorporated herein by reference.
- 10.8 Preferred Stock Purchase Agreement, dated March 27, 1997, between the Registrant and Sirrom Capital Corporation was filed as Exhibit 10.8 to the Registrant's Form 10-KSB for the fiscal year ended February 28, 1997 and is incorporated herein by reference.
- 10.9 Stock Purchase Warrant, dated March 27, 1997, issued by the Registrant to Sirrom Capital Corporation was filed as Exhibit 10.9 to the Registrant's Form 10-KSB for the fiscal year ended February 28, 1997 and is incorporated herein by reference.
- 13 Portions of Registrant's 1999 Annual Report to Shareholders which are incorporated by reference into this Form 10-KSB.
- 21 List of subsidiaries.
- 23 Consent of Grant Thornton L.L.P.
- 27 Financial Data Schedule

* Represents a management contract or a compensatory plan or arrangement.

ENVIRONMENTAL TECTONICS CORPORATION

2001

ANNUAL SHAREHOLDERS' REPORT

FINANCIAL REVIEW

(\$ in thousands, except share and per share data)

Fiscal Year End	2001 ----	2000 ----	1999 ----	1998 ----	1997 ----
Net sales	\$ 32,452	\$ 34,920	\$ 29,225	\$ 29,284	\$ 21,884
Gross profit	13,075	12,798	11,672	9,298	5,742
Operating income	4,122	5,327	4,759	4,208	1,196
Net income (loss)	2,021	2,837	2,170	1,794	(20)
Earnings (loss) per common share:					
Basic	.29	.40	.32	.25	(.01)
Diluted	.27	.36	.29	.23	(.01)
Working capital	25,070	16,306	13,755	11,462	10,334
Long-term obligations	12,778	4,455	4,219	4,356	6,997
Total assets	40,705	31,897	35,448	22,955	23,095
Total stockholders' equity	18,796	16,245	11,030	8,579	6,409
Weighted average common shares:					
Basic	7,087,000	6,604,000	5,861,000	5,981,000	5,930,000
Diluted	7,499,000	7,319,000	6,312,000	6,496,000	5,930,000

All earnings per share and share amounts have been restated to reflect a 2 for 1 stock split effective May 28, 1999. No cash dividends have ever been paid on the Company's common stock, and the Company is currently prohibited from declaring any cash dividends on common stock under the terms of its credit facility.

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

Results of Operations

FORWARD-LOOKING STATEMENTS

Except for historical information, this report may be deemed to contain "forward-looking" statements. The Company desires to avail itself of the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995 (the "Act") and is including this cautionary statement for the express purpose of availing itself of the protection afforded by the Act.

These forward-looking statements includes statements with respect to the Company's vision, mission, strategies, goals, beliefs, plans, objectives,

expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business of the Company, including but not limited to, (i) projections of revenues, costs of raw materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, the effect of currency fluctuations, capital structure and other financial items, (ii) statements of plans and objectives of the Company or its management or board of directors, including the introduction of new products, or estimates or predictions of actions by customers, suppliers, competitors or regulating authorities, (iii) statements of future economic performance, (iv) statements of assumptions and other statements about the Company or its business, and (v) statements preceded by, followed by or that include the words, "may," "could," "should," "pro forma," "looking forward," "would," "believe," "expect," "anticipate," "estimate," "intend," "plan," or similar expressions. These forward-looking statements involve risks and uncertainties, which are subject to change based on various important factors (some of which, in whole or in part, are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the goals, plans, objectives, intentions and expectations expressed in such forward-looking statements: (1) the strength of the United States and global economies in general and the strength of the regional and local economies in which the Company conducts operations; (2) the effects of, and changes in U.S. and foreign governmental trade, monetary and fiscal policies and laws; (3) the impact of domestic or foreign military or political conflicts and turmoil; (4) the timely development of competitive new products and services by the Company and the acceptance of such products and services by customers; (5) willingness of customers to substitute competitors' products and services and vice versa; (6) the impact on operations of changes in U.S. and governmental laws and public policy, including environmental regulations; (7) the level of export sales impacted by export controls, changes in legal and regulatory requirements; policy changes affecting the markets, changes in tax laws and tariffs, exchange rate fluctuations, political and economic instability, and accounts receivable collection; (8) technological changes; (9) regulatory or judicial proceedings; (10) the impact of any current or future litigation involving the Company; and (11) the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

The company had a net income of \$2,021,000 or \$.27 per share (diluted), versus a net income of \$2,837,000 or \$.36 per share (diluted) in 2000. Operating income was \$4,122,000, a decrease of \$1,205,000 or 22.6% over 2000. This decrease was primarily the result of higher general and administrative expenses partially offset by an increased gross margin as the rate as a percentage of sales was up by 3.7 percentage points. The improvement in the gross margin rate as a percentage of sales reflected both an improvement in Entertainment line performance and an overall increase in Aircrew Training Systems gross margin on higher domestic and international claims revenue and corresponding gross margin. Claims bookings for the year increased operating income by \$1,325,000, net of associated manufacturing costs and legal expenses. Included in the above was a claim against an international customer which was settled in the three months ended February 23, 2001.

Total sales decreased \$2,468,000 or 7.1% from 2000 as sales performance was mixed, with the most significant decreases being evidenced in the Company's Polish Subsidiary and Simulation and Hyperbaric product areas. A partial offset was seen in the Environmental, Sterilizer and Entertainment lines (Entertainment was up \$4,719,000 or 128.2%) and sales from the Company's UK Subsidiary, which was purchased in March 2000. Geographically, international sales, including those from the Company's foreign subsidiaries, were down \$7,363,000 or 31.0% and represented 50.6% of total sales, down from 68.5% from the prior year. U.S. Government sales were down \$671,000 or 42.3%, and represented 2.8% of total sales, down from 4.5% from the prior period. Providing a partial offset was an increase in domestic sales, which were up \$5,566,000 or 58.2%, primarily from the aforementioned increase in the Entertainment line. Domestic sales represented 46.6% of the Company's total sales, up from 27.0% in the prior period. Customers in 2001 representing 10% or more of sales were the United

Kingdom Ministry of Defense, \$5,524,000, and the Walt Disney companies, \$8,400,000. Additionally, open orders for the Walt Disney companies constituted 56.5% of the Company's backlog at February 23, 2001.

The Company considers its business activities to be divided into two segments: Aircrew Training Systems (ATS) and Industrial Simulation. On a segment basis, sales of the Company's Aircrew Training Systems (ATS) products, which create and monitor the physiological effects of motion (including spatial disorientation and centrifugal forces) on humans and equipment for medical, training, research and entertainment markets, were \$23,567,000, a decrease of \$2,794,000, or 10.6% over 2000. Sales of these products accounted for 72.6% of the Company's sales compared to 75.5% in 2000. Sales in the Company's other segment, the Industrial Group, which designs and produces chambers that create environments that are used for sterilization, research and medical applications, increased \$326,000 to \$8,885,000, an increase of 3.8%, and constituted 27.4% of the Company's total sales compared to 24.5% in 2000.

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Gross profit increased \$277,000 or 2.2%. As a percentage of sales, gross profit was 40.3%, up from 36.6% in 2000. This increase was attributable to an improvement in the rate as a percentage of sales and higher domestic and international claims revenue and resulting gross margin.

Operating profit decreased \$1,205,000, or 22.6% compared to 2000. On a segment basis, ATS had an operating profit of \$5,794,000, an increase of \$755,000 from the prior period, while the Industrial Group had an operating loss of \$906,000 compared to an operating profit of \$1,355,000 in 2000. These segment operating profits were offset, in part, by unallocated corporate expenses of \$766,000, a decrease of \$170,000 over 2000.

Selling and administrative expenses increased \$1,499,000, or 22.9%, due principally to higher legal expenses to support the Company's domestic and international claims, higher staffing and related expenses in support of the Company's aggressive new initiatives, a corporate-wide ramp-up of worldwide marketing efforts, and additional selling and administrative expenses for the Company's UK subsidiary, which was purchased in March 2000. As a percentage of sales, selling and administrative expenses were 24.8% compared to 18.8% in 2000.

Research and development expenses decreased slightly (\$17,000, 1.8%) from 2000, primarily for ATS and entertainment product applications. Most of the Company's research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates. Capitalized software development costs for 2001 were \$550,000 compared to \$555,000 in 2000. Amortization of software costs, which was charged to cost of sales, was \$455,000 and \$596,000 for 2001 and 2000, respectively.

Interest expense (net of interest income) increased \$87,000 or 11.8% from 2000 reflecting higher borrowings at a higher average rate. Letter of credit and other expenses decreased \$10,000 or 9.2% principally due to decreased bank charges.

The Company's provision for taxes, rate-wise, remained unchanged from the prior year and approximated the statutory rate.

Fiscal 2000 Versus Fiscal 1999

The company had a net income of \$2,837,000 or \$.36 per share (diluted), versus a net income of \$2,170,000 or \$.29 per share (diluted) in 1999. Operating income was \$5,327,000, an increase of \$568,000 or 11.9% over 1999. These increases were primarily the result of a higher gross margin reflecting the increased sales level.

Total sales increased \$5,695,000 or 19.5% from 1999 as sales increases were evidenced in all areas, most significantly in the domestic market, which

was up \$4,209,000, or 80.7%. Domestic sales represented 27.0% of the Company's total sales, up from 17.9% in the prior period. Increases were evidenced across all product areas except hyperbaric, with the most significant increases in entertainment products and the Company's disaster management simulator product. Sales to the U.S. Government increased \$430,000, 37.1%, and represented 4.5% of total sales, up slightly from 4.0% in the prior period. The increase reflected sales to the U.S. Navy for large submarine decompression chambers. International sales, including sales of the Company's Polish subsidiary, increased \$1,056,000, and represented 68.5% of the Company's total sales, down from 78.1% in the prior period. The increase reflected additional sales in the Company's Polish subsidiary, which benefited from an additional 4 months activity in the current period. Customers in 2000 representing 10% or more of sales were Mends International \$8,107,000, the United Kingdom Ministry of Defense \$4,821,000, and the Walt Disney companies \$3,681,000. Additionally, open orders for the Walt Disney companies constituted 56.7% of the Company's backlog at February 25, 2000.

On a segment basis, sales of the Company's Aircrew Training Systems (ATS) products, which create and monitor the physiological effects of motion (including spatial disorientation and centrifugal forces) on humans and equipment for medical, training, research and entertainment markets, were \$26,361,000 an increase of \$1,896,000, or 7.7% over 1999. Sales of these products accounted for 75.5% of the Company's sales compared to 83.7% in 1999. Sales in the Company's other segment, the Industrial Group, which designs and produces chambers that create environments that are used for sterilization, research and medical applications, increased \$3,799,000 or 79.8% and accounted for 24.5% of the Company's total sales compared to 16.3% in 1999.

3

Gross profit increased \$1,126,000 or 9.6%. As a percentage of sales, gross profit was 36.6%, down from 39.9% in 1999. This decrease was attributable to a product mix shift to lower margin Industrial Group products.

Operating profit increased \$568,000, or 11.9% compared to 1999. On a segment basis, ATS had an operating profit of \$5,039,000, a decrease of \$658,000 from the prior period, while the Industrial Group had an operating profit of \$1,355,000 compared to an operating loss of \$89,000 in 1999. These segment operating profits were offset, in part, by unallocated corporate expenses of \$936,000, an increase of \$87,000 over 1999.

Selling and administrative expenses increased \$35,000, or 0.5%, due principally to higher staffing and related expenses in support of the expanded sales activity and additional selling and administrative expenses for the Company's Polish subsidiary which had an additional four months activity in the current period. As a percentage of sales, selling and administrative expenses were 18.8% compared to 22.3% in 1999.

Research and development expenses increased \$523,000, or 131.7% from 1999, primarily for ATS and entertainment product applications. Most of the Company's research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates. Capitalized software development costs for 2000 were \$555,000 compared to \$581,000 in 1999. Amortization of software costs, which was charged to cost of sales, was \$596,000 and \$651,000 for 2000 and 1999, respectively.

Interest expense was down \$386,000, 34.3% from 1999 reflecting lower borrowings. Letter of credit and other expenses decreased \$79,000 principally due to decreased bank charges.

The Company's provision for taxes, rate-wise, remained unchanged from the prior year and approximated the statutory rate.

Fiscal 1999 Versus Fiscal 1998

The Company had a net income of \$2,170,000 or \$.29 per share (diluted), versus a net income of \$1,794,000, or \$.23 per share (diluted) in 1998. Operating income was \$4,759,000, an increase of \$551,000, or 13.1% over 1998. These increases were primarily the result of higher gross margins reflecting increased sales of ATS products.

Total sales decreased slightly \$59,000, .2% from 1998 as decreases domestically and to the U.S. Government were only partially offset by an increase internationally and the addition of sales from the Company's Polish subsidiary purchased in April, 1998. Domestic sales decreased \$3,640,000, 41.1%, and represented 17.9% of the Company's total sales, down from 30.2% in the prior year. The decrease domestically primarily reflected reduced industrial sterilizer sales coupled with decreased sales of the Company's entertainment products. Sales to the U.S. Government decreased \$1,779,000, 60.6% and represented 4.0% of the Company's total sales, down from 10.0% for the prior year. The decrease in U.S. Government sales primarily reflected the completion in the prior year of a large chamber project. International sales, including sales of the Company's Polish subsidiary, increased \$5,360,000, 30.6% and represented 78.1% of the Company's total sales. The increase internationally primarily resulted from additional progress on two large centrifuge projects including a Centrifuge project for the United Kingdom Ministry of Defense (UK MOD). Sales in 1999 to the UK MOD were approximately \$7.0 million or 24.0% of the Company's total sales. Open orders for the UK MOD constituted \$11.1 million of the Company's sales backlog at February 26, 1999.

On a segment basis, sales of the Company's Aircrew Training Systems (ATS) products, which create and monitor the physiological effects of motion (including spatial disorientation and centrifugal forces) on humans and equipment for medical, training, research and entertainment markets were \$24,465,000 an increase of \$2,410,000, or 10.9% over 1998. Sales of these products accounted for 83.7% of the Company's sales compared to 75% in 1998. Sales in the Company's other segment, the Industrial Group, which designs and produces chambers that create environments that are used for sterilization, research and medical applications, decreased \$2,469,000 or 34.2%, and accounted for 16.3% of the Company's total sales compared to 25% in 1998. Although the primary reduction was in sterilizer sales, decreases were evidenced across all product lines for this Group.

4

Gross profit increased \$2,374,000 or 25.5%. As a percentage of sales, gross profit was 39.9% up from 31.8% in 1998. These increases were attributable to a product mix shift to higher margin ATS products.

Operating profit increased \$551,000, or 13.1% compared to 1998. On a segment basis, ATS has an operating profit of \$5,697,000, an increase of \$1,466,000 while the Industrial Group had an operating loss of \$89,000 compared to an operating profit of \$691,000 in 1998. These segment operating profits were offset, in part, by unallocated corporate expenses of \$849,000, an increase of \$135,000 over 1998.

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

Selling and administrative expenses increased \$1,574,000, or 31.8%, due principally to higher commissions expense on higher commissionable sales,

increased government claim expenses, and the addition of selling and administrative expenses for the Company's Polish subsidiary. As a percentage of sales, selling and administrative expenses were 22.3% compared to 16.9% in 1998.

Research and development expenses increased \$249,000, or 168.2% from 1998. Most of the Company's research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates. Capitalized software development costs for 1999 were \$581,000 compared to \$395,000 in 1998. Amortization of software costs, which was charged to cost of sales, was \$651,000 and \$670,000 for 1999 and 1998, respectively.

Interest expense was down \$120,000, 9.6% from 1998 reflecting a lower average interest rate. Letter of credit and other expenses decreased \$16,000 principally due to decreased bank charges.

The Company's provision for taxes, rate-wise, remained unchanged from the prior year and approximated the statutory rate.

Liquidity and Capital Resources

At February 23, 2001, the Company had a Credit Agreement with a bank which provided a credit facility of \$15 million. This agreement expires on August 31, 2002. Substantially all of the company's short-term financing is provided by this bank. At February 23, 2001, the Company had \$4,772,000 available under the credit agreement.

During fiscal 2001, the company used \$6,670,000 of cash for operating activities. This was primarily the result of an increase in accounts receivable and reductions in billings in excess of costs and estimated earnings on uncompleted long-term contracts and customer deposits. Partial offsets were provided by net income, non-cash charges, and an increase in accrued liabilities including income taxes. In general, the net use of cash for operations reflected a build up of current assets, primarily accounts receivable (which includes claims receivables) and a decrease in current liabilities, primarily those associated with customer billing and deposits.

Investing activities used \$2,983,000 and consisted of purchases for capital equipment and capitalized software, partially offset by the purchase of ETC Europe.

Financing activities generated \$8,943,000 of cash. This included the net effect of bank borrowing, cash from the issuance of long-term bonds and cash from the issuance of stock partially offset by an increase in restricted cash.

At February 23, 2001, the Company was in violation of one of its Credit Agreement loan covenants, specifically the requirement to maintain a specified Funds Flow Ratio. This violation resulted from the unusually high capital spending in the fiscal period for the Company's modernization program in relation to net income in the fiscal period. Accordingly, the Company received a waiver for this violation at February 23, 2001 from its Bank and also the Bank agreed to adjust this covenant for the period through November 23, 2001.

The Company believes it will be able to meet the revised covenant and also that cash generated from operating activities as well as available borrowing under the Credit Agreement will be sufficient to meet its future obligations.

In reference to the Company's outstanding claims with both the U.S. government and an international customer, to the extent the Company is unsuccessful in further recovery of contract costs, such an event could have a material adverse effect on the Company's liquidity and results of operations. Historically, the Company has had good experience in that recoveries have exceeded claims (see Note 3 of Notes to Consolidated Financial Statements).

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

Market for the Registrant's Common Stock and Related Security Holder Matters

The Company's Common Stock (the Common Stock) is traded on the American Stock Exchange under the symbol ETC. As of May 18, 2001, the Company had 303 shareholders of record.

The following table sets forth the quarterly ranges of high and low sale prices, and the closing sale price, for shares of the Common Stock for the periods indicated. Such prices represent quotations between dealers and do not include mark-ups, markdowns or commissions, and may not necessarily represent actual transactions.

	Sale Prices		Closing Sale Price
	High	Low	
2001			
First Quarter	\$15-5/8	\$7-7/8	\$9-1/2
Second Quarter	10-1/2	8-1/8	9-1/16
Third Quarter	9-3/4	7	7-5/16
Fourth Quarter	8-3/5	6-3/8	8-2/5
2000			
First Quarter	\$14-1/2	\$7-15/16	\$11-7/8
Second Quarter	12-1/8	9	10-11/16
Third Quarter	10-5/8	8-5/8	9-5/8
Fourth Quarter	21	9-3/8	12-7/8

The Company has never paid any cash dividends on the Common Stock in the past and does not anticipate that any cash dividends will be declared or paid in the foreseeable future. The Company's current line of credit facility prohibits the payment of any dividends by the Company without the lender's prior written consent.

Backlog

The Company's sales backlog at February 23, 2001 and February 25, 2000, for work to be performed and revenue to be recognized under written agreements after such dates, was \$40,439,000 and \$44,146,000, respectively. In addition, the Company's training and maintenance contracts backlog at February 23, 2001 and February 25, 2000, for work to be performed and revenue to be recognized after that date under written agreements, was approximately \$1,347,000 and \$1,288,000, respectively. Of the February 23, 2001 backlog, approximately \$32,799,000 was under contracts for ATS and maintenance support including \$23,627,000 for the Walt Disney companies. Approximately 79% of the February 23, 2001 backlog is expected to be completed prior to February 24, 2002.

Board of Directors
Environmental Tectonics Corporation

We have audited the accompanying consolidated balance sheets of Environmental Tectonics Corporation and Subsidiaries as of February 23, 2001 and February 25, 2000, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three fiscal years in the period ended February 23, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Environmental Tectonics Corporation and Subsidiaries as of February 23, 2001 and February 25, 2000, and the consolidated results of their operations and cash flows for each of the three fiscal years in the period ended February 23, 2001, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 3 to the consolidated financial statements, the Company has recorded receivables in the amount of \$11.3 million related to claims made to or against the United States government and an international customer for contract costs incurred through February 23, 2001. The total net claims amount made is approximately \$26.0 million based on costs incurred through February 23, 2001, and is subject to negotiation, arbitration and audit by the U.S. government and the international customer.

Philadelphia, Pennsylvania
April 18, 2001

Consolidated Balance Sheets
(\$ in thousands, except share data)

	February 23, 2001	February 25, 2000
	-----	-----
ASSETS		
Cash and cash equivalents	\$ 851	\$ 1,725
Cash equivalents restricted for letters of credit	544	32
Accounts receivable, net	16,776	10,771
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	9,595	8,878
Inventories	4,624	3,904
Deferred tax asset	615	689
Prepaid expenses and other current assets	423	482
	-----	-----
Total current assets	33,428	26,481
Property, plant and equipment, net	5,337	3,300
Software development costs, net of accumulated amortization of \$ 5,670 and \$ 5,215 in 2001 and 2000, respectively	1,191	1,096
Other assets	749	1,020
	-----	-----

Total assets	\$ 40,705	\$ 31,897
=====		
LIABILITIES		
Current portion of long-term obligations	\$ 643	\$ 78
Accounts payable - trade	1,929	1,830
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	1,712	3,282
Customer deposits	1,443	2,935
Accrued income taxes	754	455
Accrued commissions	668	517
Other accrued liabilities	1,209	1,078
Total current liabilities	8,358	10,175

Long-term obligations, less current portion:		
Credit facility payable to banks	7,564	4,093
Long Term Bonds	5,195	-
Subordinated debt	-	350
Other	19	12
	12,778	4,455

Deferred tax liability	674	652

Total liabilities	21,810	15,282

Minority Interest	99	370

STOCKHOLDERS' EQUITY		
Common stock - authorized 20,000,000 shares, \$.05 par value; 7,110,546 and 6,864,280 shares issued and outstanding in 2001 and 2000, respectively	355	343
Capital contributed in excess of par value of common stock	6,514	5,832
Accumulated other comprehensive loss	(226)	(62)
Retained earnings	12,153	10,132

Total stockholders' equity	18,796	16,245

Total liabilities and stockholders' equity	\$ 40,705	\$ 31,897
=====		

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

Consolidated Statements of Operations
(\$ in thousands, except share data)

	Year Ended February 23, 2001	Year Ended February 25, 2000	Year Ended February 26, 1999
	-----	-----	-----
Net sales	\$ 32,452	\$ 34,920	\$ 29,225
Cost of goods sold	19,377	22,122	17,553
Gross profit	13,075	12,798	11,672

Operating expenses:			
Selling and administrative	8,050	6,551	6,516
Research and development	903	920	397
	8,953	7,471	6,913

Operating income	4,122	5,327	4,759

Other expenses:			
Interest expense (net)	825	738	1,124
Letter of credit fees	65	53	26
Other, net	34	56	162
	924	847	1,312

Income before provision for income taxes and minority interest	3,198	4,480	3,447
Provision for income taxes	1,126	1,573	1,201

Income before minority interest	\$ 2,072	\$ 2,907	\$ 2,246
=====			
Income attributable to minority interest	51	70	76
Net income	\$ 2,021	\$ 2,837	\$ 2,170

Per share information Earnings per common share:			
Basic	\$.29	\$.40	\$.32
Diluted	\$.27	\$.36	\$.29

Income available to common stockholders	\$ 2,021	\$ 2,671	\$ 1,853
Weighted average common shares:			
Basic	7,087,000	6,604,000	5,861,000
Diluted	7,499,000	7,319,000	6,312,000

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

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Consolidated Statements of Changes in Stockholders' Equity
(\$ in thousands, except share data)

For the years ended February 23, 2001, February 25, 2000, and February 26, 1999

	Common stock		Capital contributed in excess of par value of common stock	Accumulated other comprehensive income (loss)	Retained earnings	Total stockholders' equity
	Shares	Amount				
Balance, February 27, 1998	3,006,596	\$ 300	\$ 2,671	\$ -	\$ 5,608	\$ 8,579
Net income for the year	-	-	-	-	2,170	2,170
Other comprehensive income	-	-	-	21	-	21
Total comprehensive income	-	-	-	21	2,170	2,191
Stock issued in connection with acquisition	55,000	6	489	-	-	495
Accretion of preferred stock	-	-	-	-	(42)	(42)
Dividends on preferred stock	-	-	-	-	(275)	(275)
Shares issued in connection with employee stock purchase and stock option plans	21,610	2	80	-	-	82
Balance, February 26, 1999	3,083,206	\$ 308	\$ 3,240	\$ 21	\$ 7,461	\$11,030
Net income for the year	-	-	-	-	2,837	2,837
Other comprehensive loss	-	-	-	(83)	-	(83)
Total comprehensive income	-	-	-	(83)	2,837	2,754
Stock split effective May 28, 1999	3,083,206	-	-	-	-	-
Dividend on preferred stock	-	-	-	-	(38)	(38)
Accretion of preferred stock	-	-	-	-	(128)	(128)
Shares issued in connection with conversion of preferred stock	666,666	33	2,467	-	-	2,500
Shares issued in connection with employee stock purchase and stock option plans	31,202	2	125	-	-	127
Balance, February 25, 2000	6,864,280	\$ 343	\$ 5,832	\$ (62)	\$10,132	\$16,245
Net income for the year	-	-	-	-	2,021	2,021
Other comprehensive loss	-	-	-	(164)	-	(164)
Total comprehensive income	-	-	-	(164)	2,021	1,857
Shares issued in connection with conversion of warrants	212,866	10	508	-	-	518
Shares issued in connection with employee stock purchase and stock option plans	33,400	2	174	-	-	176
Balance, February 23, 2001	7,110,546	\$ 355	\$ 6,514	\$ (226)	\$12,153	\$18,796

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

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Consolidated Statements of Cash Flows
(\$ in thousands)

Year Ended February 23, 2001 ----	Year Ended February 25, 2000 ----	Year Ended February 26, 1999 ----
--	--	--

Cash flows from operating activities:			
Net income	\$ 2,021	\$ 2,837	\$ 2,170
Adjustments to reconcile net income to net cash (used in) provided by operating activities			
Depreciation and amortization	1,278	1,395	1,642
Decrease (increase) in allowance for accounts receivable and inventory	(87)	77	(409)
Minority interest	(170)	(6)	76
Changes in operating assets and liabilities:			
(Increase) decrease in assets			
Accounts receivable	(6,007)	(1,097)	(1,202)
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	(717)	1,538	(4,765)
Inventories	(630)	(888)	623
Prepaid expenses and other current assets	5	145	(530)
Other assets	34	(125)	12
Increase (decrease) in liabilities:			
Accounts payable	99	276	112
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(1,570)	(3,493)	5,630
Customer deposits	(1,492)	(2,761)	4,323
Accrued income taxes	291	(465)	(64)
Other accrued liabilities	264	(93)	637
Payments under settlement agreements	(85)	(120)	(120)
Increase (decrease) in deferred income taxes, net	96	397	(366)
Net cash (used in) provided by operating activities	(6,670)	(2,383)	7,769
Cash flows from investing activities:			
Acquisition of equipment	(2,628)	(1,014)	(567)
Software development costs capitalized	(550)	(555)	(581)
Purchase of subsidiary, net of cash acquired	195	-	60
Net cash used in investing activities	(2,983)	(1,569)	(1,088)
Cash flows from financing activities:			
Net borrowings (payments) under credit facility	3,471	4,093	(467)
Proceeds from long-term bonds	5,470	-	-
Net payments on subordinated debt	-	(3,774)	-
Payment of dividends on preferred stock	-	(38)	(275)
Deferred financing costs	(175)	-	-
Decrease (increase) in restricted cash	(512)	15	(32)
Decrease in notes payable - related party	-	-	(800)
Net decrease in other long-term obligations	(5)	(40)	(70)
Proceeds from issuance of common stock/warrants	694	160	82
Net cash provided by (used in) financing activities	8,943	416	(1,562)
Effect of exchange rates on cash	(164)	(83)	21
Net (decrease) increase in cash and cash equivalents	(874)	(3,619)	5,119
Cash and cash equivalents at beginning of year	1,725	5,344	225
Cash and cash equivalents at end of year	\$ 851	\$ 1,725	\$ 5,344
Supplemental schedule of cash flow information:			
Interest paid	\$ 806	\$ 421	\$ 925
Income taxes paid			
Supplemental information on non-cash operating and investing activities:	\$ 649	\$ 1,533	\$ 1,357

During the year ended February 25, 2000, the Company reclassified \$216 from inventory to property, plant and equipment.

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

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

1. Summary of Significant Accounting Policies:

Nature of Business

Environmental Tectonics Corporation ("ETC" or the "Company") is primarily engaged in the development, marketing and manufacturing of Aircrew Training Systems (ATS) and industrial simulation equipment. The Company utilizes its internally developed software systems in virtually all of its products. ETC focuses on software enhancements, product extensions, new product development and new marketplace applications. Sales of ATS products are made principally to U.S. and foreign government agencies and to the entertainment market. Sales of industrial simulation equipment, which includes sterilizers, environmental systems, and hypo/hyperbaric equipment, are made to both commercial customers and governmental agencies worldwide.

Stock Split: On February 25, 1999, the Company's Board of Directors declared a 2-for-1 stock split for stockholders of record on May 17, 1999. All earnings per share and share amounts in the financial statements for all years presented have been restated to reflect the 2-for-1 split.

Principles of Consolidation:

The consolidated financial statements include the accounts of Environmental Tectonics Corporation, its wholly owned subsidiary, ETC International Corporation and its 95% owned subsidiary, ETC-PZL Aerospace Industries SP. Z 0.0, and its 99% owned subsidiary, ETC Europe. All material inter-company accounts and transactions have been eliminated. The Company's fiscal year is the 52- or 53-week annual accounting period ending the last Friday in February.

Use of Estimates:

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made for revenue recognition under the percentage of completion method (see Note 1, Revenue Recognition), claims receivable, inventory, and computer software costs.

The Company has recorded receivables in the amount of \$11.3 million for claims made or to be made against the United States government and an international customer for contract costs incurred through February 23, 2001. The total net claims amount filed with the U.S. government and an international customer is approximately \$26.0 million based on costs incurred through February 23, 2001, and additional claims are in preparation for filing in fiscal 2002 against an international customer. These claims are subject to negotiation, arbitration and audit by the United States government and the international customer.

Revenue Recognition:

Revenue is recognized on long-term contracts utilizing the percentage of completion method based on costs incurred as a percentage of estimated total costs. Revenue recognized on uncompleted long-term contracts in excess of amounts billed to customers is reflected as an asset. Amounts billed to customers in excess of revenue recognized on uncompleted long-term contracts are reflected as a liability. When it is estimated that a contract will result in a loss, the entire amount of the loss is accrued. The effect of revisions in cost and profit estimates for long-term contracts is reflected in the accounting period in which the facts requiring the revisions become known. Contract progress billings are based upon contract provisions for customer advance payments, contract costs incurred, and completion of specified contract milestones. Contracts may provide for customer retainage of a portion of amounts billed until contract completion. Retainage is generally due within one year of completion of the contract. Revenue for contracts under \$100, or to be completed in less than one year, and revenue on parts and services, are recognized as shipped. Revenue for service contracts is recognized ratably over the life of the contract with related material costs expensed as incurred.

In September 2000, the Emerging Issues Task Force reached a consensus on Issue 00-10, "Accounting for Shipping and Handling Fees and costs" (Issue 00-10). Issue 00-10 requires that all amounts billed to customers related to shipping and handling should be classified as revenues. In addition, Issue 00-10 specifies that the classification of shipping and handling costs is an accounting policy decision that should be disclosed pursuant to APB 22, "Disclosure of Accounting Policies". The Company's product costs includes amounts for shipping and handling, therefore, it charges its customers shipping and handling fees at the time the products are shipped or when its services are performed. The cost of shipping products to the customer is recognized at the time the products are shipped to the customer and is included in Cost of Goods Sold expenses. Accordingly, this consensus opinion had no effect on the Company's current and previous classifications.

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

1. Summary of Significant Accounting Policies (Continued):

Cash and Cash Equivalents:

Cash and cash equivalents include short-term deposits at market interest rates with original maturities of three months or less. The Company maintains cash balances at several financial institutions located in the Northeast United States and at some locations internationally. Accounts in each domestic institution are insured by the Federal Deposit Insurance Corporation up to \$100. During the year the Company had cash and cash equivalents in excess of insured amounts. However, most of the Company's funds are with one financial institution which has had no experience of significant customer losses to date.

Inventories:

Inventories are valued at the lower of cost or market. Cost is determined principally by the first-in, first-out method. The costs of finished goods and work-in-process inventories include material, direct engineering, manufacturing labor and overhead components. The Company periodically reviews the net realizable value of the inventory and, if necessary, writes down the recorded costs.

Depreciation of Property, Plant and Equipment:

Property, plant and equipment are depreciated over their estimated useful lives by the straight-line method for financial reporting purposes. Accelerated depreciation methods are used for tax purposes. Upon sale or retirement of property, plant and equipment, the costs and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the determination of net income.

Amortization of Goodwill:

The Company amortizes costs in excess of fair values of net assets of the businesses acquired using the straight - line method over a period not to exceed 20 years. The Company periodically reviews the value of its goodwill to determine if an impairment has occurred.

Goodwill of \$662 was recorded in fiscal 1999 for the Company's 65% ownership purchase of ETC-PZL Aerospace Industries, SP. Z O.O. On September 27, 2000, the Company purchased an additional 30% ownership for \$300 cash, bringing the Company's total ownership to 95%. This transaction resulted in a reduction in goodwill of \$101. Amortization expense was \$35, \$36, and \$25 in fiscal years 2001, 2000 and 1999, respectively, and accumulated amortization was \$96 and \$61 as of February 23, 2001 and February 25, 2000, respectively.

Amortization of Capitalized Software Development Costs:

The Company capitalizes the qualifying costs of developing software contained in certain products. Capitalization of costs requires that technological feasibility has been established. When the software is fully documented and tested, capitalization of development costs cease and amortization commences over a period ranging from 36 to 60 months (dependent upon the life of the product) on a straight-line basis which, at a minimum, approximates estimated sales. Realization of capitalized software costs is subject to the Company's ability to market the related product in the future and generate cash flows to support future operations. Capitalized software costs and related amortization totaled \$ 550 and \$455, respectively, for the year ended February 23, 2001. Capitalized software costs and related amortization totaled \$555 and

\$596, respectively, for the year ended February 25, 2000.

Amortization of Deferred Financing Costs:

Capitalized costs relating to the March 1997 financing of the Company are being amortized over the respective terms of each agreement. Additionally, expenses totaling \$175 relating to the Company's bond issuance on March 15, 2000 are being amortized over the relevant term. Amortization expense relating to deferred financing costs was \$146, \$331 and \$181 in 2001, 2000, and 1999, respectively (see note 7).

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Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

1. Summary of Significant Accounting Policies (Continued):

Income Taxes:

The Company accounts for income taxes using the liability method, which reflects the impact of temporary differences between values recorded for assets and liabilities for financial reporting purposes and values utilized for measurement in accordance with tax laws.

Long-Lived Assets:

The Company follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," which provides guidance on when to recognize and how to measure impairment losses of long-lived assets and certain identifiable intangibles, and how to value long-lived assets to be disposed of. The adoption of SFAS No. 121 had no material effect on the Company's consolidated financial position or results of operations.

Stock Options:

The Company accounts for stock options in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," which contains a fair value-based method for valuing stock-based compensation that entities may use, which measures compensation cost at the grant date based on the fair value of the award. Compensation is then recognized over the service period, which is usually the vesting period. Alternatively, the standard permits entities to continue accounting for employee stock options and similar instruments under Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." Entities that continue to account for stock options using APB Opinion No. 25 are required to make pro forma disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS No. 123 had been applied (see note 12). The Company's Incentive Stock Option Plan is accounted for under APB Opinion No. 25.

Advertising Costs:

The Company expenses advertising costs (which include trade shows) as incurred. Advertising expense was \$345, \$270 and \$294 in 2001, 2000, and 1999, respectively.

Earnings Per Common Share:

The Company has adopted SFAS No. 128, "Earnings Per Share," which is effective for financial statements issued after December 15, 1997. The new standard eliminates primary and fully diluted earnings per share and requires presentation of basic and diluted earnings per share together with disclosure of how the per share amounts were computed. Basic earnings per share excludes dilution and is computed by dividing income

available to common shareholders by the weighted average common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

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Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

1. Summary of Significant Accounting Policies (Continued):

The following table illustrates the reconciliation of the numerators and denominators of the basic and diluted earnings per share computations. All earnings per share and share amounts have been restated to reflect a 2 for 1 stock split effective May 28, 1999.

	Year ended February 23, 2001		
	Income (\$000)	Weighted average shares	Per share amount
	(numerator)	(denominator)	
Net income	\$ 2,021		
Basic earnings per share			
Income available to common stockholders	\$ 2,021	7,087,163	\$.29
Effective of dilutive securities			
Stock options		97,653	
Stock warrants		313,901	
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$ 2,021	7,498,717	\$.27
Year ended February 25, 2000			
	Income (\$000)	Weighted average shares	Per share amount
	(numerator)	(denominator)	
Net income	\$ 2,837		
Less preferred stock dividends	(38)		
Less accretion of preferred stock	(128)		
Basic earnings per share			
Income available to common stockholders	\$ 2,671	6,604,184	\$.40
Effective of dilutive securities			
Stock options		224,151	
Stock warrants		490,358	
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$ 2,671	7,318,693	\$.36
Year ended February 26, 1999			
	Income (\$000)	Weighted average shares	Per share amount
	(numerator)	(denominator)	
Net income	\$ 2,170		
Less preferred stock dividends	(275)		
Less accretion of preferred stock	(42)		
Basic earnings per share			

Income available to common stockholders	\$ 1,853	5,861,377	\$.32
	-----	-----	-----
Effective of dilutive securities			
Stock options		38,641	
Stock warrants		412,007	

Diluted earnings per share			
Income available to common stockholders plus			
effect of dilutive securities	\$ 1,853	6,312,025	\$.29
	-----	-----	-----

There were conversion provisions of preferred stock totaling 666,666 shares of common stock which were not included in the computation of diluted earnings per share because the effect of assumed conversions was anti-dilutive. These conversion provisions were not outstanding at February 23, 2001.

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Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

1. Summary of Significant Accounting Policies (Continued):

Reporting Comprehensive Income:

In June 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards to provide prominent disclosure of comprehensive income items. Comprehensive income is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. SFAS No. 130 is effective for all periods beginning after December 15, 1997. Other comprehensive income consists of foreign currency translation adjustments. The adoption of SFAS No. 130 did not have a material impact on the Company's consolidated financial position or results of operations.

Business Segment Presentation:

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 requires that public business enterprises report certain information about operating segments in complete sets of financial statements of the enterprise and in condensed financial statements of interim periods issued to shareholders. It also requires that public business enterprises report certain information about their products and services, the geographic areas in which they operate, and their major customers. SFAS No. 131 is effective for all periods beginning after December 15, 1997. The adoption of SFAS No. 131 had no impact on the Company's consolidated financial position or results of operations.

Derivative Financial Instruments:

In January, 2001, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 133 requires the recognition of all derivative financial instruments as either assets or liabilities in the Consolidated Balance Sheet, and the periodic adjustment of those instruments to fair value. The classification of gains and losses resulting from changes in the fair value of derivatives is dependent on the intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives that are not considered highly effective hedges are reflected in earnings. Adjustments to reflect changes in fair values of derivatives that are considered highly effective hedges are either reflected in earnings and largely offset by corresponding adjustments related to the fair values of the hedged items, or reflected in other comprehensive income until the hedged transaction matures and the entire transaction is recognized in earnings. The change in fair value of the ineffective

portion of a hedge is immediately recognized in earnings. SFAS No. 133 is effective for all periods beginning after June 15, 1999. This effective date was later deferred to all periods beginning after June 15, 2000 by SFAS No. 137, "Accounting for Derivative Instruments and Hedging activities-Deferral of the Effective Date of FASB Statement Number 133." The adoption of SFAS No. 133 had no impact on the Company's consolidated financial position or results of operations.

2. Acquisitions

ETC-PZL Aerospace Industries SP. Z O.O.

On April 21, 1998, the Company acquired a 65% ownership in MP-PZL Aerospace Industries, Ltd. ("MP-PZL"), a simulation and advanced training device manufacturing company located in Warsaw, Poland, for \$375 in cash, an 8% interest-only three-year note payable for \$350 and 55,000 shares of the Company's common stock amounting to \$495. MP-PZL was subsequently renamed ETC-PZL Aerospace Industries SP. Z O.O. ("ETC-PZL"). The Company's cost for this acquisition was \$1,220 and has been recorded in the accompanying balance sheet under the purchase method of accounting for business combinations. In connection with the acquisition, the Company recorded goodwill of \$662 and a minority interest of \$300.

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

2. Acquisitions (Continued):

ETC-PZL's fiscal period ends December 31. The results of ETC-PZL for the period May 1, 1998 through December 31, 1998 have been included in the Company's results of operations for the twelve months ended February 26, 1999. On a pro forma basis, had the Company consolidated the results of ETC-PZL for a full 12 months in 1999, the following comparisons would result:

Twelve months ended:

	February 25, 2000 ----	February 26, 1999 ---- (as reported)	February 26, 1999 ---- (pro forma)
Net sales	\$ 34,920	\$ 29,225	\$ 29,841
Gross profit	12,798	11,672	11,906
Operating income	5,327	4,759	4,723
Net income	2,837	2,170	2,155
Per share information			
Income available to common shareholders	2,671	1,853	1,838
Income per share: basic	0.40	0.32	0.31
Income per share: diluted	0.36	0.29	0.29
Number of shares: basic	6,604,000	5,861,000	5,861,000
Number of shares: diluted	7,319,000	6,312,000	6,312,000

On September 9, 2000, the Company purchased an additional 30% ownership interest in ETC-PZL for \$300 cash, bringing the Company's total ownership to 95%. This transaction resulted in a reduction in goodwill of \$101.

Pro-Pilot Assets

During the quarter ended November 24, 2000, the Company purchased the assets of the "Pro-Pilot" flight simulation game for \$400. This purchase was classified as an asset purchase and thus no goodwill resulted from

the transaction.

3. Accounts Receivable:

The components of accounts receivable at February 23, 2001 and February 25, 2000, are as follows:

	2001	2000
	----	----
U.S. government receivables billed and unbilled contract costs subject to negotiation	\$ 5,707	\$ 5,145
U.S. commercial receivables billed	2,484	1,395
International receivables billed and unbilled contract costs subject to negotiation	8,955	4,598
	-----	-----
	17,146	11,138
Less allowance for doubtful accounts	(370)	(367)
	-----	-----
	\$16,776	\$10,771
	=====	=====

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Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

3. Accounts Receivable (Continued):

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

Unbilled contract costs subject to negotiation represent claims made or to be made against the U.S. government under a contract for a centrifuge. These costs were recorded beginning in fiscal year 1994, including \$1,148 recorded during the three months ended May 26, 2000. The Company has recorded claims, amounting to \$3,898 to the extent of contract costs incurred, and accounts receivable of \$1,649 representing the balance due under the contract, collectibility of which may be dependent upon resolution of outstanding claims. Claim costs have been incurred in connection with U.S. government caused delays, errors in specifications and designs, and other unanticipated causes, and, although classified as current in the financial statements, may not be received in full during fiscal 2002. In accordance with accounting principles generally accepted in the United States of America, revenue recorded by the Company from a claim does not exceed the incurred contract costs related to the claim. The Company currently has approximately \$12.0 million in claims filed with the U.S. government (including the aforementioned recorded claim and accounts receivable balances) which are subject to negotiation and audit by the U.S. government. The U.S. government has responded to the claims with either denials or deemed denials that the Company has appealed. In May 2000, the Company and the U.S. government reached an agreement in principle, which would have included resolution of all U.S. Navy claims on a global basis and contracted additional work on the centrifuge. In July 2000, the Company received notice that the Navy, citing an inability to obtain the prerequisite approvals and thus the necessary funding to effect the settlement, was rescinding the agreement.

International receivables billed:

International receivables billed included \$930 at February 23, 2001 and February 25, 2000 related to a certain contract with the Royal Thai Air Force.

In October 1993, the Company was notified by the Royal Thai Air Force (RTAF) that the RTAF was terminating a certain \$4.6 million simulator contract with the Company. Although the Company had performed in excess of 90% of the contract, the RTAF alleged a failure to completely

perform. In connection with the termination, the RTAF made a call on a \$229 performance bond, as well as a draw on an approximately \$1.1 million advance payment letter of credit. Work under this contract had stopped while under arbitration, but on October 1, 1996, the Thai Trade Arbitration Counsel rendered its decision under which the contract was reinstated in full and the Company was given a period of nine months to complete the remainder of the work. Except as noted in the award, the rights and obligations of the parties remain as per the original contract including the potential invoking of penalties or termination of the contract for delay. On December 22, 1997, the Company successfully performed acceptance testing and the unit passed with no discrepancy reports. Although the contract was not completed in the time allotted, the Company has requested an extension on the completion time due to various extenuating circumstances, including allowable "force majeure" events. The balance due on the contract is still under review. However, the Company has received a letter from the Directorate of Finance for the RTAF which notes that the Directorate has instructed the Ministry of Finance to return \$229 of the balance, representing the performance bond, and states the Ministry is currently working on the approval. At this point, the Company is not able to determine what, if any, impact the extended completion and payment period will have upon the receipt of the total due.

Unbilled contract costs subject to negotiation represent claims made or to be made against an international customer for three contracts covering 1994 to the present. Claims aggregating \$5,758 have been recorded in connection with costs associated with customer caused delays, errors in specifications and designs, and other out-of-scope items and may not be received in full during fiscal 2002. In accordance with accounting principles generally accepted in the United States of America, revenue recorded by the Company from a claim does not exceed the incurred contract costs related to the claim. One of these claims was settled in the fourth quarter of fiscal 2001, and another claim was formally filed with the customer subsequent to fiscal year end. The company is currently updating and finalizing additional claims. As a related item, during fiscal 2000 the aforementioned international customer, citing failure to deliver product within contract terms, assessed liquidated damages totaling approximately \$1.6 million on two contracts currently in progress. The Company disputes the basis for

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

these liquidated damages and plans to contest them vigorously. However, following accounting principles generally accepted in the United States of America, the Company reduced contract values and corresponding revenues by approximately \$1.6 million.

Claim bookings for the year increased operating income by \$1,325 in fiscal 2001, net of associated manufacturing costs and legal expenses.

4. Costs and Estimated Earnings on Uncompleted Contracts:

The following is a summary of long-term contracts in progress at February 23, 2001 and February 25, 2000:

	2001	2000
	-----	-----
Costs incurred on uncompleted long-term contracts	\$ 30,251	\$ 23,468
Estimated earnings	10,209	14,937
	-----	-----
	40,460	38,405
Less billings to date	(32,577)	(32,809)
	-----	-----

\$ 7,883 \$ 5,596
=====

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

4. Costs and Estimated Earnings on Uncompleted Contracts (Continued):

	2001 ----	2000 ----
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	\$ 9,595	\$ 8,878
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(1,712)	(3,282)
	-----	-----
	\$ 7,883	\$ 5,596
	=====	=====

Included in billings in excess of costs and estimated earnings on uncompleted long-term contracts is a provision for anticipated losses on contracts of \$200 and \$306 in 2001 and 2000, respectively.

5. Inventories:

Inventories consist of the following:

	Raw material -----	Work in process -----	Total -----
February 23, 2001	\$ 359	\$ 4,265	\$ 4,624
February 25, 2000	343	3,561	3,904

Inventory is presented net of an allowance for obsolescence of \$ 630 and \$ 720 in 2001 and 2000, respectively.

6. Property, Plant and Equipment:

The following is a summary of property, plant and equipment, at cost, and estimated useful lives at February 23, 2001 and February 25, 2000:

	2001 ----	2000 ----	Estimated useful lives -----
Land	\$ 100	\$ 100	
Building and building additions	3,260	1,908	40 years
Machinery and equipment	8,039	6,865	3- 5 years
Office furniture and equipment	1,180	1,039	10 years
Building improvements	1,393	1,392	5-10 years
	-----	-----	
	13,972	11,304	
Less accumulated depreciation	(8,635)	(8,004)	
	-----	-----	
Property, plant and equipment, net	\$5,337	\$ 3,300	
	=====	=====	

Depreciation expense for the years ended February 23, 2001, February 25, 2000, and February 26, 1999, was \$ 602, \$ 535 and \$ 707, respectively.

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

7. Long-Term Obligation and Credit Arrangements:

Long-term obligations at February 23, 2001 and February 25, 2000 consist of the following:

	2001 ----	2000 ----
Credit facility payable to banks	\$ 7,564	\$ 4,093
Long Term Bonds	5,470	-
Subordinated debt, net	350	350
Products liability settlement (net of unamortized discount of \$ 37 in 2000 based on imputed rate of 11%)	-	48
Term loans payable accruing interest at between 9% and 9.9% collateralized by priority liens on certain equipment	37	42
	-----	-----
	13,421	4,533
Less current portion	(643)	(78)
	-----	-----
	\$ 12,778	\$ 4,455
	=====	=====

The amounts of future long-term obligations maturing in each of the next five fiscal years are as follows:

2002	\$ 643
2003	7,845
2004	281
2005	281
2006 and thereafter	4,371

Total future obligations	\$13,421

The approximate average loan balance, maximum aggregate borrowings outstanding at any month-end payable under the credit facility and subordinated debt during the fiscal years, and weighted average interest rate computed by the days outstanding method as of February 23, 2001 and February 25, 2000 are as follows:

	2001 ----	2000 ----
Approximate average loan balance	\$ 3,764	\$ 575
Maximum aggregate	\$ 7,564	\$ 5,393
Weighted average interest rate	8.74%	8.16%

Interest is charged on direct borrowings at the bank's prime rate less a factor ranging from 0% to 0.5% based on the Company's Leverage Ratio, as defined, or adjusted LIBOR in 2001 and 2000. The interest rates ranged from 7.85% to 8.83% at February 23, 2001 and 8.1% at February 25, 2000.

The Company's letter of credit limit is \$5.0 million, provided that the cumulative of all outstanding trade letters of credit does not exceed \$2.5 million. The balance outstanding under these provisions at February 23, 2001, was \$2,442. Fees on letters of credit outstanding were 0.75% at both February 23, 2001 and February 25, 2000.

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

7. Long-Term Obligation and Credit Arrangements (Continued):

On February 25, 2000, the Company signed an amendment to its revolving Credit Agreement originally entered into on March 27, 1997, which increased its credit facility to \$15 million and extended its expiration

date to August 31, 2002. These funds are available to support working capital needs and letter of credit. Terms and conditions of the amendment remained essentially the same as the original agreement. The Credit Agreement is collateralized by substantially all of the Company's assets. The Company is prohibited from declaring any cash dividends under the terms of the Credit Agreement. This facility bears interest at the bank's prime lending rate less a factor ranging from 0% to 0.5% based on the Company's Leverage Ratio, as defined, or adjusted LIBOR. A commitment fee of 0.2% is charged for unused available funds. The credit facility includes certain covenants related to, among other things, prohibitions on incurring additional debt, change in ownership of certain officers, payment of dividends and maintenance, on a quarterly basis, of certain financial ratios. Substantially all of the Company's short-term financing is provided by this bank. The Company had \$4,772 available under the Credit Agreement at February 23, 2001.

At February 23, 2001, the Company was in violation of one of its Credit Agreement loan covenants, specifically the requirement to maintain a specified Funds Flow Ratio. This violation resulted from the unusually high capital spending for the Company's modernization program in relation to net income in the fiscal period. Accordingly, the Company received a waiver for this violation at February 23, 2001, from its Bank and also the bank agreed to adjust this covenant for the period through November 23, 2001.

On March 27, 1997, the Company issued \$4 million of subordinated debentures, bearing interest at 12% per annum, due March 27, 2004, to a financial institution, a director of which has been subsequently appointed and elected to the Company's Board of Directors. On January 11, 2000, the Company utilized \$4.1 million of its revolving credit facility to repay these subordinated debentures. See also commentary concerning long term bonds. In connection with the subordinated debentures, warrants were issued to acquire 332,820 shares of the Company's common stock at an exercise price of \$.50 per share; \$499 of the proceeds from the sale of the debentures was allocated to the warrants and credited to capital contributed in excess of par value of common stock. This amount is being amortized to interest expense over the term of the warrants, which is seven years.

On March 27, 1997, the Company also issued 25,000 shares of 11% redeemable convertible preferred stock for \$2.5 million. Each share of convertible stock was convertible, at the option of the shareholder, into 26.66 shares of the Company's common stock at a price of \$3.75 per share. On February 26, 1999, the Company issued a redemption notice to redeem the outstanding 25,000 shares of Series A Preferred Stock in their entirety. On March 25, 1999, the Company received notice that Sirrom Capital Corporation had exercised its conversion privilege under the terms of the agreement to convert its 25,000 shares of Series A Preferred Stock into the Company's common shares. Consequently, on April 19, 1999, the Series A Preferred was retired and 666,666 shares of common stock were issued to Sirrom Capital Corporation. Concurrent with this transaction the Company charged retained earnings for \$128 representing the difference between book and face value of the Preferred Stock and then reclassified \$2,500 of Preferred Stock value to common stock at par and additional paid in capital.

Total financing fees associated with the March 27, 1997 financing were approximately \$876, all of which had been charged to interest expense or accreted to retained earnings by February 25, 2000. The proceeds from these transactions were used to repay, in full, amounts outstanding with a prior lender.

Subordinated debt at February 25, 2001, consisted of debt issued for the acquisition of ETC-PZL (see note 2).

7. Long-Term Obligation and Credit Arrangements (Continued):

As a condition to the extension of the prior credit facility through March 31, 1997, warrants were issued to an affiliate of a Bank to purchase 200,000 shares of the Company's common stock at a price equal to \$2.59. On March 6, 2000, these warrants were exercised and the Company received \$518 representing the full purchase price. Subsequently, on March 20, 2000, the Company issued 212,866 shares (representing the original warrant value as adjusted) of its common shares.

On March 15, 2000, the Company issued approximately \$5.5 million of unregistered Taxable Variable Rate Demand/Fixed Rate Revenue Bonds (Series of 2000). Net proceeds from these bonds were used to repay a \$4.1 million advance taken on the Company's revolving credit facility and to finance construction of an addition to the Company's main plant in Southampton, Pennsylvania. The bonds are secured by a \$5.6 million irrevocable direct pay Letter of Credit issued by the Company's main lender which expires on March 15, 2005 and which is secured by all assets of the Company. The Bonds carry a maturity date of April 1, 2020, bear a variable interest rate which adjusts each week to a rate required to remarket the bonds at full principal value (currently at 4.15% on May 17, 2001) with a cap of 17%, and are subject to mandatory redemption of \$275 per year for 19 years and \$245 for the 20th year.

Product Liability Settlement:

During June 1995, the Company entered into a settlement with the employee of a customer who brought a products liability claim against the Company. The settlement of \$1,195 was to be satisfied with (i) funds of \$547 (including accrued interest) previously deposited by the Company's products liability insurance carrier with the U.S. District Court, and (ii) a settlement payable to the plaintiff for the remaining amount of \$648. The Company paid \$53 by July 20, 1995 and \$100 on April 20, 1996. In September 1996, the Company renegotiated the payment schedule, agreeing to pay, beginning October 1996, \$10 per month. The claimant did reserve the right to pursue additional payment amounts as per the original settlement agreement of July 29, 1995. This settlement was fully satisfied as of February 23, 2001.

The carrying value of the aforementioned financial instruments approximates their fair values at February 23, 2001.

8. Related Parties:

ETC Europe:

The Company transacts its business in Europe through ETC Europe, an affiliated entity which at February 25, 2000, was 99% owned by the President of the Company. Sales through ETC Europe were \$6,025 and \$1,957 in 2000 and 1999, respectively. Amounts due from ETC Europe as of February 25, 2000 and February 26, 1999, were \$56. Effective March 7, 2000, the Company completed the purchase for \$100 of the 99% ownership held by the President of the Company, resulting in goodwill of \$26.

Subordinated Debt and Preferred Stock:

During 2000, a director of ETC was also a director of one of its creditors (see note 7).

9. Leases:

Operating Leases:

The Company leases certain premises and office equipment under operating leases which expire over the next five years. Future minimum rental payments required under noncancellable operating leases having a

remaining term expiring after one fiscal year as of February 23, 2001 are \$188 in 2002; \$133 in 2003; \$132 in 2004; \$119 in 2005; and \$122 in 2006 and thereafter.

Total rental expense for all operating leases for the years ended February 23, 2001, February 25, 2000, and February 26, 1999, was \$ 117, \$39, and \$69, respectively.

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Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

10. Income Taxes:

The components of the provision for income taxes are as follows:

	Year Ended February 23, 2001	Year Ended February 25, 2000	Year Ended February 26, 1999
	-----	-----	-----
Currently payable:			
Federal	\$ 911	\$ 889	\$ 1,272
State	109	179	184
Foreign taxes	73	108	111
	-----	-----	-----
	1,088	1,176	1,567
	-----	-----	-----
Deferred:			
Federal	88	360	(333)
State	8	37	(33)
	-----	-----	-----
	96	397	(366)
	-----	-----	-----
	\$1,184	\$1,573	\$1,201
	=====	=====	=====

A reconciliation of the statutory federal income tax to the effective tax is as follows:

	Year Ended February 23, 2001	Year Ended February 25, 2000	Year Ended February 26, 1999
	-----	-----	-----
Statutory income tax	34.0%	34.0%	34.0%
State income tax, net of federal tax benefit and state net operating loss carryforwards in 1999	2.2	2.9	3.9
Foreign sales corporation	(5.5)	(5.2)	(4.4)
Other	4.6	3.4	1.5
	-----	-----	-----
	35.3%	35.1%	35.0%
	=====	=====	=====

The tax effects of the primary temporary differences are as follows:

	2001	2000	1999
	----	----	----
Deferred tax assets:			
Net arbitration award against Company	\$ -	\$ -	\$ 446
Net products liability settlement	74	115	161
Vacation reserve	58	59	45
Inventory reserve	233	270	236
Receivable reserve	138	138	145
Warranty reserve	46	46	44
Other, net	66	61	59
	-----	-----	-----
Total current deferred tax asset	\$ 615	\$ 689	\$1,136
	-----	-----	-----
Deferred tax liabilities:			
Amortization of capitalized software	\$ 429	\$ 395	\$ 407
Depreciation	245	257	295
	-----	-----	-----
Total noncurrent deferred tax liability	\$ 674	\$ 652	\$ 702
	=====	=====	=====

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11. Business Segment Information:

The Company primarily manufactures, under contract, various types of high-technology equipment which it has designed and developed. The Company considers its business activities to be divided into two segments: Aircrew Training Systems (ATS) and Industrial Simulation. The ATS business produces devices which create and monitor the physiological effects of motion, including spatial disorientation and centrifugal forces for medical, training, research and entertainment markets. The Industrial Group business produce chambers that create environments that are used for sterilization, research and medical applications. The following segment information reflects the accrual basis of accounting:

	ATS -----	Industrial Group -----	Total -----
2001			

Net sales	\$ 23,567	\$ 8,885	\$ 32,452
Interest expense	558	94	652
Depreciation and amortization	796	482	1,278
Operating income	5,794	(906)	4,888
Income tax provision	1,833	(350)	1,483
Identifiable assets	27,534	4,652	32,186
Expenditures for segment assets	2,306	322	2,628
2000			

Net sales	\$ 26,361	\$ 8,559	\$ 34,920
Interest expense	465	125	590
Depreciation and amortization	1,024	371	1,395
Operating income	5,039	1,355	6,394
Income tax provision	1,601	431	2,032
Identifiable assets	20,344	5,538	25,882
Expenditures for segment assets	650	167	817
1999			

Net sales	\$ 24,465	\$ 4,760	\$ 29,225
Interest expense	711	84	795
Depreciation and amortization	1,289	353	1,642
Operating income (loss)	5,697	(89)	5,608
Income tax provision (benefit)	1,745	(61)	1,684
Identifiable assets	22,470	2,644	25,114
Expenditures for segment assets	438	26	464
	2001 ----	2000 ----	1999 ----
Reconciliation to consolidated amounts:			
Segment operating income	\$ 4,888	\$ 5,608	\$ 4,922
Less interest expense	(652)	(795)	(966)
Less income taxes	(1,483)	(1,684)	(1,385)
Total profit for segments	2,641	3,129	2,571
Corporate home office expense	(766)	(849)	(714)
Interest and other expenses	(272)	(517)	(482)
Income tax benefit	357	483	419
Minority interest	(51)	(76)	--
Net income	\$ 2,021 -----	\$ 2,170 -----	\$ 1,794 -----

Segment operating income (loss) consists of net sales less applicable costs and expenses relating to these revenues. Unallocated general corporate expenses, letter of credit fees, interest expense, and income taxes have been excluded from the determination of the total profit for segments. General corporate expenses are primarily central administrative office expenses. Property, plant, and equipment are not identified with specific business segments because most of these assets are used in each of the segments.

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

11. Business Segment Information (Continued):

Approximately 43% of sales totaling \$13,924 in 2001 were made to one international and one domestic customer in the ATS segment. Approximately 63% of sales totaling \$16,609 in 2000 were made to two international and one domestic customer in the ATS segment. Approximately 24% of sales totaling \$7,005 in 1999 were made to one international customer in the

ATS segment.

Included in the segment information for the year ended February 23, 2001, are export sales of \$16,404. Of this amount, there are sales to or relating to governments or commercial accounts in Great Britain of \$5,660. Sales to the U.S. government and its agencies aggregate \$916 for the year ended February 23, 2001.

Included in the segment information for the year ended February 25, 2000 are export sales of \$23,907. Of these amounts, there are sales to or relating to governments or commercial accounts in Great Britain (\$4,821), Poland (\$4,201), and Nigeria (\$8,107) for ATS sales. Sales to the U.S. government and its agencies aggregate \$1,587 for the year ended February 25, 2000.

Included in the segment information for the year ended February 26, 1999 are export sales of \$22,876. Of these amounts, there are sales to or relating to governments or commercial accounts in Great Britain (\$7,005), Poland (\$2,530), Japan (\$2,130), Nigeria (\$1,990), Bangladesh (\$1,548), Turkey (\$1,057), the UAE (\$1,040), and Egypt (\$949) for ATS sales. Sales to the U.S. government and its agencies aggregated \$1,158 for the year ended February 26, 1999.

12. Stock Options:

In August 1998 the Company adopted an Incentive Stock Option Plan to replace the 1988 Incentive Stock Option Plan which expired in August 1998. The plan authorizes a committee of the Board of Directors to grant options for the purchase of up to 500,000 shares of common stock to qualifying officers and other key employees. The Plan provides that option price shall not be less than 100% (or in the case of a ten percent owner, 110%) of the current market price of the stock on the date of the grant. Options may be exercised on a cumulative basis at the rate of 25% per year commencing one year after the date of grant. The Plan will terminate on August 1, 2008. At February 23, 2001, there were 321,500 shares available to be granted under the Plan.

Since the exercise price of each option is not less than 100% of the current market price of the Company's stock on the date of grant, no compensation cost has been recognized for the Plan. Had compensation cost for the Plan been determined based on the fair value of the options at the grant dates consistent with the method of SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below. Reported amounts reflect the 2 for 1 stock split declared by the Company on February 25, 1999 (see note 1).

	2001	2000	1999
	-----	-----	-----
Net income:			
As reported	\$ 2,021	\$ 2,837	\$ 2,170
Pro forma	\$ 1,549	\$ 2,350	\$ 2,073
Basic earnings per share:			
As reported	\$.29	\$.40	\$.32
Pro forma	\$.22	\$.33	\$.30
Diluted earnings per share:			
As reported	\$.27	\$.36	\$.29
Pro forma	\$.21	\$.30	\$.28

The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted average assumptions used for grants in 1999: dividend yield of 0%; expected volatility of; risk-free interest rate of 5.47%; and expected life of five years.

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

12. Stock Options (Continued):

A summary of the status of the Plan as of February 23, 2001, February 25, 2000, and February 26, 1999, and changes during the years ending on those dates is presented below.

	2001		2000	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	497,750	\$ 6.80	543,700	\$ 6.57
Granted	-	-	-	-
Exercised	(33,400)	4.79	(28,950)	3.59
Forfeited	-	-	(17,000)	4.86
Outstanding at end of year	464,350		497,750	
Options exercisable at year end	147,936		41,657	
Weighted average fair value of options granted during the year		\$ -		\$ -

	1999	
	Shares	Weighted average exercise price
Outstanding at beginning of year	92,350	\$ 1.99
Granted	490,000	7.05
Exercised	(38,650)	1.78
Forfeited	-	-
Outstanding at end of year	543,700	
Options exercisable at year end	16,781	
Weighted average fair value of options granted during the year		\$ 3.70

The following information applies to options outstanding at February 23, 2001:

Range of exercise prices	Options outstanding			Options exercisable		
	Number Outstanding at February 23, 2001	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at February 23, 2001	Weighted average exercise price	
\$1.75 to \$2.63	19,600	5.5 years	\$ 2.25	17,248	\$ 2.25	
\$5.00 to \$7.81	104,000	7.8 years	\$ 5.00	45,500	\$ 5.00	
\$7.81 to \$9.76	340,750	8 years	\$ 7.81	85,188	\$ 7.81	

Notes to Consolidated Financial Statements
(\$ in thousands, except share data)

13. Claims and Litigation:

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against the Company. In the opinion of management, after consultation with legal counsel, all such matters are reserved for or adequately covered by insurance or, if not so covered, are without merit or are of such kind, or involve such amounts, as would not have a significant effect on the financial

position or results of operations of the Company if disposed of unfavorably.

14. Employee Benefit Plan

The Company maintains a retirement savings 401(k) plan for eligible employees. The Company's contributions to the plan are based on a percentage of the employees' qualifying contributions. The Company's contributions totaled \$124, \$121, and \$103 in 2001, 2000, and 1999, respectively.

15. Quarterly Consolidated Financial Information (Unaudited):

Financial data for the interim periods of 2001, 2000 and 1999 were as follows:

Fiscal Year 2001	Quarter Ended			
	May 26	August 25	November 24	February 23
Net sales	\$ 7,157	\$ 6,994	\$ 8,622	\$9,679
Gross profit	3,355	2,678	2,809	4,233
Operating income	1,522	482	617	1,501
Income before income taxes	1,351	246	335	1,266
Minority interest	2	22	0	27
Net income	882	118	227	794
Earnings per common share:				
Basic	.13	.02	.03	.11
Diluted	.12	.02	.03	.10

Fiscal Year 2000	Quarter Ended			
	May 28	August 27	November 26	February 25
Net sales	\$ 8,295	\$ 8,279	\$ 9,107	\$ 9,239
Gross profit	3,418	2,679	3,381	3,320
Operating income	1,426	716	1,401	1,784
Income before income taxes	1,231	522	1,187	1,540
Minority interest	(35)	(32)	8	129
Net income	835	372	763	867
Earnings per common share:				
Basic	.11	.05	.11	.13
Diluted	.10	.05	.10	.11

Fiscal Year 1999	Quarter Ended			
	May 29	August 28	November 27	February 26
Net sales	\$ 7,460	\$ 5,996	\$ 7,475	\$ 8,294
Gross profit	2,749	2,283	2,648	3,992
Operating income	999	829	1,003	1,928
Income before income taxes	712	441	597	1,697
Minority Interest	-	61	(10)	25
Net income	464	234	399	1,073
Earnings per common share:				
Basic	.07	.03	.05	.17
Diluted	.07	.02	.05	.15

Note: All earnings per share amounts have been restated to reflect a 2 for 1 stock split effective May 28, 1999.

ENVIRONMENTAL TECTONICS CORPORATION AND SUBSIDIARIES
SCHEDULE 21 LIST OF SUBSIDIARIES

Name	Jurisdiction	% Ownership
----	-----	-----
Entertainment Technology Corporation	PA	100%
ETC International Corporation	Barbados	100%
ETC-PZL Aerospace Industries	Poland	65%
ETC-Europe	Great Britain	99%

Consent of Independent Certified Public Accountants

We have issued our report dated April 18, 2001, accompanying the consolidated financial statements incorporated by reference in the Annual Report of Environmental Tectonics Corporation and Subsidiaries on Form 10-K for the year ended February 23, 2001 and Part II of this form. We have also audited Schedule II for each of the three years in the period ended February 23, 2001. In our opinion, this schedule represents fairly, in all material respects, the information required to be set forth therein. We hereby consent to the incorporation by reference of said reports in the Registration Statement of Environmental Tectonics Corporation and Subsidiaries of Form S-8 (File No. 333-65469, effective October 8, 1998), Form S-8 (File No 2-92407, effective August 14, 1984) and on Form S-3 (File No. 33-42219, effective September 4, 1991).

Philadelphia, Pennsylvania
May 23, 2001