

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED FEBRUARY 25, 2011

or

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

For the transition period from _____ to _____.

Commission File Number 1-10655

ENVIRONMENTAL TECTONICS CORPORATION

(Exact name of Registrant as specified in its Charter)

State or other jurisdiction of incorporation or organization: Pennsylvania

I.R.S. Employer Identification No.: 23-1714256

Address of principal executive offices: 125 James Way, County Line Industrial Park, Southampton, PA 18966

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

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$.05 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant 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.

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of August 28, 2010, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant was approximately \$16,966,000 based upon the closing sale price of the registrant's Common Stock on the Over the Counter Bulletin Board of \$3.05 on such date. (The information provided is not an admission that any person whose holdings are excluded from the figure is not an affiliate or that any person whose holdings are included is an affiliate and any such admission is hereby disclaimed. The information provided is solely for record keeping purposes of the Securities and Exchange Commission.)

As of April 29, 2011, there were 9,104,601 shares of the registrant's Common Stock issued and outstanding.

Documents incorporated by reference:

Parts I and II - Portions of the Registrant's Annual Report to Shareholders for the fiscal year covered by this Form 10-K (the "Annual Report to Shareholders"), which portions are included as an exhibit to this Form 10-K.

PART III – Portions of Registrant's Proxy Statement for the Registrant's 2011 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A within 120 days after the end of Registrant's fiscal year covered by this Form 10-K.

ENVIRONMENTAL TECTONICS CORPORATION
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED
FEBRUARY 25, 2011

TABLE OF CONTENTS

PART I	2
<u>Item 1. Business</u>	2
<u>Item 1A. Risk Factors</u>	9
<u>Item 1B. Unresolved Staff Comments</u>	14
<u>Item 2. Properties</u>	14
<u>Item 3. Legal Proceedings</u>	14
<u>Item 4. Removed and Reserved</u>	15
PART II	
<u>Item 5. Market for the Registrant’s Common Stock and Related Security Holder Matters and Issuer Purchases of Equity Securities</u>	16
<u>Item 6. Selected Financial Data</u>	16
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 8. Financial Statements and Supplementary Data</u>	16
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	16
<u>Item 9A Controls and Procedures</u>	17
<u>Item 9B. Other Information</u>	18
PART III	
<u>Item 10. Directors and Executive Officers of the Registrant</u>	19
<u>Item 11. Executive Compensation</u>	19
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	19
<u>Item 13. Certain Relationships and Related Transactions and Director Independence</u>	19
<u>Item 14. Principal Accountant Fees and Services</u>	19
PART IV	
<u>Item 15. Exhibits and Financial Statement Schedules</u>	20
<u>SIGNATURES</u>	23
<u>EXHIBIT INDEX</u>	
<u>EXHIBIT 13. Portions of 2011 Annual Report to Shareholders</u>	1
<u>EXHIBIT 21. Subsidiaries of Registrant</u>	38
<u>EXHIBIT 23. Consent of Friedman, LLP</u>	39
<u>EXHIBIT 31.1. Certification of Chief Executive Officer (“CEO”) pursuant to Rule 13a-14(a)</u>	40
<u>EXHIBIT 31.2. Certification of Chief Financial Officer (“CFO”) pursuant to Rule 13a-14(a)</u>	41
<u>EXHIBIT 32 Certification by CEO and CFO pursuant to 18 U.S.C. Section 1350</u>	42

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

FORWARD-LOOKING STATEMENTS

Discussions of some of the matters contained in this Annual Report on Form 10-K for ETC may constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, and, as such, may involve risks and uncertainties. Some of these discussions are contained under the captions “Item 1. Business” and “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We have based these forward-looking statements on our current expectations and projections about future events or future financial performance, which include implementing our business strategy, developing and introducing new technologies, obtaining, maintaining and expanding market acceptance of the technologies we offer, and competition in our markets. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about ETC and its subsidiaries that may cause actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

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 materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items and the effects of currency fluctuations, (ii) statements of our 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 of customers, suppliers, competitors or regulatory authorities, (iii) statements of future economic performance, (iv) statements of assumptions and other statements about the Company or its business, (v) statements made about the possible outcomes of litigation involving the Company, (vi) statements regarding the Company’s ability to obtain financing to support its operations and other expenses, and (vii) statements preceded by, followed by or that include terminology such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “future,” “predict,” “potential,” “intend,” or “continue,” and similar expressions. These forward-looking statements involve risks and uncertainties which are subject to change based on various important factors. Some of these risks and uncertainties, in whole or in part, are beyond the Company’s control. Factors that might cause or contribute to such a material difference include, but are not limited to, those discussed in this Annual Report on Form 10-K, in the section entitled “Risk Factors.” Shareholders are urged to review these risks carefully prior to making an investment in the Company’s Common Stock.

The Company cautions that the foregoing list of factors that could affect forward-looking statements by ETC is not exclusive. Except as required by federal securities law, 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.

References to fiscal 2011 or the 2011 fiscal year are references to the fifty-two week period ended February 25, 2011. References to fiscal 2010 or the 2010 fiscal year are references to the fifty-two week period ended February 26, 2010.

PART I

Item 1. Business

ETC was incorporated in 1969 in Pennsylvania. For over forty years, we have provided our customers with products, service and support. Innovation, continuous technological improvement and enhancement, and product quality are core values and critical to our success. We are a significant supplier and innovator in the following product areas: (1) software driven products and services used to create and monitor the physiological effects of flight; (2) high performance jet tactical flight simulation; (3) steam and gas sterilization; (4) testing and simulation devices for the automotive industry; (5) hyperbaric and hypobaric chambers; and (6) driving and disaster simulation systems.

We operate in two business segments – Training Services Group (“TSG”) and Control Systems Group (“CSG”). TSG operations encompass the design, manufacture and sale of training products and services of ETC’s core technologies including:

- software driven products and services used to create and monitor the physiological effects of flight;
- high performance jet tactical flight simulation; and
- driving and disaster simulation systems.

TSG product categories include Aircrew Training Systems (ATS), flight simulators and disaster management.

[Table of Contents](#)

CSG operations encompass the design, manufacture and sale of core technologies including:

- steam and gas sterilization;
- environmental testing and simulation devices for the automotive industry; and
- hyperbaric (100% oxygen) and hypobaric (altitude) chambers.

CSG products include sterilizers, environmental control devices, monoplace and multiplace chambers and parts and service support.

Revenue and other financial information regarding our segments may be found in Note 10 – Business Segment Information of the Notes to the Consolidated Financial Statements in Exhibit 13.

Product Development

Technological improvement and enhancement is an integral part of our business and philosophy. New ideas and products come from customer feedback based on the markets in which they operate, and from all levels of our design and engineering staff. Within the TSG segment, product development emphasizes additional functionality and fidelity, enhancing control systems and software graphics and exploring commercial possibilities. Our recent product development efforts are as follows:

TSG Segment

Tactical Flight Combat and G-force / Disorientation Trainers

Initially, the Company's high-G (the physiological impact of gravity on humans) pilot training centrifuges were developed for the aeromedical community to provide G-training such as G-loss of consciousness ("G-LOC") for high performance jet pilots. However, we believed that we could incorporate tactical flight simulation into a high-G ground simulator. By 2004 the engineering tools and technology had evolved sufficiently to allow us to begin this integration in earnest. The result of this evolution is our Authentic Tactical Fighting System ("ATFS"), the first fully "flyable" centrifuge-based tactical maneuvering ground based simulator. This technology allows a fighter pilot to practice tactical air combat maneuvers such as dodging enemy missiles, ground fire and aircraft obstacles while experiencing the real life environment of a high G-force fighter aircraft. These flight trainers provide a low cost and extremely less risky alternative to actual air flight. Development of this technology is a core objective of ETC. Additionally we are now migrating elements of this technology to other products, especially our GYROLAB, our four axes motion platform simulator.

During fiscal 2011, we were awarded a contract by the United States Air Force to provide a suite of altitude chambers. The contract, valued at over \$38 million, calls for the June 2013 delivery of a suite of four altitude chambers to the 711th Human Performance Wing at Wright Patterson Air Force Base in Dayton, Ohio. The chambers will support research activities to investigate and develop solutions for current and future Department of Defense aviation and space operations. The cutting edge research capabilities of these altitude chambers will allow investigation of physiological issues associated with exposure to medium and high altitudes in extreme environments as well as equipment development, qualification and human rating.

Upset Recovery Training (URT)

Loss of control in flight is a major cause factor in loss of life and hull damage in aircraft accidents. Modern day commercial aviation currently has no requirement for training of pilots to deal with these situations, commonly referred to as "upsets." Twenty years ago, 80% of civilian pilots were from a military training background; today this percentage is down to 20%. Realistic training for responding to and recovering from upsets, or URT, requires more than a non-centrifuge-based simulator because non-centrifuge-based simulators do not reproduce the physiological stresses and disorientation that a pilot experiences during an actual upset. We believe our GYROLAB simulator series is an answer to providing pilots with the dynamic environment necessary for effective training.

ETC's GYROLAB has been utilized in numerous research studies, including in conjunction with research funded by the Federal Aviation Administration (FAA) and the National Aeronautics and Space Administration (NASA). These studies are focused on comparing the benefits of various types of URT. The Company anticipates that this simulator will have significant application in the training of commercial airline pilots.

Advanced Disaster Management Simulator ("ADMS")

Our Simulation Division based in Orlando, Florida continues development of their software-driven disaster scenario products. ETC-PZL, our subsidiary in Poland, provides software support on the ADMS software platform while engineers in our Orlando office expand our library of visual environments and incidents, incorporating additional functionality and applications. We now offer training in aircraft accidents, hazardous material incidents, train and tunnel incidents, major traffic accidents, structural fires in high-rise, commercial, industrial and apartment buildings, large wildfires, terrorist attacks, bomb threats and explosions and school shootings, among others.

In fiscal 2011, we experienced continued interest for our ADMS product at the state community college level. Additional scenarios were delivered under a prior year contract for multiple ADMS-COMMAND units to a national training institute in the Middle East. This simulator included several team training systems, customized scenarios, regionalized environments, and models of appropriate vehicles, equipment, responders, and citizens. The system was delivered in Arabic with specific evaluation, scoring, and record keeping components to train and assess individuals and teams according to the country's national standards. A two-year service, support, and scenario expansion package was also included. The ADMS-COMMAND systems will be used to train emergency responders in command and control. Trainees will exercise in dynamic scenarios in realistic virtual environments. Fires, hazardous material

releases, and victims' health status react dynamically to mitigation efforts, offering real-world incident conditions and realistic experiences for trainees.

Table of Contents

In fiscal 2010, we completed a contract for the New York City Office of Emergency Management to supply a multi-station ADMS COMMAND, our most advanced training system. This system included a turnkey, multi-discipline team-training system with a comprehensive library of customized training scenarios. We believe that our simulators are an integral component of the overall New York City's Citywide Incident Management System Training Program.

In September 2010, we were awarded a contract from the United States Air Force, Air Education and Training Command to implement ADMS into the fire officer training program at the Louis F. Garland Department of Defense (DoD) Fire Training Academy located at the 312th Training Squadron at Goodfellow Air Force Base (AFB), San Angelo, Texas. For this contract, ETC will team with the Adayana Government Group ("Adayana") who will provide project management and associated consulting services. The ADMS simulator will include a virtual replica of Norma Brown AFB, staffed vehicles, and a variety of scenarios including aircraft incidents and structural fires. Norma Brown is a tabletop model of a fictitious air force base that has been used by the Fire Academy for three decades to provide incident command training. ADMS will bring Norma Brown AFB to life by creating a complete environment, and dynamic, interactive scenarios. Fire officers will be trained using ADMS to invoke higher-order thinking to enhance decision making, problem solving, and communications in their roles as incident commanders according to the National Incident Management System. The capstone training exercise using ADMS includes formal evaluations as part of the curriculum. The first simulator will have three Commander Positions for the Incident Commander, Operations Chief and Safety officer, and an Exercise Control Station for the Instructor/Facilitator. The complete system is portable and will be used in-residence and deployed with Mobile Training Teams for on-site training. Adayana will conduct the analysis and develop the design documentation in conjunction with ETC, who will develop the Incident Management Simulator that will be part of the customized solutions. Both companies will assist in the integration and testing, delivery, and training of the Academy personnel.

CSG Segment

Sterilizer Division

Our industrial sterilizers, which can utilize either steam or ethylene oxide as the sterilizing agent, are sold to the animal research, medical device, and pharmaceutical sectors. Sterilizers are designed for general processing of medical equipment, cages, racks, carts, linens, gowns, and other miscellaneous items. When products cannot withstand the high temperature or high humidity conditions of steam sterilization, chemical sterilization using ethylene oxide gas is an available option.

During 2011, performance was mixed in our two sterilizer product lines. The Ethylene Oxide (EtO) Sterilization Systems market was strong as we were awarded two major contracts from major multi-national corporations totaling almost \$8 million for multiple large units. The contracts call for industrial EtO Systems, sophisticated material handling systems, emissions control systems and validation consulting work. Each of the sterilizer systems will include ETC's PRO-GENESIS Advantage control system.

Conversely, our steam product line continued to suffer from the significant reduction in U.S. Government grant awards for facility expansions and modernizations in colleges and universities. This market has been the main source of contract awards in recent years.

Green projects: During fiscal 2010, we were awarded a large "green" project from a domestic customer that is intended to dramatically reduce their consumption of water by reusing cooling water. This project virtually eliminates all wastewater from the current sterilizers. The project calls for us to retrofit the customer's older sterilizers (which were manufactured by another supplier) with state of the art control systems and vacuum systems while also adding a chilled water loop for cooling the older sterilizers. The project will result in significant monetary savings for the customer due to reduced energy consumption and maintenance expense, while improving process reliability. The largest benefit will be the reduction of tens of thousands of gallons of wastewater each year. Additionally, this project will extend the useful life of their sterilizers at a fraction what it would cost to replace the systems.

Hyperbaric Division

Hyperbaric oxygen therapy (HBOT) is the medical use of 100% oxygen at a level higher than atmospheric pressure. Among other uses, HBOT is used to treat decompression sickness, carbon monoxide poisoning, and to enhance certain wound healing. A monoplace chamber provides a cylindrical environment for one person to receive HBOT.

Table of Contents

During fiscal 2011, the Company introduced a new BARA-MED® Select monoplace hyperbaric chamber. This new chamber, which is an addition to ETC's monoplace line, includes an undercarriage gurney storage for optimized space usage and features a fourth-generation, automated computerized operating system for control and recordkeeping, a passive pressure relief mattress, SMOOTH-RIDE™, and an adjustable height gurney and computerized treatment protocols.

With respect to Electronic Medical Records (EMR), our engineering staff has addressed this part of the federal government's plan to modernize the nation's healthcare system by developing O.S.C.A.R.™ (Operating System for Control and Recordkeeping). O.S.C.A.R. is a computer-based pressure vessel control device designed for single compartment (i.e., monoplace) hyperbaric chambers. The technology in O.S.C.A.R. has the potential to provide comprehensive EMR of the Hyperbaric Oxygen Therapy (HBOT) each patient receives. During fiscal 2011, the Company obtained FDA 510-k clearance for the use of O.S.C.A.R., the first stand alone computer hyperbaric oxygen control system intended for use as an ancillary device. The innovation behind O.S.C.A.R. is a proprietary software system that allows hyperbaric technicians to program, manage, and reproduce the HBOT protocol time after time with the same accuracy of the first treatment. This proprietary software is included in each of our BARA-MED® computerized monoplace chambers.

In September 2010, we were awarded a significant order for monoplaces from a long standing Japanese customer. We have been the major supplier of monoplaces for this customer for many years. Next to the domestic 50 states, Japan is our second largest market for hyperbaric chambers.

Environmental Division

Our Environmental Division provides equipment for testing and research purposes. Applications include automotive engine development, automotive air conditioning systems, fuels, lubricants, and various other automotive test and research applications.

This business unit has suffered in recent years from the downturn in the domestic automotive market. However, during fiscal 2011 we did see some limited signs of a market recovery and were awarded three contracts totaling almost \$1.7 million. These contracts consisted of an order for multiple pre-conditioning and aeration units by a major domestic medical device manufacturer and an order for an altitude simulation system by a Turkish company.

Marketing

We utilize both employees and independent representatives to market our products and services. At February 25, 2011, approximately thirty (30) employees were committed to sales and marketing functions. We have branch offices in England, Turkey, Egypt, the United Arab Emirates and Malaysia, and representatives in China and India. Internationally, we contract with numerous independent sales representatives and organizations

Subsidiaries

We presently have one major operating subsidiary and three other legal entities. ETC-PZL Aerospace Industries, our 95%-owned subsidiary, is a Polish corporation that manufactures simulators and provides software to support our domestic products. ETC-Europe, our 99%-owned subsidiary, functions as a sales office in the United Kingdom. NASTAR Center LLC is our wholly-owned Delaware subsidiary which includes our NASTAR Center.

Suppliers

The components being used in the assembly of systems and the parts used to manufacture our products are purchased from equipment manufacturers, electronics supply firms and others. Generally we have historically had little difficulty in obtaining supplies. Further, most of the raw materials, parts, components and other supplies which we use to manufacture our products can be obtained at competitive prices from alternate sources should existing sources of supply become unavailable. However, on any given job, the late delivery of a component or part can create delays in the delivery of a product. We do maintain designs, drawings, molds, tools, safety stock, alternate vendors, and other techniques to eliminate or mitigate the effects of the loss of a single source vendor.

To support our backlog, we have formed Team ETC, a vendor teaming arrangement which includes approximately thirty of our most valuable vendors. Formation of this Team expands our design and manufacturing capabilities to support large, multiple year contracts.

Intellectual Property

We own or have rights to certain intellectual property used in our business (i.e., patents or patent applications, trade secrets, copyrights, trademarks and trade names). While we consider patents, trademarks and copyrights to be valuable assets, we do not believe that our competitive position is dependent solely on patent, trademark or copyright protection, or that any business segment or our operations as a whole is dependent on any individual patent, trademark or copyright. We believe that it is unlikely that we could lose any intellectual property rights that are material to our business.

Customers

Throughout most of our history, in any given fiscal year a substantial portion of our revenues reflect significant contracts with a small number of customers. These customers tend to vary from year to year. Although many of these accounts are long time customers and over time tend to order additional or replacement products, upgrades or devices, we do not depend upon repeat orders from these same customers. We sell our Aircrew Training Systems principally to U.S. and foreign governmental agencies. Our ADMS products are sold domestically primarily to municipalities and quasi-governmental agencies and internationally to training schools and academies. In our CSG group, most of our sterilizer sales are domestic while environmental systems and hyperbaric sales include both domestic and international sales.

In fiscal 2011, sales to three customers totaled \$38,123,000, and represented 68.8% of net sales. In fiscal 2010, sales to two customers totaled \$10,536,000, or 24.6%, of total sales. For fiscal 2011, international sales totaling at least \$500,000 per country, listed in order of magnitude, were made to customers in South Korea, Saudi Arabia, Malaysia and Japan. Additionally, two customers represented a total of \$80,184,000, or 76.0%, of ETC's total backlog of \$105,534,000 as of February 25, 2011. Comparable figures at February 26, 2010 were three customers representing \$85,724,000 or 88.4% of a total backlog of \$96,964,000. See also the Risk Factors below the headings "During the current and prior fiscal years, our core business, aircrew training systems, was awarded three large multi-year contracts from the U.S. Department of Defense and a large multi-year contract with a major international defense agency. Contracts such as these are infrequent and inconsistent" and "Our sources of revenues are not consistent; they tend to be concentrated within a few contracts with a few customers and in a particular mix. It cannot be assumed that any of these contracts, customers or mix will recur in future years."

We do not have any relationship with these customers other than as customers. We are continuing to conduct business with these customers in fiscal 2012.

Foreign and Domestic Operations and Export Sales

The following schedule presents sales information by geographic area (amounts in thousands except percentages):

Geographic area:	Fiscal year ended February 25, 2011		Fiscal year ended February 26, 2010	
	Sales	%	Sales	%
Domestic	\$ 12,181	22.0%	\$ 12,870	30.5%
US Government	23,271	42.0%	7,711	18.2%
International	19,999	36.0%	21,690	51.3%
Total	\$ 55,451	100.0%	\$ 42,271	100.0%

We do not believe that the distribution of our sales between Domestic, U.S. Government and International for any particular period is necessarily indicative of the distribution expected for any other period.

We derive a large portion of our sales from long-term contracts requiring more than one year to complete. We account for sales under long-term contracts on the percentage of completion ("POC") basis. Contracts under POC accounted for \$45,819,000 (82.6%) and \$29,066,000 (68.8%) of our total revenues during fiscal 2011 and 2010, respectively.

Our U.S. Government contracts contain standard terms permitting termination either for the convenience of the U.S. Government or for default. In the event of termination for convenience, we are entitled to receive reimbursement on the basis of work completed (cost incurred plus a reasonable profit). We customarily record the amounts that we anticipate 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.

Product Warranties and Service

We provide warranties against defects in materials and workmanship in our products. Warranty periods for our products generally range from 90 days to two years. We maintain a general provision for estimated expenses of providing service under these warranties. Non-warranty service is billed to the customer as performed. The assumptions we use to estimate warranty accruals are evaluated periodically in light of actual experience and management's estimates of future claims, and, when appropriate, the accruals are adjusted. Our determination of the appropriate level of warranty accrual is subjective and based on estimates, and actual experience may be different than our accruals.

Manufacturing Facilities

Our manufacturing is located on a five-acre site owned by the Company in Southampton, Pennsylvania, a northern suburb of Philadelphia. We have approximately 64,000 square feet devoted to manufacturing, assembly and testing. We are an ISO 9001 certified manufacturer. We have instituted the Lean Manufacturing process with the intent of streamlining project execution and reducing costs and we intend to continue to optimize the process in the foreseeable future. Given the significantly increased volume and nature (*i.e.*, large devices) of additional work, we are considering renting additional manufacturing capacity in the Southampton area.

Green Initiative

We have adopted a “green” initiative to save energy. Some of the applications we have initiated include:

- Our ATFS-400 regenerative braking technology recovers 80% of the energy used to power the centrifuge.
- We are currently replacing all the CRT computer monitors (90 watts) with more energy efficient LCD monitors (45 watts).
- We are undergoing a full “energy audit” in an effort to reduce consumption.
- We are investigating switching to LED lighting and the feasibility of a Solar Farm on our roof.

Operationally, we continue to emphasize the following:

- Expand our recycling effort so as to reduce waste sent to landfills.
- Use our printers less and email more. When printing we strive to use recycled or FSC certified paper. (Products carrying the FSC label are independently certified to assure consumers that they come from forests that are managed to meet the social, economic and ecological needs of present and future generations.) Also, we have added the following disclaimer to the bottom of our emails: “Please consider the environment before printing this email”.

Sales Backlog

Below is a breakdown of the Company’s February 25, 2011 sales backlog (amounts in thousands except percentages):

Geographic area:	Business segment:		Total	%
	TSG	CSG		
Domestic	\$ 1,352	\$ 6,972	\$ 8,324	7.9%
US Government	30,956	35,004	65,960	62.5
International (Commercial and Government)	25,785	5,465	31,250	29.6
Total	\$ 58,093	\$ 47,441	\$ 105,534	100.0%
% of total	55.0%	45.0%	100.0%	

Our sales backlog at February 25, 2011, for work to be performed and revenue to be recognized under written agreements after such dates, was \$105,534,000. Of the February 25, 2011 sales backlog, one product line (aircrew training systems) represented at least 10% of the total backlog (the aircrew training systems backlog is \$51,661,000, or 49.0%, of the total backlog). Additionally, two customers represented a total of \$80,184,000, or 76.0%, of ETC’s total backlog at February 25, 2011.

We expect to complete approximately 60% of the February 25, 2011 sales backlog prior to February 24, 2012, the end of our 2012 fiscal year. Of the February 26, 2010 sales backlog, we completed approximately 42% by February 25, 2011.

Of significance is the continued shift in the mix in fiscal year-end backlog to U.S. Governmental contracts. At February 25, 2011, this category constituted 62.5% of the total backlog and at February 26, 2010, U.S. Government contracts constituted 51.0% of the total backlog. It is also important to note that almost the entire U.S. Government backlog at February 25, 2011 reflected contracts awarded under funding allocated to the Base Realignment and Closure Act (BRAC). It should not be assumed that significant U.S. Government contracts of this magnitude would necessarily be awarded in the future.

Competition

Competition in our diverse product groups reflects our product applications (military versus commercial), market (defense purchases, capital goods for testing and production, etc.), customer (governmental versus commercial), and geographic area (domestic versus international). Our business strategy in recent years has been to seek niche markets in which there is limited competition. However, in some areas of our business we compete with well-established firms, some of which have substantially larger financial and personnel resources than we have.

[Table of Contents](#)

Some competing 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 us for this business. Awards for any particular project are determined by various factors, including the technological requirements of the project, financial capability, reliability, product performance, past performance and price. Competition for our aeromedical products has increased in recent years.

We face competition in the sale of the larger, custom-designed industrial sterilizers both from other manufacturers and from our customers' in-house production capabilities. Most of our competition for environmental products comes from small manufacturers, while the hyperbaric monoplace line has two major competitors.

We believe that we are a significant participant in the markets in which we compete, such as air crew training systems and disaster management simulation software, where we believe that we have a technical advantage.

Compliance with Environmental Laws

We did not incur during fiscal 2011, nor do we anticipate incurring during fiscal 2012, 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 do we anticipate that compliance with these provisions will have a material adverse effect on our earnings or competitive position. We believe that we are currently in compliance with federal, state and local statutes, rules and regulations concerning the discharge of materials into the environment.

Governmental policy makers, industry representatives and scientists continue to discuss global climate change and potential legislation to reduce greenhouse gases. Due to the high level of uncertainty regarding the character and timing of any legislation or regulations that may be adopted, management is unable to evaluate the potential economic impact of any such measures at this time. Additional regulation in this area could result in incurring additional capital spending and higher operating expenses.

Compliance with Export Controls

Depending on the product, customer, location and the application or use, some of our aeromedical products require an export license from the U.S. Departments of Commerce or State. Certain international letters of credit for contracts which include controlled equipment may also include the requirement for us to obtain export licenses before applying for payments. We have an Export License Compliance Program which covers all key aspects of the International Traffic in Arms Regulations ("ITAR"). The U.S. Directorate of Defense Trade Controls is charged with controlling the export and temporary import of defense articles and defense services covered by the ITAR. Although most export licenses are readily obtainable in a reasonable timeframe, depending on the equipment and customer, some of our international contracts for aeromedical equipment include the issuance of an export license as a force majeure (a natural and unavoidable catastrophe that disrupts the expected course of events) exception for any contract penalties or liquidated damages.

Employees

On February 25, 2011, we had 321 full-time employees and two part-time employees (compared to 273 full-time employees a year ago), of which five were employed in executive positions, 113 were engineers, engineering designers, or draftspersons, 90 were administrative (sales, sales support, accounting and general administrative and executive) and clerical personnel, and 120 were engaged principally in production, operations and field support. A total of 217 employees were stationed in our Southampton, Pennsylvania corporate headquarters.

Available Information

Our Internet address is www.etcusa.com. The content on our website is available for informational purposes only. You should not rely upon such content for investment purposes and such content is not incorporated by reference into this Form 10-K.

We make available free of charge, on our Internet website under the heading "Investor Relations," this Annual Report on Form 10-K, our Proxy Statement, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. We also make available on or through our website copies of our key corporate governance documents, including our Charters for the Audit Committee, Compensation Committee, and the Nominating and Governance Committee of the Board of Directors and our Codes of Ethics and Conduct. Shareholders may request free copies of these documents from our Investor Relations Department by writing to Environmental Tectonics Corporation, Investor Relations, 125 James Way, Southampton, PA 19866, by calling (215) 355-9100, or by sending an email request to invest@etcusa.com.

Item 1A. Risk Factors

RISK FACTORS

Our business is subject to numerous risks and uncertainties which could cause our actual operating results to be materially different from those expressed or implied in any of our public announcements or filings, including this Annual Report on Form 10-K for the fiscal year ended February 25, 2011. These risks and uncertainties include the following items, which do not represent a comprehensive list of all the risks and uncertainties associated with our business.

Our Common Stock is currently quoted on the Over-the-Counter – OTCQB market tier which may limit purchase and sale of our Common Stock.

Our Common Stock is quoted over-the-counter on the OTCQB market tier (“OTCQB”). Certain investors, for example, institutional investors, have policies and regulations that may not allow investment in our common stock because it is quoted on the OTCQB. This may limit trading volume and affect the price of our common stock.

In general, the market price of securities of thinly traded public companies has historically faced significant volatility. Our common stock does not experience a significant average daily trading volume. Accordingly, if one shareholder either elects to purchase or sell a block of our Common Stock, it may have a significant effect on the current trading price. In addition, the stock market in recent years has experienced significant price and volume fluctuations that often have been unrelated or disproportionate to the operating performance of particular companies. Factors that have influenced the trading prices for our common stock include, but are not limited to, the following:

- actual or anticipated operating results;
- market conditions in the industries in which we compete;
- announcements by competitors;
- results of litigation;
- regulatory actions; and
- general economic conditions.

Any of the above factors would likely affect the market price of our Common Stock.

During the current and prior fiscal years, our core business, aircrew training systems, was awarded three large multi-year contracts from the U.S. Department of Defense and a large multi-year contract with a major international defense agency. Contracts such as these are infrequent and inconsistent.

As of February 25, 2011, \$64.2 million of our backlog was for three contracts awarded under Base Realignment and Closure Act (BRAC) funds. BRAC has a specific focus and purpose and funds allocation. Although possible, it should not be assumed that additional awards will be obtained under BRAC nor that additional funding under BRAC will be available. If we are unsuccessful in obtaining additional contracts under BRAC funding our financial performance could be significantly negatively impacted.

Additionally, \$21.8 million of our backlog represented one large international contract.

Given the current political and economic environment, and the extremely competitive nature of U.S. and international defense contracts, there is no assurance that we will be successful in obtaining additional major contracts.

We have spent significant funds over the prior years to develop advanced technologies to support the defense simulator industry and our cost of software, plant assets and operating expenses is relatively high in comparison to our revenue base. Also, the cost of preparing these complicated proposals is significant. Depending on the size and nature of the technical proposal, preparation costs (including pre-engineering costs) can exceed \$500,000. Any of these costs related to enhancing existing products (via additional application or functionality) may be initially appropriately capitalized into inventory and then transferred to cost of goods sold upon receipt of a relevant contract of contracts.

Consequently, our financial performance is highly dependent upon obtaining these contracts.

There is a risk of an unfavorable outcome in litigation and resulting negative financial impact on our cash flow and operating results.

Our business, which involves primarily large long-term contracts for the manufacture of unique equipment, is subject to risks related to litigation. It is not possible to predict the outcome of pending or future litigation, and, as with any litigation, it is possible that some of the actions could be decided unfavorably and could have a material adverse effect on the results of the Company’s operations, cash flows or financial condition.

Our sources of revenues are not consistent; they tend to be concentrated within a few contracts with a few customers and in a particular mix. It cannot be assumed that any of these contracts, customers or mix will recur in future years.

In any given fiscal year, a substantial portion of our revenues is typically derived from a small number of contracts and customers. In fiscal 2011, sales to three customers totaling \$38,123,000, represented 68.8% of net sales. In fiscal 2010, sales to two customers, represented in total \$10,536,000, or 24.6%, of total sales. Additionally, two customers represented a total of \$80,184,000, or 76.0%, of ETC's total backlog of \$105,534,000 at February 25, 2011. Comparable figures at February 26, 2010 were three customers representing \$85,724,000, or 88.4%, of a total backlog of \$96,964,000.

Of significance is the continued mix shift in fiscal year-end backlog to U.S. Governmental contracts. At February 25, 2011, this category constituted 61.5% of the total backlog and at February 26, 2010, U.S. Government contracts constituted 51.0% of the total backlog. It is also important to note that almost the entire U.S. Government backlog at February 25, 2011 reflected contracts awarded under funding allocated to the Base Realignment and Closure Act (BRAC). It should not be assumed that significant U.S. Government contracts of this magnitude would necessarily be awarded in the future.

Our debt is concentrated and directly dependent upon either direct arrangements or under guarantee arrangements with H. F. Lenfest.

In addition to cash flow from operations, a significant portion of our cash needs are supplied under direct arrangements or bank agreements guaranteed personally by H.F. Lenfest, a major shareholder and member of our Board of Directors. Mr. Lenfest has provided funding in multiple arrangements and at multiple times since 2003. Should these personal guarantees no longer be available, this event might cause a disruption of available funds under our various financing arrangements.

Additionally, we have a significant amount of indebtedness to Mr Lenfest and Mr. Lenfest has a substantial investment in the Company's Preferred Stock. We may not generate sufficient cash flow from operations, or have future additional sources of cash available to us to service our required payments.

Our ability to make debt payments depends on our future performance, which, to a certain extent, is subject to general economic, financial, competitive and other factors, many of which are beyond our control. Based upon our current level of operations and anticipated growth, we believe that cash on hand, future availability under the PNC Bank line of credit and our Line of Credit with Mr. Lenfest will be adequate to meet our future obligations through at least June 1, 2012. However, given that our bank debt is personally guaranteed by Mr. Lenfest and that all of our arrangements and agreements are with him as an individual, there can be no assurance that, should our business not generate sufficient cash flow from operations to enable us to pay our debts or to make necessary capital expenditures, we will be successful in negotiating new financial arrangements with Mr. Lenfest or any other party, or that any refinancing of debt would be available and on commercially reasonable terms.

See the Liquidity and Capital Resources section of the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K.

We need to attain validation from the U.S. defense agencies of our Authentic Tactical Fighting Systems (ATFS) technology.

A challenge for our ATFS technology has been marketing this technology to the world's defense agencies. This is a new technology that is contrary to the conventional training belief that tactical flight and combat skills can only be learned in a flying aircraft. Although we made significant progress toward this goal during fiscal 2010 by being awarded a contract by the United States Air Force to provide a high performance human centrifuge, at this point we cannot be certain that we will be able to overcome conventional thinking on training nor achieve an acceptable level of validation with respect to the applicability and efficacy of ATFS training.

Our operations involve rapidly evolving products and technological change.

The pace of technological change impacts products in our Training Services Group. Changing technology requires us to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. Technology development is only partially funded through enhancements included in customer orders. We cannot guarantee that we will continue to maintain comparable levels of research and development nor that this development will be customer-funded in the same ratio going forward. Reinvestment of operating funds and profits in an amount greater than currently earned may be required. Even so, we cannot be assured that we will successfully identify new opportunities and continue to have the financial resources required to develop new products profitably. At the same time, products and technologies developed by others may render our products and systems obsolete or non-competitive.

Long term contracts under percentage of completion (“POC”) accounting comprise a significant portion of our fiscal 2011 revenues and our backlog at February 25, 2011. Delays in the delivery of our products may prevent us from invoicing our costs and estimated earnings on uncompleted contracts.

At February 25, 2011, contracts accounted for under the percentage of completion (“POC”) accounting method comprised \$94,154,000, or 89.2%, of our total backlog. Additionally, contracts under POC revenue recognition method generated \$45,819,000, or 82.6%, of our total revenues. In conformity with accounting principles generally accepted in the United States for long-term contracts under the POC accounting method, we record, due to timing differences, an asset for our costs and estimated earnings that exceed the amount we are able to bill our customers on uncompleted contracts. At February 25, 2011, this asset totaled \$10,371,000. Although a significant portion of these costs are related to U.S. Government contracts which have progress billing terms, under progress billing procedures, we can recover only a portion of these costs before completion of the contract. Additionally, we cannot bill additional amounts unless and until we make satisfactory progress in the production, delivery and integration of our products. Typically, there will be a time lag ranging from six to twenty-four months between performance and associated costs for these types of projects and billing and collection of all contract payments. Our failure to either execute on schedule or meet milestones by delivering and integrating our products in a timely manner may impact our ability to collect final payments on these contracts, which could severely impact our cash flow.

For an explanation of percentage of completion accounting, see the section “Critical Accounting Estimates” in Management’s Discussion and Analysis of Financial Condition and Results of Operations and Note 2 – Summary of Significant Accounting Policies of the notes to our consolidated financial statements in the Annual Report to Shareholders attached hereto as Exhibit 13 and incorporated herein by reference.

In the event we suffer production delays, we may be required to pay certain customers substantial liquidated damages and other penalties.

The variety and complexity of our high technology product lines require us to deal with a multitude of suppliers and subcontractors. Some of the parts we purchase are highly specialized. Planning production, optimizing inventory levels, and meeting delivery schedules all require high coordination and at times may have conflicting goals. Most of our large aircrew training simulators and our software products must be custom designed and manufactured, which is not only complicated and expensive, but can also require long periods of time to accomplish. Slight errors in design, planning and managing production, inventory levels, delivery schedules, or manufacturing can result in unsatisfactory products that may not be correctable. If we are unable to meet our delivery schedules, we may be subject to penalties, which may have an adverse impact on our business.

Our fixed-price and cost-reimbursement contracts may commit us to unfavorable terms.

Historically, we have provided our products and services primarily through fixed-price contracts. Under a fixed-price contract, we agree to perform the scope of work required by the contract for a predetermined contract price. Although a fixed-price contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain contract losses. Therefore, unless there are customer-requested changes in scope or other changes in specifications which are reimbursable, we fully absorb cost overruns on fixed-price contracts and this reduces our profit margin on the contract. These cost overruns may result in us recognizing a loss on a contract. A further risk associated with fixed-price contracts is the difficulty of estimating sales and costs that are related to performance in accordance with contract specifications. Our failure to anticipate technical problems, estimate costs accurately or control costs during performance of a fixed-price contract may reduce our profitability and may cause us to incur a loss on the project.

In connection with certain commercial contracts, we have been required to obtain bonds, letters of credit, or similar credit enhancements. We cannot assure you that we will be successful in obtaining these types of instruments or that these types of instruments, if available, will be affordable in the future.

Under the terms of our commercial contracts, we typically must satisfy strict performance obligations and project milestones, which we may not be able to satisfy. If we fail to meet these performance obligations and milestones, the other party may terminate the contract and, under certain circumstances, recover liquidated damages or other penalties from us which could have a negative effect on our business, financial condition or results of operations.

As a U.S. Government contractor, we are subject to a number of procurement rules and regulations.

Government contractors must also comply with specific procurement regulations and other requirements. These regulations and requirements, although customary in government contracts, increase our performance and compliance costs. In addition, current U.S. Government budgetary constraints could lead to changes in the procurement environment. If such changes occur, our costs of complying with procurement requirements could increase and reduce our margins.

Depending on the product, customer, location and the application or use, some of our aeromedical products require an export license from the U.S. Commerce or State Department. Certain international letters of credit for contracts which include controlled equipment may also include the requirement for us to obtain export licenses before applying for payments. We have an Export License Compliance Program which covers all key aspects of the International Traffic in Arms Regulations (ITAR). Although most export licenses are readily obtainable in a reasonable timeframe, depending on the equipment and customer, some of our international contracts for aeromedical equipment include the issuance of an export license as a force majeure (a natural and unavoidable catastrophe that disrupts the expected course of events) exception for any contract penalties or liquidated damages.

Failure to comply with these regulations and requirements could result in reductions of the value of contracts, contract modifications or termination, and the assessment of penalties and fines, which could negatively impact our results of operations and financial condition. The termination of a government contract or relationship could also, under certain circumstances, result in our suspension or debarment from future government contracting for a period of time, and this could have a negative impact on our reputation and ability to procure other government contracts in the future. Presently, the Company is not aware of any circumstances which could result in its suspension or debarment from government contracting.

Our business could be adversely affected by a negative audit by the U.S. Government.

As a government contractor, we are subject to routine audits and investigations by U.S. Government agencies such as the Defense Contract Audit Agency (DCAA). These agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. The DCAA also reviews the contractor's adequacy of and compliance with its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed or must be refunded if already reimbursed. If an audit contains a significant adverse finding, we could be subject to penalties and fines and contract termination, which could negatively impact our results of operations and financial condition. The termination of a government contract or relationship could also, under certain circumstances, result in our suspension or debarment from future government contracting for a period of time, and this could have a negative impact on our reputation and ability to procure other government contracts in the future. Presently, the Company is not aware of any circumstances which could result in a significant adverse finding by the DCAA.

Our contracts that are funded by the U.S. Government or foreign governments are subject to a competitive bidding process that may affect our ability to win contract awards or renewals in the future.

Government supply contracts generally are awarded to us through a competitive bidding process in which we may have many qualified competitors. Upon expiration, government supply contracts may be subject, once again, to the competitive bidding process. We cannot assure that we will be successful in winning contract awards or renewals in the future. Our failure to renew or replace government contracts when they expire could have a material adverse effect on our business, financial condition or results of operations. Our business, financial condition and results of operations could be materially and adversely affected to the extent that government agencies believe our competitors offer a more attractive combination of technical merit, personnel qualifications, financial capability, experience and price. In addition, new government contract awards also are subject to protest by competitors at the time of award that can result in the re-opening of the competitive bidding process, the evaluation process or the award of a contract to a competitor. Other characteristics of the government contract market that may affect our operating results include the complexity of designs, and the difficulty of forecasting costs and schedules when bidding on developmental and highly sophisticated technical work. Our earnings may vary materially on some contracts depending upon the types of government long-term contracts undertaken, the costs incurred in their performance, and the achievement of other performance objectives.

Our international business is subject to geo-political and economic factors, regulatory requirements and other risks.

Our international business exposes us to geo-political and economic factors, regulatory requirements and other risks associated with doing business in foreign countries. These risks differ from and potentially may be greater than those associated with our domestic business. In addition, our exposure to such risks may increase if our international business continues to grow as we anticipate. An example is the recent political disruption in numerous countries in the Middle East. This region has historically been a strong market for ETC's ATS products.

Our international business is sensitive to changes in the priorities and budgets of international customers, which may be driven by changes in threat environments and potentially volatile worldwide economic conditions, regional and local economic and political factors, as well as U.S. foreign policy. Our international sales are subject to U.S. laws, regulations and policies, which sometimes include the Foreign Corrupt Practices Act, the ITAR, and other export laws and regulations. They are also subject to local government laws, regulations and procurement policies and practices which may differ from U.S. Government regulations, including regulations relating to import-export control, investments, exchange controls and repatriation of earnings, as well as to varying currency (which we mitigate by denominating our contracts in U.S. dollars when possible), geo-political and economic risks. Our international contracts may include requirements on specific in-country purchases, manufacturing agreements or financial support obligations, known as offsets, and provide for penalties if we fail to meet such requirements. We also are exposed to risks associated with using foreign representatives and consultants for international sales and operations and teaming with international subcontractors, partners and suppliers in connection with international programs. As a result of these factors, we could experience award and funding delays on international programs and could incur losses on such programs which could negatively impact our results of operations and financial condition.

Legislative actions resulting in higher compliance costs are likely to adversely affect our future consolidated results of operations, financial position and cash flows.

Compliance with laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Sarbanes-Oxley Act of 2002, and new regulations enacted by the Securities and Exchange Commission (the “SEC”), are resulting in increased compliance costs. We, like all other public companies, are incurring expenses and allocating additional human resources to ensure compliance with Section 404 of the Sarbanes-Oxley Act of 2002. We are a smaller reporting company, and have completed the process of documenting our systems of internal control and have evaluated our systems of internal control. Beginning with the year ended December 31, 2007, we have been required to assess continuously our compliance with Section 404 of the Sarbanes-Oxley Act of 2002. We expect to continue to devote the necessary resources, including internal and external resources, to support our assessment. In the future, if we identify one or more material weaknesses, this could subject us to sanctions or investigation by regulatory authorities. In addition, the SEC is expected to implement a number of new rules in fiscal 2012 and beyond to implement the Dodd-Frank Act. Compliance with these evolving standards will result in increased general and administrative expenses and may cause a diversion of human resources from revenue-generating activities to compliance activities.

The Company is subject to environmental laws and potential exposure to environmental liabilities.

We are subject to various international, federal, state and local environmental laws and regulations that govern our operations, including the handling and disposal of non-hazardous and hazardous wastes, the recycling and treatment of electrical and electronic equipment, and emissions and discharges into the environment. Failure to comply with such laws and regulations could result in costs for corrective action, penalties or the imposition of other liabilities. We are also subject to laws and regulations that impose liability and clean-up responsibility for releases of hazardous substances into the environment. Based on currently available information, although there can be no assurance, we believe that such costs and liabilities have not had and will not have a material adverse impact on our consolidated results of operations.

Our quarterly operating results may vary significantly from quarter to quarter.

Our revenues and earnings tend to fluctuate from quarter to quarter based on factors that include the following:

- the number, size and scope of our projects;
- the mix of contracts (POC versus other);
- our ability to finance our operations;
- the number of bid and proposal efforts undertaken;
- delays in sales bookings or production;
- the level of employee productivity;
- the adequacy of our provisions for receivable, inventory and other losses;
- the accuracy of our estimate of resources required to complete ongoing projects; and
- general economic conditions.

Demand for our products and services in each of the markets we serve can vary significantly from quarter to quarter due to revisions in customer budgets or schedules and other factors beyond our control. Due to all of the foregoing factors, our results of operations may fall below the expectations of our investors in a particular period.

Our officers and directors own a significant amount of our common stock which permits them to exert significant influence over the direction of our business and affairs.

As of April 29, 2011, our directors and executive officers own and could vote an aggregate of approximately 73% of our outstanding common stock on a fully converted basis. Accordingly, our directors and executive officers, if they act together, will be able to exert significant control over the direction of our business and affairs.

We depend on the recruitment and retention of qualified personnel, and our failure to attract and retain such personnel could seriously harm our business.

Due to the specialized nature of our business, our future performance is highly dependent upon the continued services of our key engineering personnel and executive officers, the development of additional management personnel and the hiring of new qualified engineering, manufacturing, marketing, sales and management personnel for our operations. Competition for qualified personnel is intense, and we may not be successful in attracting or retaining qualified personnel. The loss of key employees, our inability to attract new qualified employees or adequately train employees, or the delay in hiring key personnel, could seriously harm our business, results of operations and financial condition.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own our executive offices and principal production facility (an approximately 92,000 square foot steel and masonry building) located on a five-acre site in the County Line Industrial Park, Southampton, Pennsylvania. Approximately 64,000 square feet of the building is devoted to manufacturing, our NASTAR training center occupies approximately 22,000 square feet, and approximately 6,000 square feet of this building is devoted to office space. The original building was erected in 1969 and additions were most recently made in 2001. These properties are encumbered by an Amended and Restated Open-End Mortgage and Security Agreement with H.F. Lenfest (“Lenfest”), which secures obligations which the Company may have to Lenfest pursuant to a 2003 Senior Subordinated Note and a 2009 Secured Promissory Note, any future obligations which we may have to Lenfest with respect to the \$7,500,000 credit facility provided by Lenfest to ETC, and Lenfest’s guarantee of all of ETC’s obligations to PNC Bank, National Association pursuant to the Company’s revolving line of credit. A copy of this Amended and Restated Open-End Mortgage and Security Agreement was filed as Exhibit 10.1 to ETC’s Form 8-K dated April 27, 2009.

Additionally, we rent office space at various sales and support locations throughout the world and in Warsaw, Poland at ETC-PZL Aerospace Industries, our Polish subsidiary.

We consider our machinery and plant to be in satisfactory operating condition. Increases in the level of operations beyond what we expect in the current fiscal year might require us to obtain additional facilities and equipment.

The NASTAR Center includes aerospace training and research equipment including:

- ATFS-400 Authentic Tactical Flight Simulator
- GYROLAB GL-2000 Advanced Spatial Disorientation Trainer
- Hypobaric Chamber
- Ejection Seat Trainer
- Night Vision and Night Vision Goggle Training System

Item 3. Legal Proceedings

Mends International, Ltd.

On May 29, 2008, a Request for Arbitration was filed against the Company with the Secretariat of the International Court of Arbitration by Mends International Ltd. (“Mends”). Mends’ Request for Arbitration arose out of a February 3, 1999 contract between the Company and Mends wherein Mends purchased aeromedical equipment for sale to the Nigerian Air Force (the “First Arbitration”). Mends asserted a claim for breach of contract and demanded \$797,486, plus interest and costs. On September 16, 2008, Mends filed an Amended Request for Arbitration, adding tort claims for conversion and breach of fiduciary duty and seeking punitive damages. In response, the Company asserted a counterclaim seeking damages for other disputes with Mends that have arisen under the contract that Mends has put at issue in this arbitration. On July 1, 2010 and October 18, 2010, the International Court of Arbitration issued a Partial Final Award and an Award on Costs which have been fully accrued and did not have a material adverse effect on the Company’s financial condition or results of operation.

In September 2010, a second arbitration involving ETC and Mends was heard by the International Court of Arbitration. In the second arbitration, the Company alleged the breach of a separate contract between the parties and sought monetary damages. This second arbitration may affect the ultimate payment due in the above-referenced First Arbitration. The second arbitration award is expected shortly, and it is not expected that any award adverse to the Company would have a material effect on the Company’s financial position or results of operations.

ITAR Disclosure

Subsequent to February 25, 2011, the Company submitted an initial notification of voluntary disclosure to the Directorate of Defense Trade Controls within the U.S. Department of State (DDTC) concerning the potential export of technical data and defense services to foreign persons. The services at issue (which constitute less than 0.5% of the Company's total annual sales) consisted of the provision of low gravitational force training in a human-rated centrifuge. The human-rated centrifuge is subject to the jurisdiction of DDTC in accordance with the International Traffic in Arms Regulations (ITAR). The Company filed the initial notification because we determined that the training programs may be subject to the jurisdiction of the ITAR. In approximately one month, we will provide a full disclosure to DDTC. At this time it is not possible to determine whether any fines or other penalties will be asserted against the Company or the materiality of any outcome.

Other Matters

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against us. We believe, after consultation with legal counsel handling these specific matters, 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 be expected to have a significant effect on our financial position or results of operations if determined adversely against us.

Item 4. [Removed and Reserved]

PART II

Item 5. Market for the Registrant's Common Stock and Related Security Holder Matters and Issuer Purchases of Equity Securities

Our Common Stock is currently traded over-the-counter on the OTCQB market tier under the symbol ETCC.PK. Our Common Stock moved from the OTC Bulletin Board (symbol was ETCC.OB) to the OTCQB Market Tier on February 23, 2011. The table set forth below shows the high and low bid information on these markets for the past two years. These quotations reflect inter-dealer prices, without retail mark-up, mark down or commission and may not represent actual transactions. According to our stock transfer records, we had 280 shareholders of record of our common stock as of April 29, 2011, and as of such date there were 9,104,601 common shares issued and outstanding.

	Bid Prices	
	High	Low
Fiscal 2011		
First Quarter	\$ 3.40	\$ 2.25
Second Quarter	3.25	2.50
Third Quarter	3.49	2.90
Fourth Quarter	3.26	2.60
Fiscal 2010		
First Quarter	\$ 2.84	\$ 0.73
Second Quarter	1.68	1.05
Third Quarter	2.69	1.20
Fourth Quarter	3.55	2.26

On April 29, 2011, the closing price of our Common Stock was \$2.89. We have never paid any cash dividends on our Common Stock and do not anticipate that any cash dividends on our common stock will be declared or paid in the foreseeable future.

Issuer Purchases of Equities

During fiscal 2011, the Company repurchased and retired at face value \$2,000,000 (2,000 shares) of Series E Preferred Stock from H.F. Lenfest.

Item 6. Selected Financial Data

Not applicable.

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 to Shareholders attached hereto as Exhibit 13 and incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

See the information appearing under the headings "Consolidated Financial Statements" and "Notes to the Consolidated Financial Statements" in the Annual Report to Shareholders 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.

Item 9A. Controls and Procedures

(a) *Disclosure Controls and Procedures; Changes in Internal Control Over Financial Reporting*

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in the reports we file under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosures. A controls system cannot provide absolute assurances, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that ETC's disclosure controls and procedures were effective as of the end of the period covered by this report.

(b) *Remediation of Material Weaknesses*

We previously reported in our Quarterly Report on Form 10-Q for the third quarter of fiscal 2011 material weaknesses with respect to (i) the Company's failure to include management's annual report on internal control over financial reporting in ETC's Form 10-K for the period ended February 26, 2010 and (ii) errors in prior fiscal periods relating to the calculation and presentation of the Company's earnings per share in accordance with United States generally accepted accounting principles because of the failure to reflect the participating features of its Series D Preferred Stock and Series E Preferred Stock when calculating its earnings per share in financial statements.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of interim or annual financial statements will not be prevented or detected on a timely basis by the company's internal controls.

As disclosed in our Quarterly Report on Form 10-Q for the third quarter of fiscal 2011, management implemented efforts to remediate the two material weaknesses described above including:

- Company management prepared, published and enforced a detailed reporting schedule to allow adequate time for proper review by a newly formed compliance disclosure committee comprising the Company's Chief Financial Officer, the Company's General Counsel and the Company's key operations and accounting personnel.
- Company management reviewed all internal procedural controls to ensure that all process participants understand their respective individual roles and that controls and other checks and balances in the control environment are functioning adequately.
- Company staff involved in calculating earnings per share have been trained and now understand how to take into account the participating features of the Company's Series D Preferred Stock and Series E Preferred Stock when calculating its earnings per share.

We implemented and tested the above controls at the end of the fourth quarter of fiscal 2011. We have determined as of February 25, 2011 that the remediation controls discussed above were effectively designed and demonstrated effective operation and for this reason we are able to conclude that the material weaknesses have been remediated.

(c) *Management Report on Internal Control Over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and Rule 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

[Table of Contents](#)

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of February 25, 2011. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting using the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the internal control system are met. Because of the inherent limitations of any internal control system, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected.

Based on our evaluation, and the above criteria, our management concluded that our internal control over financial reporting was effective as of February 25, 2011.

This report on Form 10-K does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to the rules of the SEC that permit the Company to provide only management's report in this report on Form 10-K.

(d) Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably expected to materially affect, our internal control over financial reporting other than the remediation of the material weaknesses identified above.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this Item is incorporated by reference to the information under the captions “Election of Directors,” “Information Concerning the Board of Directors, Board Committees and Corporate Governance,” “Executive Officers,” “Committees of the Board of Directors” and “Compliance with Section 16(a) of the Securities Exchange Act of 1934” included in our proxy statement for our 2011 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission.

Our Chief Executive Officer and our senior financial officers are required to comply with the Code of Ethics adopted by the Company. The Code of Ethics sets forth policies covering a range of subjects and requires adherence to laws and regulations applicable to our business. The Code of Ethics is available on our website at www.etcusa.com under the “Investor Relations-Code of Ethics” captions. We will post to our website any amendments to the Code of Ethics, or waiver from the provisions thereof for our Chief Executive Officer and our senior financial officers under the “Investor Relations-Code of Ethics” caption.

Item 11. Director and Executive Compensation

The information required by this Item is incorporated by reference to the information under the caption “Executive Compensation” included in our proxy statement for our 2011 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The information required by this Item is incorporated by reference to the information under the captions “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” included in our proxy statement for our 2011 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by this Item is incorporated by reference to the information under the captions “Director Independence” and “Transactions with Related Persons” included in our proxy statement for our 2011 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission.

Item 14. Principal Accountant Fees and Services

The information required by this Item is incorporated by reference to the information under the caption “Independent Public Accountants – Accounting Fees” included in our proxy statement for our 2011 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a)(1) and (a)(2) Consolidated Financial Statements:

The financial statements listed in the following table, which are included in our Annual Report to Shareholders, are incorporated herein by reference to the portions of this Annual Report on Form 10-K filed as Exhibit 13 hereto.

	Page
Management's Discussion and Analysis of Financial Condition and Results of Operations	2
Report of Independent Registered Public Accounting Firm	14
Consolidated Balance Sheets	15
Consolidated Statements of Income	16
Consolidated Statements of Changes in Shareholders' Equity	17
Consolidated Statements of Cash Flows	18
Notes to the Consolidated Financial Statements	19

All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the financial statements, including the notes thereto.

(a)(3) Exhibits:

<u>Number</u>	<u>Item</u>
3.1(i)(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.
3.1(i)(2)	Statement with respect to shares of Series D Convertible Preferred Stock, was filed on April 27, 2009 as Exhibit 10.1 to Registrant's Form 8-K and is incorporated herein by reference.
3.1(ii)	Registrant's amended and restated By-Laws were filed as Exhibit 3.2 to Registrant's Form 8-K dated May 25, 2005, and are incorporated herein by reference.
3.1(i)(3)	Statement with respect to shares of Series E Convertible Preferred Stock was filed on July 6, 2009 as Exhibit 3.1 to Registrant's Form 8-K and is incorporated herein by reference.
3.1(i)(4)	Amendment to Articles of Incorporation of the Company was filed on July 6, 2009 as Exhibit 3.2 to Registrant's Form 8-K and is incorporated herein by reference.
4.1	Secured Promissory Note by the Registrant in favor of H.F. Lenfest, dated as of February 20, 2009, was filed on February 26, 2009 as Exhibit 10.2 to Form 8-K and is incorporated herein by reference.
4.2	Common Stock Warrant issued by the Registrant in favor of H.F. Lenfest, dated as of February 20, 2009, was filed on February 26, 2009 as Exhibit 10.3 to Form 8-K and is incorporated herein by reference.
4.3	Amended and Restated Warrant, dated as of April 24, 2009, between Registrant and Lenfest, was filed on April 27, 2009 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
10.1	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. *
10.2	Registrant's Stock Award Plan adopted April 7, 1993, was 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. *
10.3	2005 Non-employee Director Stock Option Plan, incorporated by reference to Annex A of Registrant's Definitive Proxy Statement on Schedule 14A filed on August 16, 2005 and is incorporated herein by reference. *
10.4	Registrant's 2009 Employee, Director and Consultant Stock Plan was filed on September 4, 2009 on Form S-8 and is incorporated herein by reference. *

[Table of Contents](#)

10.5	Employment Agreement, dated as of November 1, 2005, between Registrant and Duane D. Deaner, Chief Financial Officer was filed on May 24, 2007 as Exhibit 10.33 to the Registrant's Form 10-K for the fiscal year ended February 23, 2007 and is incorporated herein by reference.*
10.6	Employment Agreement, dated as of July 24, 2006, between Registrant and William F. Mitchell , was filed on July 24, 2006 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.*
10.7	Security Agreement by the Registrant in favor of H.F. Lenfest, dated as of February 20, 2009, was filed on February 26, 2009 as Exhibit 10.2 to Form 8-K and is incorporated herein by reference.
10.8	Secured Credit Facility and Warrant Purchase Agreement, dated April 24, 2009, between Registrant and H.F. Lenfest, was filed on November 24, 2010 as Exhibit 10.1 to Form 8-K/A and is incorporated herein by reference.
10.9	Letter Agreement, dated April 24, 2009, between Registrant and PNC Bank, with the Amended and Restated PNC Credit Agreement, the Amended and Restated PNC Note, the Amended and Restated Guaranty Agreement, the Pledge Agreement and the Notification and Control Agreement (each as defined in such letter agreement) attached thereto as exhibits, was filed on April 27, 2009 as Exhibit 10.3 to Form 8-K and is incorporated herein by reference.
10.10	Second Amended and Restated Subordination Agreement, dated April 24, 2009, among PNC Bank, Lenfest and Registrant, was filed on April 27, 2009 as Exhibit 10.4 to Form 8-K and is incorporated herein by reference.
10.11	Amended and Restated Open-End Mortgage and Security Agreement, dated as of April 24, 2009, by Registrant in favor of Lenfest was filed on May 12, 2009 as Exhibit 10.32 to Form 10-K and is incorporated herein by reference.
10.12	Letter Agreement by and between the Registrant and H.F. Lenfest was filed on July 6, 2009 as Exhibit 10.1 to Form 10-K and is incorporated herein by reference.
10.13	First Amendment to Executive Employment Agreement dated as of June 9, 2009, by and between the Registrant and Duane D. Deaner was filed on July 6, 2009 as Exhibit 10.2 to Form 10-K and is incorporated herein by reference.
10.14	First Amendment to 2007 PNC Credit Facility, between Registrant and PNC Bank, dated October 1, 2009, was filed on October 7, 2009 as Exhibit 1.1 to Form 10-K and is incorporated herein by reference.
10.15	Letter Agreement between the Registrant and PNC Bank, dated as of November 16, 2009 was filed on November 20, 2009 as Exhibit 1.1 to Form 8-K and is incorporated herein by reference.
10.16	Reimbursement Agreement between the Registrant and PNC Bank, dated as of November 16, 2009 was filed on November 20, 2009 as Exhibit 1.2 to Form 8-K and is incorporated herein by reference.
10.17	Pledge Agreement between the Registrant and PNC Bank, dated as of November 16, 2009 was filed on November 20, 2009 as Exhibit 1.3 to Form 8-K and is incorporated herein by reference.
10.18	Amendment to Subordination Agreement between the Registrant, H.F. Lenfest and PNC Bank, dated as of November 16, 2009, was filed on November 20, 2009 as Exhibit 1.4 to Form 8-K and is incorporated herein by reference.
10.19	Stock Repurchase Agreement between the Registrant and H.F. Lenfest, dated March 10, 2010, was filed on March 16, 2010, as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
10.20	Amendment to Loan Documents dated as of May 7, 2010, between the Registrant, H.F. Lenfest and PNC Bank, National Association was filed on June 1, 2010 as Exhibit 1.1 to Form 8-K and is incorporated herein by reference.
10.21	Amendment to Loan Documents dated as of June 2, 2010 between the Registrant and PNC Bank, National Association was filed on July 12, 2010 as Exhibit 10.2 to Form 10-Q and is incorporated herein by reference.
10.22	Stock Repurchase Agreement between the Registrant and H.F. Lenfest, dated August 10, 2010, was filed on August 12, 2010, as Exhibit 9.01 to Form 8-K and is incorporated herein by reference.
10.23	Amendment to Loan Documents dated as of August 18, 2010 between the Registrant and PNC Bank, National Association was filed on August 20, 2010 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
10.24	Secured Credit Facility and Warrant Purchase Agreement, dated April 24, 2009, between Registrant and H.F. Lenfest, was filed on November 24, 2010 as Exhibit 10.1 to Form 8-K/A and is incorporated herein by reference.

Table of Contents

10.25	Amendment to Common Stock Warrant issued to H.F. Lenfest on April 23, 2009, executed January 4, 2011, between the Registrant and H.F. Lenfest, was filed on January 7, 2011 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
10.26	Amendment to Stock Purchase Warrant issued to H.F. Lenfest on July 2, 2009, executed January 4, 2011, between the Registrant and H.F. Lenfest, was filed on January 7, 2011 as Exhibit 10.2 to Form 8-K and is incorporated herein by reference.
10.27	Stock Repurchase Agreement between the Registrant and H.F. Lenfest, dated February 9, 2011, was filed on February 11, 2011, as Exhibit 9.01 to Form 8-K and is incorporated herein by reference.
13	Portions of Registrant's 2011 Annual Report to Shareholders which are incorporated herein by reference into this Form 10-K. Any information incorporated by reference in Items 1, 2, 3, 5, 6, 7, 7A, 8 and 9A of this Form 10-K from the Annual Report to Shareholders is filed with the SEC. The balance of the information in the Annual Report to Shareholders will be furnished to the SEC in accordance with Item 601(b) (13) of Regulation S-K.
14	Code of Ethics was filed on May 24, 2007 as Exhibit 14 to Form 10-K and is incorporated herein by reference.
21	Subsidiaries of the Registrant (Filed herewith).
23	Consent of Friedman LLP dated May 26, 2011.
31.1	Certification dated May 26, 2011 pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 made by William F. Mitchell, Chief Executive Officer. (Filed herewith)
31.2	Certification dated May 26, 2011 pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 made by Duane D. Deaner, Chief Financial Officer. (Filed herewith)
32	Certification dated May 26, 2011 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by William F. Mitchell, Chief Executive Officer and Duane D. Deaner, Chief Financial Officer. (Filed herewith)

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

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, the following persons on behalf of the registrant and in the capacities and on the dates indicated have signed this report below.

<u>Name</u>	<u>Position</u>	<u>Date</u>
<u>/s/ William F. Mitchell</u> William F. Mitchell	Chairman of the Board, Chief Executive Officer, President and Director (Principal Executive Officer)	May 26, 2011
<u>/s/ Duane D. Deaner</u> Duane D. Deaner	Chief Financial Officer (Principal Financial and Accounting Officer)	May 26, 2011
<u>/s/ H.F. Lenfest</u> H.F. Lenfest	Director	May 26, 2011
<u>/s/ George K. Anderson</u> George K. Anderson, M.D.	Director	May 26, 2011
<u>/s/ Stephen F. Ryan</u> Stephen F. Ryan	Director	May 26, 2011
<u>/s/ George A. Sawyer</u> George A. Sawyer	Director	May 26, 2011
<u>/s/ Winston E. Scott</u> Winston E. Scott	Director	May 26, 2011
<u>/s/ Linda J. Brent</u> Linda J. Brent	Director	May 26, 2011

EXHIBIT INDEX

Exhibit

No. Item

13	Portions of Registrant's 2011 Annual Report to Shareholders which are incorporated by reference into this Form 10-K.
21	Subsidiaries of the Registrant.
23	Consent of Friedman LLP.
31.1	Certification dated May 26, 2011 pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 made by William F. Mitchell, Chief Executive Officer.
31.2	Certification dated May 26, 2011 pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 made by Duane D. Deaner, Chief Financial Officer.
32	Certification dated May 26, 2011 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by William F. Mitchell, Chief Executive Officer and Duane D. Deaner, Chief Financial Officer.

EXHIBIT 13**PORTIONS OF
ENVIRONMENTAL TECTONICS CORPORATION
2011
ANNUAL REPORT TO SHAREHOLDERS****FINANCIAL REVIEW****(amounts in thousands, except share and per share information)**

	Fiscal years ended:	
	February 25, 2011	February 26, 2010
Net sales	\$ 55,451	\$ 42,271
Gross profit	21,790	18,824
Operating profit	8,290	6,600
Net income attributable to Environmental Tectonics Corporation	14,534	6,453
Income per common share:		
Basic earnings per share:		
Distributed earnings per share:		
Common	\$ -	\$ -
Preferred	\$ 0.20	\$ 0.22
Undistributed earnings per share:		
Common	\$ 0.27	\$ 0.13
Preferred	0.33	0.13
	<u>\$ 0.60</u>	<u>\$ 0.26</u>
Diluted earnings per share	<u>\$ 0.59</u>	<u>\$ 0.26</u>
Working capital	\$ 20,242	\$ 15,326
Long-term obligations	3,084	9,820
Total assets	54,051	51,729
Total shareholders' equity	28,129	17,414
Weighted average common shares:		
Basic	20,531,000	17,708,000
Diluted	20,898,000	17,855,000

We have never paid any cash dividends on our common stock and do not anticipate that any cash dividends will be declared or paid in the foreseeable future.

Dividends on the Company's Preferred Stock as declared are accrued according to the terms of the Preferred Stock and paid in cash.

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

FORWARD-LOOKING STATEMENTS

Discussions of some of the matters contained in this Annual Report on Form 10-K for Environmental Tectonics Corporation may constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, and as such, may involve risks and uncertainties. Some of these discussions are contained under the captions "Item 1. Business" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." We have based these forward-looking statements on our current expectations and projections about future events or future financial performance, which include implementing our business strategy, developing and introducing new technologies, obtaining, maintaining and expanding market acceptance of the technologies we offer, and competition in our markets. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about ETC and its subsidiaries that may cause actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

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 materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items and the effects of currency fluctuations, (ii) statements of our 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 of customers, suppliers, competitors or regulatory authorities, (iii) statements of future economic performance, (iv) statements of assumptions and other statements about the Company or its business, (v) statements made about the possible outcomes of litigation involving the Company, (vi) statements regarding the Company's ability to obtain financing to support its operations and other expenses, and (vii) statements preceded by, followed by or that include terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "future," "predict," "potential," "intend," or "continue," and similar expressions. These forward-looking statements involve risks and uncertainties which are subject to change based on various important factors. Some of these risks and uncertainties, in whole or in part, are beyond the Company's control. Factors that might cause or contribute to such a material difference include, but are not limited to, those discussed in this Annual Report on Form 10-K, in the section entitled "Risk Factors." Shareholders are urged to review these risks carefully prior to making an investment in the Company's common stock.

The Company cautions that the foregoing list of important factors is not exclusive. Except as required by federal securities law, 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.

References to fiscal 2011 or the 2011 fiscal year are references to the fifty-two week period ended February 25, 2011. References to fiscal 2010 or the 2010 fiscal year are references to the fifty-two week period ended February 26, 2010.

In this report all references to "ETC," the "Company", "we," "us," or "our," mean Environmental Tectonics Corporation and our subsidiaries.

Overview

We are principally engaged in the design, manufacture and sale of software driven products and services used to recreate and monitor the physiological effects of motion on humans and equipment to control, modify, simulate and measure environmental conditions. These products include aircrew training systems (aeromedical, tactical combat and general), disaster management systems, sterilizers (steam and gas), environmental testing products and hyperbaric chambers and other products and services that involve similar manufacturing techniques and engineering technologies. We are a designer, developer and contract manufacturer of various types of high-technology equipment. Our business activities are divided into two segments: the Training Services Group (TSG) and the Control Systems Group (CSG). Product categories included in TSG are pilot training and flight simulators and disaster management systems. CSG includes sterilizers, environmental control devices, hyperbaric chambers and parts and service support.

We sell utilizing two business approaches: integrated training services and products. Some of our products are customized, using our proprietary software based on specifications provided by our customers. Some of our products take more than one year to manufacture and deliver to the customer. In the TSG segment, we offer integrated training services to both commercial and government military defense agencies and training devices to government military defense agencies both in the United States and internationally. We sell our disaster management simulation training and products to fire and emergency training schools and state and local governments. In the CSG segment, we sell our sterilizers to pharmaceutical and medical device manufacturers. We sell our environmental testing systems primarily to commercial automobile manufacturers and heating, ventilation and air conditioning (HVAC) manufacturers. We sell our hyperbaric products to the military (mainly larger chambers) and hospitals and clinics (mainly single occupant monoplace chambers). To a lesser degree, we provide upgrade, maintenance and repair services for our products and for products manufactured by other parties.

We currently market our products and services primarily through our sales offices and employees. In addition, we also utilize the services of approximately 100 independent sales representatives and organizations in seeking foreign orders for our products.

We have operating subsidiaries in Turkey and Poland, maintain regional offices in the United Kingdom, Middle East, Asia and Canada, and use the services of numerous independent sales representatives and organizations throughout the world. ETC International Corporation is a holding company established for federal income tax purposes and is not an operating subsidiary.

Significant Impacts and Transactions during Fiscal 2011

The following items had a material impact on our financial performance, cash flow and financial position for the fiscal year ended February 25, 2011:

- Increased production under U.S. Government contracts

The Base Realignment and Closure (BRAC) Act passed in 2005 by Congress mandated base closures and consolidations through all the U.S. defense services. As a result of this Act, in the past two years we have been awarded three major contracts for pilot training. Our fiscal 2011 opening backlog of firm orders included approximately \$64.2 million for BRAC related contracts. In June 2010, we were awarded a \$38.3 million contract from the U.S. Air Force to provide a suite of four altitude chambers, also a BRAC related contract. As a result of engineering and production activity on these two contracts, sales to the U.S. Government increased by \$13.7 million in our Training Services Group during the current fiscal year versus the prior year. The Company's backlog at February 25, 2011 was \$105.5 million. Given the current domestic economic conditions and political environment, it should not be assumed that any additional contracts will be awarded to us.

- Higher absorption of fixed plant costs

Increased production activities and the corresponding additional direct labor hours helped to reduce the manufacturing overhead rate from 163% in fiscal 2010 to 144% for fiscal 2011. (We apply manufacturing overhead costs as a markup on direct labor dollars.) The increase in production resulted in better overall utilization of our plant and equipment and better absorption of fixed costs.

- Market disruptions in our Control Systems Group

The product groups in our CSG sell primarily to domestic commercial accounts. Two of these business units have been adversely impacted by current domestic economic conditions. Our environmental products unit received only one order for a testing unit. Additionally, sales for our domestic monoplace hyperbaric chamber line decreased significantly reflecting the cutback of capital expansion in hospitals and wound care centers. Acting as a partial offset, sales of Ethylene Oxide (EtO) sterilizers were strong as this unit exceeded the prior year's sales performance by \$1.2 million.

- Availability of operating funds

On April 24, 2009, we entered into a transaction with H. F. Lenfest, a member of our Board of Directors and a significant shareholder, that provided us access to a \$7.5 million credit facility from Mr. Lenfest and an increase in our PNC Bank line of credit from \$15 million to \$20 million. These additional facilities coupled with the generation of income and significant collections under major contracts resulted in cash provided by operating activities of \$13.5 million. Having adequate cash from operations and additional availability under new and existing credit lines allowed us to effectively and efficiently execute on our contracts. Additionally, we expect to be adequately cash funded throughout fiscal 2012.

- Positive impact of income taxes

During fiscal 2011, an income tax benefit of \$7.7 million was reflected in our Consolidated Statements of Income. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carryforwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the potential realization of the related deferred tax asset. Valuation allowances had been recorded against a significant portion of the deferred tax asset in prior periods due to an uncertainty of sustaining an appropriate level of profitability in future periods. As a result of our increase in booked contracts and our positive operating results, we reduced this reserve by \$7.7 million, leaving a balance of \$0.7 million, during fiscal 2011.

- Continued expanded use of our NASTAR Center

Our National Aerospace Training and Research (NASTAR) Center, which opened in fiscal 2008, is an integrated pilot training center offering a complete range of aviation training and research support for military jet pilots and civil aviation as well as space travel and tourism. The NASTAR Center houses state of the art equipment including the ATFS-400, a GYROLAB GL-2000 Advanced Spatial Disorientation Trainer, a Hypobaric Chamber, an Ejection Seat Trainer, and a Night Vision and Night Vision Goggle Training System. These products represent approximately four decades of pioneering development and training solutions for the most rigorous stresses encountered during high performance aircraft flight including the effects of altitude exposure, High G-force exposure, spatial disorientation and escape from a disabled aircraft.

During the past two fiscal years we have been successful in utilizing the NASTAR Center for research, space training and as a showroom to market our Authentic Tactical Fighting System (“ATFS”) technology. We feel that demonstrating tactical flight simulation in our NASTAR Center was instrumental to our obtaining significant orders in our Aircrew Training Systems Division. Going forward, we hope to expand research aimed at examining the effectiveness of using centrifuge based simulation for Upset Recovery Training (“URT”).

Loss of control in flight is a major cause factor in loss of life and hull damage in aircraft accidents. Modern day commercial aviation currently has no requirement for training of pilots to deal with these situations, commonly referred to as “upsets.” Realistic training for responding to and recovering from upsets, or URT, requires more than a non-centrifuged based simulator because non-centrifuge-based simulators do not reproduce the physiological stresses and disorientation that a pilot experiences during an actual upset. We believe our GYROLAB simulator series is an answer to providing pilots with the dynamic environment necessary for effective training. ETC’s GYROLAB has been utilized in numerous research studies, including in conjunction with studies by the Federal Aviation Administration (FAA) and the National Aeronautics and Space Administration (NASA). These studies are focused on comparing the benefits of various types of URT. The Company anticipates that this simulator will have significant application in the training of commercial airline pilots.

- Increased selling and marketing expenses.

Our non-commission selling and marketing expenses increased about 4% in fiscal 2011 versus fiscal 2010, reflecting heightened promotional activities on individual product lines, attendance at trade shows and exhibitions and work on our web sites. Although the volume of U.S. Government work has increased significantly, we are cautious in our ability to maintain market share and a presence in our various industries. .

- Continued capital and consulting spending to enhance and market worldwide our ATFS and other technologies.

During the past two fiscal years we have spent over \$3.7 million (including \$1.4 million in fiscal 2011) in capital, software development and consulting expenses. This is in addition to several full time employees whose main responsibilities are to support the Advanced Tactical Fighting System initiative. Most of this spending has been related to enhancement and promotion of our pilot training simulation equipment. This includes engineering costs to improve the technical abilities of our ATFS line of products, validation effort associated with Upset Recovery Training, and consulting arrangements. Going forward, we expect spending to be significant for these efforts.

- Cash impact of the payment of Preferred Stock dividends and repurchase of Preferred Stock.

The Preferred Stock held by Mr. Lenfest carries a 10% coupon. Total Preferred Stock dividends paid in fiscal 2011 approximated \$2.3 million. Additionally, we repurchased \$2.0 million of Mr. Lenfest’s Preferred Stock in fiscal 2011.

CRITICAL ACCOUNTING ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements requires the use of judgments and estimates. Our critical accounting policies are described below to provide a better understanding of how we develop our assumptions and judgments about future events and related estimations and how they can impact our financial statements. A critical accounting estimate is one that requires our most difficult, subjective, or complex estimates and assessments and is fundamental to our results of operations. We identified our most critical accounting estimates (not in any specific order) to be:

- estimating budget costs for large, multi-year contracts which involve significant engineering and software development;
- percentage-of-completion accounting for long-term, construction-type contracts;
- legal reserves and contingencies;
- valuations of long-lived assets, including assets of the NASTAR Center and intangible assets;
- forecasting our effective income tax rate, including our future ability to value and utilize tax credits and to realize deferred tax assets, and providing for uncertain tax positions; and
- inventory valuation and reserves.

We base our estimates on historical experience and on various other assumptions we believe to be reasonable according to the current facts and circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We believe the following are the critical accounting policies used in the preparation of our consolidated financial statements, as well as the significant estimates and judgments affecting the application of these policies. This discussion and analysis should be read in conjunction with our consolidated financial statements and related notes included in this report.

We have discussed the development and selection of these critical accounting policies and estimates with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed the disclosure presented below.

- Revenue Recognition

We recognize revenue using three methods:

On long-term contracts, with a contract value over \$250,000 and a minimum completion period of six months, the percentage-of-completion ("POC") method is applied based on costs incurred from inception to date as a percentage of estimated total costs required to fulfill the contract. This percentage is then multiplied by the total estimated contract value to determine the amount of revenue recognized in any given accounting period. Revenue recognized on uncompleted long-term contracts in excess of amounts billed to customers is reflected as an asset on the balance sheet under the caption "Costs and estimated earnings in excess of billings on uncompleted long-term contracts". Amounts billed to customers (milestone payments) in excess of revenue recognized on uncompleted long-term contracts are reflected as a liability on the balance sheet under the caption "Billings in excess of costs and estimated earnings on uncompleted long-term contracts". At any time during performance if it is estimated that a contract at completion will result in a loss, the entire amount of the estimated loss is accrued. The effect of revisions in cost and profit estimates for long-term contracts is reflected in the accounting period in which we learn the facts which require us to revise our cost and profit estimates. Contract progress billings are based upon contract provisions for customer advance payments, contract costs incurred, and completion of specified contract milestones. Costs related to post shipment obligations, including field installation, warranty and any additional contracted items are included in the estimated total costs required to fulfill the contract. 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 recognition under the percentage of completion method involves significant estimates, both at inception and throughout the performance period.

For contracts under \$250,000, or contracts to be completed in less than six months, and where there are no post-shipment services included in the contract (such as installation and customer acceptance), the completed contract method is applied and revenue is recognized on the date that the finished product is shipped to the customer. Estimated warranty costs for these contracts are accrued and this accrual is adjusted periodically based on actual warranty expenses and the amount and type of products shipped. Revenue derived from the sale of parts and services is also recognized on the date that the part is shipped to the customer, or when the service is completed. Revenue for service contracts is recognized ratably over the life of the contract with related material costs expensed as incurred. There are no post contract expenses associated with these types of contracts.

In accordance with accounting principles generally accepted in the United States of America, recognizing revenue on contract claims and disputes related to customer caused delays, errors in specifications and designs, and other unanticipated causes, for amounts in excess of contract value, is appropriate if it is probable that the claim will result in an increase in the contract value and if the Company can reliably estimate the amount of potential additional contract revenue (claim revenue). However, revenue recorded on a contract claim cannot exceed the incurred contract costs related to that claim. Claims are subject to negotiation, arbitration and audit by the customer or governmental agency.

- Inventory

We periodically evaluate our inventory, which affects gross margin, to ensure that it is carried at the lower of cost or net realizable value. Cost includes appropriate overhead. Overhead allocated to inventory cost includes only costs directly related to our manufacturing activities. These include general supervision, utilities, supplies, etc., and depreciation and software amortization expense. Where necessary, provision is made for obsolete, slow-moving or damaged inventory. This provision represents the difference between the cost of the inventory and its estimated market value, based on the future demand of our products. To the extent that future events affect the salability of inventory these provisions could vary significantly.

- Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carry forwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the reliability of the related deferred tax asset.

Results of Operations

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: Training Services Group (TSG) and Control Systems Group (CSG). Product categories included in TSG are pilot training and flight simulators and disaster management systems. CSG includes sterilizers, environmental control devices, hyperbaric chambers along with parts and service support.

We have historically experienced significant variability in our quarterly revenue, earnings and other operating results, and our performance may fluctuate significantly in the future.

Fiscal 2011 versus Fiscal 2010

	Summary Table of Results		Variance \$	Variance %
	Fiscal years ended: February 25, 2011	February 26, 2010		
	(amounts in thousands)			
Sales:				
Domestic	\$ 12,181	\$ 12,870	\$ (689)	(5.4)%
US Government	23,271	7,711	15,560	201.8
International	19,999	21,690	(1,691)	(7.8)
Total sales	<u>55,451</u>	<u>42,271</u>	<u>13,180</u>	<u>31.2</u>
Gross profit	21,790	18,824	2,966	15.8
Selling and marketing expenses	4,630	5,010	380	7.6
General and administrative expenses	7,208	6,405	(803)	(12.5)
Research and development expenses	1,662	809	(853)	(105.4)
Operating income	8,290	6,600	1,690	25.6
Interest expense, net	824	1,308	484	37.0
Other expense, net	589	347	(242)	(69.7)
Loss on early extinguishment of debt	-	315	315	100.0
Income tax benefit	(7,665)	(1,819)	5,846	321.4
Income/(loss) attributable to the noncontrolling interest	8	(4)	(12)	(300.0)
Net income attributable to ETC	<u>\$ 14,534</u>	<u>\$ 6,453</u>	<u>\$ 8,081</u>	<u>125.2%</u>
Basic earnings per share:				
Distributed earnings per share:				
Common	<u>\$ -</u>	<u>\$ -</u>		
Preferred	<u>\$ 0.20</u>	<u>\$ 0.22</u>	<u>\$ (0.02)</u>	
Undistributed earnings per share:				
Common	\$ 0.27	\$ 0.13	\$ 0.14	
Preferred	0.33	0.13	0.20	
Basic earnings per share	<u>\$ 0.60</u>	<u>\$ 0.26</u>	<u>\$ 0.34</u>	
Diluted earnings per share	<u>\$ 0.59</u>	<u>\$ 0.26</u>	<u>\$ 0.33</u>	

Net income

ETC had net income of \$14,534,000, or \$0.59 per diluted share in fiscal 2011, versus \$6,453,000, or \$0.26 per diluted share in fiscal 2010, an increase in net income of \$8,081,000, or 125.2%. Operating income in fiscal 2011 was \$8,290,000 versus \$6,600,000 in fiscal 2010, an increase of \$1,690,000, or 25.6%. The major factor contributing to the favorable performance in operating income was a 31.2% increase in sales and the corresponding increase in gross profit.

Net income attributable to ETC also benefited from a credit for income taxes of \$7,665,000 and \$1,819,000 in fiscal 2011 and fiscal 2010, respectively, reflecting reductions in the Company's deferred tax asset reserve related to the expected realization of net operating loss carryforwards.

Sales

The following schedule presents the Company's sales by segment, business unit and geographic area:

Segment sales:	(amounts in thousands)							
	Domestic	Fiscal year ended February 25, 2011			Fiscal year ended February 26, 2010			
		USG	International	Total	Domestic	USG	International	Total
Training Services Group:								
Pilot Training Services	\$ 224	\$ 19,912	\$ 13,682	\$ 33,818	\$ 93	\$ 6,261	\$ 13,101	\$ 19,455
Simulation	953	-	961	1,914	480	-	4,384	4,864
ETC-PZL and other	311	-	724	1,035	440	-	1,276	1,716
Sub-Total	1,488	19,912	15,367	36,767	1,013	6,261	18,761	26,035
Control Systems Group:								
Environmental	649	3,359	3,628	7,636	980	1,450	1,717	4,147
Sterilizers	7,010	-	--	7,010	5,841	-	2	5,843
Hyperbaric	1,094	-	797	1,891	3,116	-	1,062	4,178
Service and spares	1,940	-	207	2,147	1,920	-	148	2,068
Sub-Total	10,693	3,359	4,632	18,684	11,857	1,450	2,929	16,236
Total	\$ 12,181	\$ 23,271	\$ 19,999	\$ 55,451	\$ 12,870	\$ 7,711	\$ 21,690	\$ 42,271

For the fiscal year ended February 25, 2011, total sales were \$55,451,000, an increase of \$13,180,000, or 31.2%, from fiscal 2010. The increase reflects increased sales to the U.S. Government and international geographic areas and in the pilot training, environmental and sterilizer product lines.

Geographically, domestic sales were \$12,181,000, a decrease of \$689,000, or 5.4%, from fiscal 2010, and represented 22.0% of total sales, down from 30.4% in fiscal 2010. The current period primarily reflects a \$1,169,000 increase in sales of sterilizers, or 20.0%, and a \$474,000 increase in sales of simulation products, or 99.0%, which were more than offset by reductions in sales of hyperbaric and environmental products of \$2,022,000, or 64.9%, and \$331,000, or 33.8%, respectively. Sterilizers benefited from expanded contracts for Ethylene Oxide (EtO) chambers and accessories. Our simulation division placed medium sized ADMS installations in municipalities and community colleges. Reduced hyperbaric sales reflected continued domestic economic disruptions and resulting reduced capital spending while our environmental division reflected the depressed automotive industry. U.S. Government sales increased \$15,560,000, or 201.8%, from the prior fiscal year. Significant increases were evidenced in aircrew training systems sales reflecting three contracts with two different U.S. defense agencies. U.S. Government sales represented 41.9% of total sales, up from 18.3% in fiscal 2010. Given the existing U.S. Government sales contracts in the Company's backlog, the Company anticipates this increase in the concentration of sales with the U.S. Government to continue at least through 2012.

International sales, including those in the Company's foreign subsidiaries, were \$19,999,000, a decrease of \$1,691,000, or 7.8%, from the prior fiscal period, due primarily to reductions in sales of simulation and hyperbaric equipment, and offset, in part, by increased sales of pilot training services and environmental products. In aggregate, international sales represented 36.1% of the Company's total net sales, down from 51.3% in fiscal 2010.

In fiscal 2011, three customers (two U.S. defense agencies and one international customer), each in the ATS division, represented 10% or more of total sales. In fiscal 2010, two customers, both in the ATS division, each represented 10% or more of total sales. Within the Company's February 25, 2011 sales backlog for work to be performed and revenue to be recognized under written agreements after such date, of \$105,534,000, two contracts (one with a U.S. defense agency and one with an international customer), each representing at least 10% of the total backlog, constituted \$80,184,000 or 76.0% of the total sales backlog. Aircrew training systems backlog totaled \$51,661,000, or 49.0%, of the total backlog, while environmental products represented \$39,675,000, or 37.6% of the total backlog.

We have historically experienced significant variability in our sales performance. This reflects the existing sales backlog, product and the nature of contract mix (size and performance time), the manufacturing cycle and amount of time to effect installation and customer acceptance, and certain factors not in our control such as customer delays and the time required to obtain U.S. Government export licenses. One or a few contract sales may account for a substantial percentage of our revenue in any period.

Domestic sales

Domestic sales in fiscal 2011 were \$12,181,000, a decrease of \$689,000, or 5.4%, from 2010 sales of \$12,870,000. The current period primarily reflects increased sales of sterilizers of \$1,169,000, or 20.0%, and increases sales of simulation of \$474,000, or 99.0%, which were more than offset by reductions in sales of hyperbaric and environmental of \$2,022,000, or 64.9%, and \$331,000, or 33.8%, respectively. Sterilizers benefited from expanded contracts for Ethylene Oxide (EtO) chambers and accessories. Our simulation division placed medium sized Advanced Disaster Management Systems ("ADMS") installations in municipalities and community colleges. Reduced hyperbaric sales reflected continued domestic economic disruptions and resulting reduced capital spending while our environmental division reflected the depressed automotive industry. .

Sales to the U.S. Government in fiscal 2011 were \$23,271,000 as compared to \$7,711,000 in fiscal 2010, representing an increase of \$15,560,000, or 201.8%. Significant increases were evidenced in aircrew training systems sales reflecting three contracts with two different U.S. defense agencies. U.S. Government sales represented 41.9% of total sales, up from 18.3% in fiscal 2010.

International sales

International sales, including those in the Company's foreign subsidiaries, were \$19,999,000, a decrease of \$1,691,000, or 7.8%, from the prior fiscal period, due primarily to reductions in sales of simulation and hyperbaric equipment, offset, in part, by increased sales of pilot training services and environmental products, and represented 36.1% of total sales, down from 51.3% in fiscal 2010. International sales totaling at least \$500,000 per country, listed in order of magnitude, were made to customers in South Korea, Saudi Arabia, Malaysia and Japan. Fluctuations in sales to international countries from year-to-year primarily reflect percentage of completion revenue recognition on the level and stage of development and production on multi-year long-term contracts.

Segment sales

Sales of our TSG products were \$36,767,000 in fiscal 2011, an increase of \$10,732,000, or 41.2%, over sales of \$26,035,000 in fiscal 2010. Sales of these products accounted for 66.3% of our sales versus 61.6% in fiscal 2010. Sales in our other segment, the CSG, increased \$2,448,000, or 15.1%, and constituted 33.7% of our total sales compared to 38.4% in fiscal 2010.

Given the Company's backlog at February 25, 2011, and the existing and continuing difficult domestic economic conditions, going forward it is anticipated that the TSG segment will continue to experience growth at some level while the environmental and hyperbaric lines of the CSG segment will be significantly negatively impacted by the domestic marketplace. In the CSG, we expect domestic environmental sales to continue to be limited by the disruptions in that marketplace. The hyperbaric monoplace line will be hampered until capital and liquidity become more accessible. Although EtO chamber sales have been strong, the steam sterilizer product group continues to suffer from delays in government funding for universities which have been steady customers for our steam sterilizers. Given the product mix in the Company's opening backlog, we would expect much of the Company's financial performance in fiscal 2012 to be generated by the TSG segment.

Gross profit

Gross profit for fiscal 2011 increased by \$2,966,000, or 15.8%, from fiscal 2010. This reflected the increase in sales and resulting gross profit. Gross profit margin as a percent of sales dropped to 39.3% in fiscal 2011 from 44.5% in fiscal 2010 due primarily to a mix shift to lower margin U.S. Government sales in the TSG segment and, in part, due to increasing material, freight and shipping costs over our course of contract performance.

Selling and marketing expenses

Selling and marketing expenses decreased \$380,000, or 7.6%, from fiscal 2010. This decrease resulted primarily from lower commissions, and lower bid and proposal costs as a result of less technical proposals. As a percentage of sales, selling and marketing expenses were 8.4% in fiscal 2011 compared to 11.9% in fiscal 2010.

General and administrative expenses

General and administrative expenses increased by \$803,000, or 12.5%. The increase primarily reflected an increase in a legal reserve and higher executive incentive payments on the favorable financial results. As a percentage of sales, general and administrative expenses decreased to 13.0% in fiscal 2011 compared to 15.2% in fiscal 2010.

Research and development expenses

Research and development expenses include spending for potential new products and technologies and work performed under government grant program, both in the United States and internationally. This spending, net of grant payments from the U.S., Polish and Turkish governments, totaled \$1,662,000 in fiscal 2011 as compared to \$809,000 for fiscal 2010, an increase of \$853,000, or 105.4%. The increase reflected development expenses domestically associated with our hyperbaric monoplace line and internationally in our Polish subsidiary, ETC-PZL, for work under Polish Government grant contracts. It is possible that some or all of the spending in ETC-PZL will be reimbursed in future periods. As a percentage of sales, research and development expenses were 3.0% in fiscal 2011, compared to 1.9% in fiscal 2010.

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.

Operating income

Operating income was \$8,290,000 in fiscal 2011 compared to \$6,600,000 in fiscal 2010, an increase in income of \$1,690,000, or 25.6%. This improvement in operating results represented a combination of higher sales resulting in higher gross profit which more than offset increased operating expenses.

On a segment basis, the TSG had an operating income of \$7,185,000, a \$1,057,000, or 17.2%, improvement over the segment operating income of \$6,128,000 in fiscal 2010. The CSG had an operating income of \$3,989,000 in fiscal 2011, an increase of \$2,262,000, or 131.0%, over fiscal 2010. These segment operating results were offset, in part, by unallocated corporate expenses, interest expense and other expenses.

Given the positive operating performance in fiscal 2011, the level and mix of the Company's backlog at February 25, 2011, open proposals and proposals under preparation, which include quotations for some significant potential international contract awards, and the Company's continuing positive feedback from potential customers for its ATFS technology, it is anticipated that the Company will experience growth in operating income again in fiscal 2012. However, it is also anticipated that the product lines in the Company's CSG segment will continue to suffer from negative market conditions.

Interest expense

Interest expense for fiscal 2011 was \$824,000 as compared to \$1,308,000 in fiscal 2010, a decrease of \$484,000, or 37.0%. The current period reflected reduced interest expense for both our bank borrowings and interest expense on the Company's subordinated debt. This debt was exchanged for preferred stock under the Lenfest Financing Transaction which was completed in July 2009.

Other income/expense, net

Other income/expense, net, was an expense of \$589,000 for fiscal 2011, versus an expense of \$347,000 for fiscal 2010. The current period consisted primarily of higher letter of credit charges.

Loss on early extinguishment of debt

During fiscal 2010, the Company recorded a loss on extinguishment of debt representing two transactions. In July 2009, the Company's Subordinated Note was exchanged for Preferred Stock under the Lenfest Financing Transaction, resulting in a charge of \$224,000, which represented the unamortized portion of the debt discount that was recorded at the issuance of this instrument. Additionally, a charge of \$91,000 resulted from the unamortized portion of the debt discount on a \$2 million note, which was repaid on September 1, 2009. See Note 7 – Long-term Obligations and Credit Arrangements in the accompanying Notes to the Condensed Consolidated Financial Statements.

Income taxes

As a result of the Company's analysis during fiscal 2011 of the various components and potential realization of the Company's net loss carryforwards, an income tax benefit of \$7,665,000 was recorded in the fiscal year ended February 25, 2011. An income tax benefit of \$1,819,000 was recognized in fiscal 2010.

Valuation allowances had been recorded against the entire deferred tax asset in periods prior to February 27, 2009 due an uncertainty of sustaining an appropriate level of profitability in future periods. As of February 25, 2011, the Company reviewed the components of its deferred tax asset and determined, based upon all available information, that its current and expected future operating income will more likely than not, result in the realization of its deferred tax assets relating primarily to its net operating loss carryforwards. The Company has realized a deferred tax asset related to its net operating loss carryforwards of \$12,986,000. As of February 25, 2011, the Company has approximately \$30,700,000 of federal net loss carry forwards available to offset future income tax liabilities, beginning to expire in 2025. In addition, the Company has the ability to offset deferred tax assets against deferred tax liabilities created for such items as depreciation and amortization.

Liquidity and Capital Resources

The Company's liquidity position and borrowing availability improved again during fiscal 2011. Cash flow provided by operating activities was a positive \$13,463,000. Working capital was \$20,242,000 and \$15,326,000 at February 25, 2011 and February 26, 2010, respectively, compared to \$4,684,000 at the end of fiscal 2009. This positive performance primarily reflects the positive operating results in the period and milestone payment collections under long term contracts. At February 25, 2011, availability under our PNC bank line was \$15,688,000 and we also continue to have unused availability under a \$7,500,000 operating line with H. F. Lenfest to fund certain U.S. Government contracts.

On April 24, 2009, we entered into a transaction with H. F. Lenfest, a member of our Board of Directors and a significant shareholder, that provides for the following: (i) a \$7,500,000 credit facility to be provided by Lenfest to ETC; (ii) exchange of the Subordinated Note held by Lenfest, together with all accrued interest and warrants issuable under the Subordinated Note, and all Series B Preferred Stock and Series C Preferred Stock held by Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock, of the Company; and (iii) an increase of the existing \$15,000,000 revolving line of credit with PNC Bank to \$20,000,000. Having adequate cash from operations and additional availability under new and existing credit lines allowed us to effectively and efficiently execute on our contracts. Additionally, we expect to be adequately cash funded throughout fiscal 2012.

Cash flows from operating activities:

Cash provided by operations is driven by income from the sale of our products, which depends on the timing of receipts, offset in part by payments in the ordinary course of business.

During fiscal 2011, we generated cash from operating activities of \$13,463,000 versus \$5,272,000 in fiscal 2010, an improvement of \$8,191,000. The increase was primarily a result of increased operating income and milestone payment collections under long-term contracts.

Cash flows from investing activities:

Cash used for investing activities primarily relates to funds used for capital expenditures in property and equipment. These uses of cash are offset by sales and borrowings under our credit facilities. The Company's cash used in investing activities, \$865,000 in fiscal 2011 and \$1,824,000 in fiscal 2010, consisted primarily of costs for the continued construction activities and the manufacturing of demonstration simulators for our NASTAR Center coupled with higher software enhancements for our Advanced Tactical Fighter Systems technology.

Cash flows from financing activities:

The Company's financing activities used \$13,642,000 of cash during fiscal 2011. This primarily reflected the repayments under the Company's bank line which reduced bank borrowing from \$9,808,000 at February 26, 2010, to \$3,041,000 at February 25, 2011, payments of Preferred Stock dividends, \$2,000,000 for repurchases of Preferred Stock and an increase in restricted cash.

Outlook

We expect to use our cash, cash equivalents and credit facilities for working capital and general corporate purposes, products, product rights, technologies, property, plant and equipment, the payment of contractual obligations, including scheduled interest payments on our credit facilities and dividends on our preferred stock, the acquisition of businesses, and/or the purchase, redemption or retirement of our credit facilities and Preferred Stock. We expect that net sales of our currently marketed products should allow us to continue to generate positive operating cash flow in fiscal 2012. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated rate of sales growth in 2012 and beyond, such as the degree of market acceptance, the impact of competition, the effectiveness of our sales and marketing efforts and the outcome of our current efforts to develop, receive approval for and successfully market our products.

At the end of each fiscal quarter in fiscal 2012 and through the current term of the PNC Bank line of credit we expect to maintain, per bank covenant requirement, a minimum aggregate EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of \$4,000,000 (calculated as the total of the fiscal quarter then ending and the three immediately preceding fiscal quarters).

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements during the fiscal years ended February 25, 2011 or February 26, 2010 that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our investors.

Recent Accounting Pronouncements

In January 2010, the FASB issued ASU No. 2010-06, "Fair Value Measurements and Disclosures (ASC 820): Improving Disclosures about Fair Value Measurements," which requires additional disclosures on transfers in and out of Level I and Level II and on activity for Level III fair value measurements. The new disclosures and clarifications on existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures on Level III activity, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company does not expect the adoption of ASU No. 2010-06 to have a material impact on our consolidated financial condition or results of operations.

In April 2010, the FASB issued ASU No. 2010-17, Milestone Method of Revenue Recognition ("ASU 2010-17"). ASU 2010-17 updates guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate with the scope of Codification Subtopic 605 (previously included within EITF 00-21, *Revenue Arrangements with Multiple Deliverables* ("EITF 00-21")). The consensus to ASU 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition in which arrangements include payment provisions whereby a portion or all of the consideration is contingent upon milestone events such as successful completion of phases or a specific result. This new approach is effective prospectively for milestones achieved in fiscal years beginning on or after June 15, 2010 and allows for retroactive application. The Company has evaluated its current contracts which include milestone clauses and has determined that the percentage of completion method of revenue recognition is the appropriate method to apply when accounting for these contracts. However, the Company will continue to apply this standard to new contracts and to evaluate the potential impact on its financial position and results of operation.

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Environmental Tectonics Corporation

We have audited the accompanying consolidated balance sheets of Environmental Tectonics Corporation and Subsidiaries (the "Company") as of February 25, 2011 and February 26, 2010 and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the fifty-two week periods ended February 25, 2011 and February 26, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 financial position of Environmental Tectonics Corporation and Subsidiaries as of February 25, 2011 and February 26, 2010, and the consolidated results of their operations and their cash flows for the each of the fifty-two weeks ended February 25, 2011 and February 26, 2010 in conformity with accounting principles generally accepted in the United States of America.

/s/ Friedman LLP
East Hanover, New Jersey
May 26, 2011

Environmental Tectonics Corporation
Consolidated Balance Sheets
(amounts in thousands, except share information)

	<u>February 25, 2011</u>	<u>February 26, 2010</u>
ASSETS		
Cash and cash equivalents	\$ 1,423	\$ 2,408
Restricted cash	5,607	2,751
Accounts receivable, net	4,727	17,356
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	10,371	3,576
Inventories, net	4,015	5,114
Deferred tax assets, current	12,986	4,983
Prepaid expenses and other current assets	<u>691</u>	<u>545</u>
Total current assets	39,820	36,733
Property, plant and equipment, at cost, net	13,359	13,643
Construction in progress	-	316
Software development costs, net	802	691
Other assets	70	346
Total assets	<u>\$ 54,051</u>	<u>\$ 51,729</u>
LIABILITIES		
Current portion of long-term debt	\$ 219	\$ 285
Accounts payable – trade	4,308	1,783
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	7,534	13,944
Customer deposits	3,907	1,799
Accrued interest and dividends	28	782
Other accrued liabilities	<u>3,582</u>	<u>2,814</u>
Total current liabilities	<u>19,578</u>	<u>21,407</u>
Long-term obligations, less current portion:		
Credit facility payable to bank	3,041	9,808
Other long-term debt	<u>43</u>	<u>12</u>
	3,084	9,820
Deferred tax liabilities	3,260	3,066
Unearned interest	-	22
Total liabilities	<u>25,922</u>	<u>34,315</u>
Commitments and contingencies	-	-
SHAREHOLDERS' EQUITY		
Cumulative convertible participating Preferred Stock, Series D, \$.05 par value, 11,000 shares authorized; 386 and 155 shares outstanding at February 25, 2011 and February 26, 2010	386	155
Cumulative convertible participating Preferred Stock, Series E, \$.05 par value, 25,000 shares authorized; 21,741 and 23,741 shares outstanding at February 25, 2011 and February 26, 2010	21,741	23,741
Common Stock, \$.05 par value, 20,000,000 shares authorized; 9,104,601 and 9,083,573 shares issued and outstanding at February 25, 2011 and February 26, 2010	455	454
Additional paid-in capital	11,932	14,050
Accumulated other comprehensive loss	(372)	(431)
Accumulated deficit	<u>(6,059)</u>	<u>(20,593)</u>
Total shareholders' equity before noncontrolling interest	<u>28,083</u>	<u>17,376</u>
Noncontrolling interest	<u>46</u>	<u>38</u>
Total shareholders' equity	<u>28,129</u>	<u>17,414</u>
Total liabilities and shareholders' equity	<u>\$ 54,051</u>	<u>\$ 51,729</u>

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

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

	Fiscal Years ended	
	February 25, 2011	February 26, 2010
Net sales	\$ 55,451	\$ 42,271
Cost of goods sold	33,661	23,447
Gross profit	<u>21,790</u>	<u>18,824</u>
Operating expenses:		
Selling and marketing	4,630	5,010
General and administrative	7,208	6,405
Research and development	1,662	809
	<u>13,500</u>	<u>12,224</u>
Operating income	<u>8,290</u>	<u>6,600</u>
Other expenses:		
Interest expense	824	1,308
Loss on extinguishment of debt	-	315
Other, net	589	347
	<u>1,413</u>	<u>1,970</u>
Income before income taxes	6,877	4,630
Income tax benefit	<u>7,665</u>	<u>1,819</u>
Net income	14,542	6,449
Less: Income (loss) attributable to the noncontrolling interest	<u>8</u>	<u>(4)</u>
Net income attributable to Environmental Tectonics Corporation	14,534	6,453
Preferred Stock dividends	<u>(2,278)</u>	<u>(1,885)</u>
Income applicable to common shareholders	<u>\$ 12,256</u>	<u>\$ 4,568</u>
Per share information:		
Basic earnings per common share:		
Distributed earnings per share:		
Common	<u>\$ -</u>	<u>\$ -</u>
Preferred	<u>\$ 0.20</u>	<u>\$ 0.22</u>
Undistributed earnings per share:		
Common	\$ 0.27	\$ 0.13
Preferred	0.33	0.13
	<u>\$ 0.60</u>	<u>\$ 0.26</u>
Diluted earnings per common share	<u>\$ 0.59</u>	<u>\$ 0.26</u>
Basic weighted average common shares:		
Common weighted average number of shares	9,091,000	9,069,000
Participating Preferred shares	11,440,000	8,639,000
Total weighted average number of shares	<u>20,531,000</u>	<u>17,708,000</u>
Diluted weighted average common shares:		
Basic common shares	20,531,000	17,708,000
Dilutive effect of stock warrants and options	367,000	147,000
Total number of shares	<u>20,898,000</u>	<u>17,855,000</u>

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

Environmental Tectonics Corporation
Consolidated Statements of Changes in Shareholders' Equity
For the fiscal years ended February 25, 2011 and February 26, 2010
(amounts in thousands, except share information)

	Preferred Stock	Common Stock		Additional paid-in capital	Accumulated other comprehensive loss	Accumulated deficit	Total Shareholders ' Equity
		shares	amount				
Balance, Feb. 27, 2009	\$ -	9,049,351	\$ 452	\$ 15,399	\$ (557)	\$ (27,046)	\$ (11,710)
Net income attributable to Environmental Tectonics Corporation	-	-	-	-	-	6,453	6,453
Interest hedge valuation	-	-	-	-	184	-	184
Foreign currency translation adjustment	-	-	-	-	(58)	-	(58)
Total comprehensive income							6,579
Issuance of common shares to Lenfest	-	20,000	1	-	-	-	1
Issuance of Series D Preferred Stock	155	-	-	-	-	-	155
Issuance of Series E Preferred Stock	23,741	-	-	-	-	-	23,741
Preferred Stock dividends	-	-	-	(1,885)	-	-	(1,885)
Stock compensation expense	-	-	-	33	-	-	33
Issuance of warrants	-	-	-	485	-	-	485
Issuance of stock under employee stock purchase plan and Board of Director's compensation	-	14,222	1	18	-	-	19
Balance before noncontrolling interest, February 26, 2010	23,896	9,083,573	454	14,050	(431)	(20,593)	17,376
Noncontrolling interest	-	-	-	-	-	-	38
Balance, Feb. 26, 2010	23,896	9,083,573	454	14,050	(431)	(20,593)	17,414
Net income attributable to Environmental Tectonics Corporation	-	-	-	-	-	14,534	14,534
Foreign currency translation adjustment	-	-	-	-	59	-	59
Total comprehensive income							14,593
Issuance of Series D Preferred Stock	231	-	-	-	-	-	231
Preferred Stock dividends	-	-	-	(2,278)	-	-	(2,278)
Stock compensation expense	-	-	-	98	-	-	98
Issuance of stock under employee stock purchase plan and Board of Director's compensation	-	21,028	1	62	-	-	63
Repurchase of Series E Preferred Stock	(2,000)	-	-	-	-	-	(2,000)
Balance before noncontrolling interest, February 25, 2011	22,127	9,104,601	455	11,932	(372)	(6,059)	28,083
Noncontrolling interest	-	-	-	-	-	-	46
Balance, Feb. 25, 2011	\$ 22,127	9,104,601	\$ 455	\$ 11,932	\$ (372)	\$ (6,059)	\$ 28,129

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

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

	Fiscal years ended	
	February 25, 2011	February 26, 2010
Cash flows from operating activities:		
Net income	\$ 14,542	\$ 6,449
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,354	1,309
Decrease in valuation allowance for deferred tax assets	(5,532)	(1,917)
Loss on extinguishment of debt	-	315
Accretion of debt discount and amortization of deferred finance costs	220	258
(Decrease) increase in allowances for accounts receivable and inventories, net	(1,078)	577
Stock option and stock compensation expense	98	51
Changes in operating assets and liabilities:		
Accounts receivable	12,646	(12,308)
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	(6,795)	(1,116)
Inventories	2,160	1,735
Prepaid expenses and other assets	(2,367)	506
Accounts payable	2,525	(322)
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(6,410)	9,789
Customer deposits	2,108	(598)
Other accrued liabilities	(8)	544
Net cash provided by operating activities	13,463	5,272
Cash flows from investing activities:		
Acquisition of equipment	(451)	(1,603)
Capitalized software development costs	(414)	(221)
Net cash used in investing activities	(865)	(1,824)
Cash flows from financing activities:		
Repayments under lines of credit, net	(6,767)	(702)
Repayment of note payable, Lenfest	-	(2,000)
Increase in restricted cash from notes payable, Lenfest	-	2,000
Issuance of Common Stock	63	2
(Repayments) borrowings of other debt obligations	(35)	281
Issuance of Preferred Stock	231	-
Payment of dividends	(2,278)	(970)
Repurchase of Preferred Stock	(2,000)	-
Increase in restricted cash	(2,856)	(297)
Net cash used in financing activities	(13,642)	(1,686)
Effect of exchange rate changes on cash	59	126
Net (decrease) increase in cash	(985)	1,888
Cash at beginning of period	2,408	520
Cash at end of period	\$ 1,423	\$ 2,408
Supplemental schedule of cash flow information:		
Interest paid	\$ 376	\$ 982
Income taxes paid	256	-
Supplemental information on non-cash operating and investing activities:		
Accrued dividends on preferred stock	\$ 569	\$ 319

On July 2, 2009, the Company exchanged certain existing related-party financial instruments for a newly-created class of Series E Convertible Preferred Stock. The value of this exchange was \$23,741,000. Additionally, the Company issued \$155,000 of Series D Preferred Stock as loan origination fees in connection with the \$7,500,000 Lenfest Credit Facility. See Note 7 – Long-Term Obligations and Credit Arrangements.

In November 2009, the Company reclassified \$2,939,000 from property, plant and equipment to inventory. See Note 5 – Inventories.

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



Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements

Description of Business:

Environmental Tectonics Corporation is principally engaged in the design, manufacture and sale of software driven products and services used to recreate and monitor the physiological effects of motion on humans and equipment and to control, modify, simulate and measure environmental conditions. These products include aircrew training systems (aeromedical, tactical combat and general), disaster management systems, sterilizers (steam and gas), environmental testing products and hyperbaric chambers and other products and services that involve similar manufacturing techniques and engineering technologies. ETC focuses on software enhancements, product extensions, new product development and new marketplace applications. Sales of its products are made principally to U.S. and foreign government agencies. We operate in two primary business segments, the Training Services Group (“TSG”) and the Control Systems Group (“CSG”).

Training Services Group. This segment includes three primary product groups: aircrew training devices and services, and disaster management training and systems.

Control Systems Group. This segment includes three primary product lines: sterilizers, environmental control systems and other products, hyperbarics, and services.

The Company’s fiscal year is the 52-or 53-week annual accounting period ending the last Friday in February. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2011.

Sales Backlog

Below is a breakdown of the Company’s February 25, 2011 sales backlog (amounts in thousands except percentages):

Geographic area:	Business segment:		Total	%
	TSG	CSG		
Domestic	\$ 1,352	\$ 6,972	\$ 8,324	7.9%
US Government	30,956	35,004	65,960	62.5
International	25,785	5,465	31,250	29.6
Total	\$ 58,093	\$ 47,441	\$ 105,534	100.0%
% of total	55.0%	45.0%	100.0%	

Our sales backlog at February 25, 2011, for work to be performed and revenue to be recognized under written agreements after such dates was \$105,534,000. Of the February 25, 2011 sales backlog, one product line represented at least 10% of the total backlog. Aircrew training systems’ backlog of \$51,661,000, represents 49.0% of the total backlog. Additionally, three customers represented a total of \$80,184,000, or 76.0%, of the total backlog.

1. Restatement of Previously Filed Financial Statements:

On November 29, 2010, the Audit Committee of the Board of Directors of ETC concluded, based on the recommendation of management reached November 23, 2010, that the Company’s consolidated financial statements for the fiscal year ended February 26, 2010 contained in the Company’s Annual Report on Form 10-K for the fiscal year ended February 26, 2010, and the consolidated interim financial statements for the periods ended August 28, 2009, November 27, 2009, May 28, 2010 and August 27, 2010 contained in the Company’s Quarterly Reports on Form 10-Q for these periods, each as filed with the Securities and Exchange Commission (collectively, the “Reports”), should be restated to correct errors relating to the calculation and presentation of the Company’s earnings per share in accordance with United States generally accepted accounting principles, and, as a result, could not be relied upon. Specifically, the Company incorrectly did not reflect the participating features of its Series D Preferred Stock and Series E Preferred Stock when calculating and presenting its earnings per share in the financial statements contained in the Reports. The Company filed an Amended Annual Report on Form 10-K on March 15, 2011, that included a restatement of earnings per share for the fiscal years ended February 26, 2010 and February 27, 2009.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

2. Summary of Significant Accounting Policies:

Basis of Presentation:

The consolidated financial statements include the accounts of Environmental Tectonics Corporation, its wholly owned subsidiaries NASTAR Center LLC, ETC Delaware, and ETC International Corporation, its 95% owned subsidiary, ETC-PZL Aerospace Industries SP. Z 0.0, and its 99% owned subsidiary, ETC Europe. "ETC SH" refers to the company's corporate headquarters and main production plant located in Southampton, Pennsylvania, USA. All material inter-company accounts and transactions have been eliminated in consolidation.

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, claims receivable, inventories and computer software costs.

Fair Value of Financial Instruments:

The carrying amounts of cash, accounts receivable and accounts payable and bank debt approximate fair value because of the short maturity associated with these instruments. Derivative financial instruments are recorded at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. The Company adopted the provisions of Accounting Standards Codification ("ASC") 820 Fair Value Measurements and Disclosures. The Company did not elect the fair value option. The levels of input are:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices or identical assets or liabilities in markets that are not active;
- Level 3: Unobservable inputs that are supported by little or no market activity, which require the reporting entity's judgment or estimation.

The assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of financial assets and financial liabilities and their placement within the fair value hierarchy.

At February 26, 2010, the Company had Level 2 interest rate swap agreements with a fair value of \$85,000. This fair value is calculated using standard industry models used to calculate the fair value of the various financial instruments based on significant observable market inputs such as swap rates, interest rates, and implied volatilities obtained from various market sources. The Company had no Level 1 or 3 inputs at February 26, 2010 and no Level 1, 2 or 3 at February 25 2011.

Revenue Recognition:

On long-term contracts, with a contract value over \$250,000 and a minimum completion period of six months, the percentage-of-completion ("POC") method is applied based on costs incurred from inception to date as a percentage of estimated total costs required to fulfill the contract. This percentage is then multiplied by the total estimated contract value to determine the amount of revenue recognized in any given accounting period. Revenue recognized on uncompleted long-term contracts in excess of amounts billed to customers is reflected as an asset on the balance sheet under the caption "Costs and estimated earnings in excess of billings on uncompleted long-term contracts". Amounts billed to customers (milestone payments) in excess of revenue recognized on uncompleted long-term contracts are reflected as a liability on the balance sheet under the caption "Billings in excess of costs and estimated earnings on uncompleted long-term contracts". At any time during performance if it is estimated that a contract at completion will result in a loss, the entire amount of the estimated loss is accrued. The effect of revisions in cost and profit estimates for long-term contracts is reflected in the accounting period when the facts require the Company to revise its cost and profit estimates. Contract progress billings are based upon contract provisions for customer advance payments, contract costs incurred, and completion of specified contract milestones. Costs related to post shipment obligations, including field installation, warranty and any additional contracted items are included in the estimated total costs required to fulfill the contract. 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 recognition under the percentage of completion method involves significant estimates, both at inception and throughout the performance period.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

For contracts under \$250,000, or contracts to be completed in less than six months, and where there are no post-shipment services included in the contract (such as installation and customer acceptance), the completed contract method is applied and revenue is recognized on the date that the finished product is shipped to the customer. Estimated warranty costs for these contracts are accrued and this accrual is adjusted periodically based on actual warranty expenses and the amount and type of products shipped. Revenue derived from the sale of parts and services is also recognized on the date that the part is shipped to the customer, or when the service is completed. Revenue for service contracts is recognized ratably over the life of the contract with related material costs expensed as incurred. There are no post contract expenses associated with these types of contract .

In accordance with accounting principles generally accepted in the United States of America, recognizing revenue on contract claims and disputes related to customer caused delays, errors in specifications and designs, and other unanticipated causes, and for amounts in excess of contract value, is generally appropriate if it is probable that the claim will result in additional contract revenue and if the Company can reliably estimate the amount of additional contract revenue the Company may receive. However, revenue recorded on a contract claim cannot exceed the incurred contract costs related to that claim. Claims are subject to negotiation, arbitration and audit by the customer or governmental agency.

Cash and Cash Equivalents:

Cash includes 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 \$250,000. During each fiscal year, the Company periodically has cash and cash equivalents in excess of insured amounts.

Restricted Cash:

Restricted cash as of February 25, 2011 represents the partial collateralization of a committed line of credit in the amount of \$5,607,000 which the Company used to satisfy performance bond and repayment guarantee requirements in a contract with an existing customer. As security for this line of credit, ETC and H.F. Lenfest, a member of the Company's Board of Directors and a significant shareholder of and investor in ETC ("Lenfest"), each agreed to deposit with PNC Bank the equivalent of \$2,711,000 in the form of cash or other financial instruments. During fiscal 2011, the Company funded the balance of the security to collateralize the committed line of credit by depositing with PNC an additional \$2,711,000 in a certificate of deposit. Subsequently, Mr. Lenfest's security was returned and his guarantee to cover the \$5.4 million line was terminated.

Accounts Receivable and Concentration of Credit Risk

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based on payment history and the customer's current creditworthiness. The Company continuously monitors collections and payments from its customers and maintain a provision for estimated credit losses based on historical experience and any specific customer collection issues that have been identified. While credit losses have historically been within the Company's expectations and the provisions established, we cannot guarantee that the Company will continue to experience the same credit loss rates. Additionally, as a result of the concentration of international receivables, the Company cannot predict the effect, if any, that geopolitical disputes and financial constraints will have on the ultimate collection of its international receivables. Amounts due under contracts related to agencies of a foreign government totaled \$596,000 or 12.6%, of the total accounts receivable, net as of February 25, 2011. The majority of these receivables have been collected subsequent to fiscal year end.

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. Overheads allocated to inventory cost are only those directly related to our manufacturing activities. Where necessary, provision is made for obsolete, slow-moving or damaged inventory. This provision represents the difference between the cost of the inventory and its estimated market value.

During fiscal 2011, additional inventory reserves totaling \$265,000 were established. Charges to the reserve totaled \$1,327,000 reflecting the write-off of certain TSG inventory items.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

In accordance with United States generally accepted accounting principles, the Company may capitalize into property, plant and equipment certain of the costs of simulation equipment. This equipment may be used to provide training or as a demonstration device to market the technology, and may be sold as a product if appropriate. Upon receipt of a contract or contracts for products which are based on this technology, certain of these costs will be transferred initially into inventory and subsequently charged to the cost of sales for that particular contract as manufacturing costs.

In November 2009, the Company reclassified \$2,939,000 from property, plant and equipment to inventory. These costs had originally been capitalized as engineering costs associated with the ATFS-400 flight simulator which is currently being used as a demonstrator model in ETC's NASTAR Center. Beginning in fiscal 2010, these costs were allocated on a one-third basis to two existing contracts for centrifuges. The remaining one-third is still being carried in inventory and will be charged to the next contract the Company receives for a centrifuge device. The costs were charged over a four quarter period to cost of sales for the two contracts. During fiscal 2011, \$1,469,000 was charged to the cost of sales over two contracts.

Property, Plant and Equipment:

Property, plant and equipment are stated at cost and are depreciated over their estimated useful lives by the straight-line method for financial reporting purposes. Buildings and building additions are depreciated over 40 years; machinery and equipment, 3 to 20 years; office furniture and equipment, 10 years; and building improvements, 5 to 10 years. The Company manufactures certain equipment that is used primarily for demonstration purposes to support its sales effort and is not listed for sale, although sales of demonstration equipment are not precluded. The gross value of demonstration equipment was \$10,716,000 at February 25, 2011. Upon sale of demonstration devices, their costs net of accumulated depreciation are transferred to cost of sales. Upon sale or retirement of property, plant and equipment, the costs and related accumulated depreciation are eliminated from the accounts with any resulting gains or losses.

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 on a straight-line basis over a period ranging from 36 to 60 months, depending upon the life of the product, 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. Software amortization totaled \$303,000 and \$543,000 in fiscal 2011 and 2010, respectively.

Research and Development:

Research and development costs, which relate primarily to the development, design and testing of products, are expensed as incurred. The Company enters into research grants with various government entities, both in the United States and internationally. Payments received under these grants are recorded as a reduction of research and development costs. Research and development expenses include spending for potential new products and technologies and work performed under government grant program, both in the United States and internationally. This spending, net of grant payments from the U.S., and the governments of Poland and Turkey, totaled \$1,662,000 in fiscal 2011 as compared to \$809,000 in fiscal 2010.

Income Taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carryforwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the potential realization of the related deferred tax asset.

Significant judgments and estimates are required in determining the provision for taxes, including judgments and estimates regarding the realization of deferred tax assets and the ultimate outcomes of tax-related contingencies. During the normal course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. A liability is recognized, including interest, or a tax asset is reduced, for the anticipated outcome of tax audits. These amounts are adjusted in light of changing facts and circumstances.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Long-Lived Assets:

The Company reviews its property and equipment for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the net undiscounted cash flows expected to be generated by the asset. An impairment loss would be recorded for the excess of net book value over the fair value of the asset impaired. The fair value is estimated based on expected undiscounted future cash flows. The results of impairment tests are subject to management's estimates and assumptions of projected cash flows and operating results. Actual results may differ.

Share-Based Compensation:

The Company follows Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC" or the "Codification") accounting guidance which addressed the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for either equity instruments of the enterprise or that may be settled by the issuance of such equity instruments. The guidance generally requires that such transactions be accounted for using a fair-value based method and stock-based compensation expense is recorded, based on the grant date fair value, estimated in accordance with the guidance, for all new and unvested stock awards that are ultimately expected to vest as the requisite service is rendered. The guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from these estimates.

The Company typically issues new shares of common stock upon the exercise of stock options, as opposed to using treasury shares.

The Company uses a Black-Scholes option valuation method to determine the fair-value of the stock-based compensation under the accounting guidance. The Black-Scholes model incorporates various assumptions including the expected term of awards, volatility of stock price, risk-free rates of return and dividend yield. The expected term of an award is no less than the award vesting period and is based on the Company's historical experience. The risk-free interest rate is approximated using rates available on U.S. Treasury securities in effect at the time of grant with a remaining term similar to the award's expected life. The Company uses a dividend yield of zero in the Black-Scholes option valuation model as it does not anticipate paying cash dividends in the near future.

Advertising Costs:

The Company expenses advertising costs, which include trade shows, as incurred. Advertising expense was \$569,000 and \$413,000 in fiscal 2011 and 2010, respectively.

Bid and Proposal Costs:

The cost and effort to provide highly technical proposals, especially for aircrew training systems products, can be significant. Any of the costs related to enhancing existing products (via additional application or functionality) may be initially appropriately capitalized into inventory and then transferred to cost of goods sold upon receipt of a relevant contractor contracts.

Foreign Exchange:

The functional currency of the Company is the U. S. dollar and the majority of the Company's revenues are in U. S. dollars. The Company attempts to negotiate international contracts in dollars and to date has been successful in most awards. Recognized foreign exchange loss was approximately \$41,000 and \$200,000 for FY 2011 and 2010, respectively. The success of negotiating contracts in dollars is highly dependent on the particular foreign country, the specific customer (commercial or governmental), and the relative volatility of the foreign currency market. It should not be assumed that the Company will continue to be successful in these negotiations. Should the Company be awarded a significant of foreign-denominated contracts, it is anticipated that foreign exchange losses may increase.

Earnings Per Common Share:

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

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

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

At February 25, 2011, there was \$22,127,000 of cumulative convertible participating Preferred Stock. These instruments were convertible at exercise prices of:

- Series D Preferred Stock of \$55,000 at \$0.94 per share, equating to 58,511 shares of Common Stock, issued in April 2009;
- Series D Preferred Stock of \$100,000 at \$1.11 per share, equating to 90,090 shares of Common Stock, issued in July 2009;

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

- Series D Preferred Stock of \$231,000 at \$3.02 per share, equating to 76,490 shares of Common Stock, issued in August 2010.
- Series E Preferred Stock of \$21,741,000 at \$2.00 per share, equating to 10,870,500 shares of Common Stock, issued in July 2009.

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

(See Note 7, Long-Term Obligations and Credit Arrangements.)

At February 25, 2011 and February 26, 2010, there were outstanding options to purchase the Company's Common Stock totaling 260,921 and 269,185 shares at an average price of \$4.44 and \$4.53 per share, respectively. Due to the conversion price of these Common Stock options, these shares were excluded from the calculation of diluted earnings per share because the effect was antidilutive.

3. Accounts Receivable:

The components of accounts receivable at February 25, 2011 and February 26, 2010 are as follows:

	February 25, 2011	February 26, 2010
	(amounts in thousands)	
U.S. government	\$ 1,936	\$ 438
U.S. commercial	1,295	1,403
International	1,895	15,930
	5,126	17,771
Less allowance for doubtful accounts	(399)	(415)
Accounts receivable, net	<u>\$ 4,727</u>	<u>\$ 17,356</u>

The reduction in international receivables primarily reflects collections on milestone billings under a large multi-year contract for ATS equipment.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

4. Costs and Estimated Earnings on Uncompleted Contracts:

Unbilled costs

The following is a summary of long-term contracts in progress at February 25, 2011 and February 27, 2010:

	February 25, 2011	February 26, 2010
	(amounts in thousands)	
Cost incurred on uncompleted long-term contracts	\$ 46,335	\$ 18,936
Estimated earnings	31,650	18,535
	<u>77,985</u>	<u>37,471</u>
Less billings to date	(75,148)	(47,839)
	<u>\$ 2,837</u>	<u>\$ (10,368)</u>

	February 25, 2011	February 26, 2010
	(amounts in thousands)	
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	\$ 10,371	\$ 3,576
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(7,534)	(13,944)
	<u>\$ 2,837</u>	<u>\$ (10,368)</u>

Included in billings in excess of costs and estimated earnings on uncompleted long-term contracts is a provision for unexpected losses on contracts of \$200,000 in fiscal 2011 and 2010.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

5. Inventories:

Inventories consist of the following:

	February 25, 2011	February 26, 2010
	(amounts in thousands)	
Raw material	\$ -	\$ -
Work in process	3,919	4,764
Finished goods	96	350
Total inventory, net	<u>\$ 4,015</u>	<u>\$ 5,114</u>

Inventory is presented above net of an allowance for obsolescence of \$1,283,000 (raw material \$133,000 and work in process \$1,150,000) and \$2,345,000 (raw material \$138,000, work in process \$1,506,000 and finished goods \$701,000) in fiscal 2011 and 2010, respectively.

In accordance with United States generally accepted accounting principles, the Company may capitalize into property, plant and equipment certain of the costs of simulation equipment. This equipment may be used to provide training or as a demonstration device to market the technology, and may be sold as a product if appropriate. Upon receipt of a contract or contracts for products which are based on this technology, certain of these costs will be transferred initially into inventory and subsequently charged to the cost of sales for that particular contract as manufacturing costs.

In November 2009, the Company reclassified \$2,939,000 from property, plant and equipment to inventory. These costs had originally been capitalized as engineering costs associated with the ATFS-400 flight simulator which is currently being used as a demonstrator model in ETC's NASTAR Center. Beginning in fiscal 2010, these costs were allocated on a one-third basis to two existing contracts for centrifuges. The remaining one-third is still being carried in inventory and will be charged to the next contract the Company receives for a centrifuge device. The costs were charged over a four quarter period to cost of sales for the two contracts. During fiscal 2011, \$1,469,000 was charged to the cost of sales over two contracts.

6. Property, Plant and Equipment:

The following is a summary of property, plant and equipment, at cost, and estimated useful lives at February 25, 2011 and February 26, 2010:

	February 25, 2011	February 26, 2010
	(amounts in thousands)	
Land	\$ 100	\$ 100
Buildings and building additions	3,851	3,851
Machinery and motors	10,719	9,909
Demonstration equipment	10,716	10,883
Office furniture and equipment	1,194	1,194
Building improvements	2,870	2,746
	<u>29,450</u>	<u>28,683</u>
Less accumulated depreciation	(16,091)	(15,040)
Property, plant and equipment, net	<u>\$ 13,359</u>	<u>\$ 13,643</u>

Depreciation expense for the fiscal years ended February 25, 2011 and February 26, 2010 was \$1,051,000 and \$766,000, respectively.

As a result of the transfer of costs from property, plant and equipment to inventory, the estimated depreciation of the remaining asset value for the ATFS-400 was reviewed and \$233,000 of depreciation expense which had previously been amortized to the cost of sales was reversed in the fourth quarter of fiscal 2010. (Please refer to Note 5, Inventories, above for a discussion on demonstration equipment.)

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

7. Long-Term Obligations and Credit Arrangements (Restated):

Lenfest Financing Transaction

On April 24, 2009, the Company entered into a transaction (the “Lenfest Financing Transaction”), which was approved by shareholders on July 2, 2009, with Lenfest that provided for the following: (i) a \$7,500,000 credit facility provided by Lenfest to ETC, which expires on December 31, 2012; (ii) exchange of the Subordinated Note (as defined below) held by Lenfest, together with all accrued interest and warrants issuable under the Subordinated Note, and all Series B Preferred Stock (as defined below) and Series C Preferred Stock (as defined below) held by Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock (see Preferred Stock disclosure below), of the Company; and (iii) the guarantee by Lenfest of all of ETC’s obligations to PNC Bank, National Association (“PNC Bank”) in connection with an increase of the Company’s existing \$15,000,000 revolving line of credit with PNC Bank (the “2007 PNC Credit Facility”) to \$20,000,000, and in connection with this guarantee, the pledge by Lenfest to PNC Bank of \$10,000,000 in marketable securities.

Lenfest Credit Facility

As part of the Lenfest Financing Transaction, the Company established a credit facility in the maximum amount of \$7,500,000 with Lenfest (the “Lenfest Credit Facility”) to be used to finance certain government projects that ETC has been awarded. The terms of the Lenfest Credit Facility are set forth in a Secured Credit Facility and Warrant Purchase Agreement between the Company and Lenfest, dated as of April 24, 2009 (the “Lenfest Credit Agreement”). In connection with the Lenfest Credit Agreement, the Company has executed, and will in the future execute, promissory notes in favor of Lenfest, in the aggregate principal amount of up to \$7,500,000 (the “Lenfest Credit Facility Note”) based on the amount borrowed by the Company pursuant to the Lenfest Credit Agreement. Each Lenfest Credit Facility Note issued under the Lenfest Credit Facility will accrue interest at the rate of 10% per annum, payable in cash or, at the option of Lenfest, in shares of Series D Preferred Stock of the Company, as described below. The Lenfest Credit Facility expires on December 31, 2012. As of February 25, 2011, the Company had not utilized any of the \$7.5 million available funding under this facility.

Exchange of Existing Instruments for Series E Preferred Stock

On April 24, 2009, the Company authorized the issuance of two newly-created classes of Convertible Preferred Stock, Series D and Series E. Shares of these have been issued in connection with the Lenfest Financing Transaction. (See Preferred Stock disclosure below.)

As part of the Lenfest Financing Transaction, the senior subordinated convertible promissory note (the “Subordinated Note”) in the original principal amount of \$10,000,000 issued by ETC to Lenfest on February 18, 2003, together with all accrued interest and warrants issuable pursuant to the terms of the Subordinated Note, and all Series B Convertible Preferred Stock (the “Series B Preferred Stock”) and Series C Cumulative Convertible Preferred Stock of the Company (the “Series C Preferred Stock”) held by Lenfest, together with all accrued dividends thereon, were exchanged (the “Series E Exchange”) for shares of a newly-created class of Series E Convertible Preferred Stock of the Company (the “Series E Preferred Stock”).

On July 2, 2009, following the receipt of the Shareholder Approvals, the Company filed with the Department of State of the Commonwealth of Pennsylvania a Statement with Respect to Shares of Series E Convertible Preferred Stock creating a new class of preferred stock consisting of 25,000 shares with a stated value of \$1,000 per share and designated Series E Convertible Preferred Stock. Immediately thereafter, the Series E Exchange occurred and the Company issued 23,741 shares of Series E Preferred Stock to Lenfest. The shares of Series E Preferred Stock are convertible to Common Stock at a conversion price per share equal to \$2.00 and would convert into 11,870,500 shares of ETC Common Stock.

Below is a summary of the instruments exchanged:

Description	Balance upon exchange
Subordinated convertible note	\$ 10,000,000
Accrued interest on subordinated convertible note	2,275,000
Series B Preferred Stock	6,000,000
Series C Preferred Stock	3,300,000
Accrued dividends on Preferred Stock, Series B and C	2,166,000
Series E Preferred Stock issued in exchange	<u>\$ 23,741,000</u>

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

As a result of this exchange, the Company recorded a loss on extinguishment of debt on the Subordinated Note of \$224,000, representing the unamortized portion of the debt discount.

Preferred Stock

The Company has two classes of Cumulative Convertible Participating Preferred Stock: Series D (11,000 shares authorized) and Series E (25,000 shares authorized) (together, the “Preferred Stock”). The Preferred Stock has a par value of \$0.05 per share and a stated value of \$1,000 per share. The Preferred Stock is entitled to receive cumulative dividends at the rate of 10% per year in preference to the holders of the Company’s common stock with respect to dividends. These dividends are payable only upon a liquidation event or when otherwise declared by the Board of Directors of the Company. The Company cannot declare or pay any dividends on its common stock until the dividends on the Preferred Stock have been paid. The Preferred Stock holders are entitled to receive any dividends paid with respect to the common stock on an “as-converted” basis. The Preferred Stock may be converted by the holder at any time and from time to time into the Company’s common stock by dividing the stated value of the Preferred Stock by the conversion price established at the time of issuance (see Series D and Series E below). Upon a liquidation event, the holders of the Preferred Stock would be entitled to participate in any proceeds in preference to any common stock holders. The Preferred Stock would also participate in any liquidation event with the common stock holders on an “as-converted” basis. The Preferred Stock conversion price is subject to adjustment for certain transactions including stock splits and issuance of equity securities below the conversion prices.

The Company has reviewed the generally accepted accounting principles applicable to the Preferred Stock and has determined that the Preferred Stock qualifies as permanent equity. Specifically, the Company reviewed ASC 815 and determined that the attributes of the preferred stock were more akin to equity than debt. The attributes considered by the Company included the designation of the instruments, the conversion of the instruments to the Company’s common stock, participation feature, no mandatory conversion, voting rights and ability to appoint directors. The Company also reviewed ASC 480 and concluded that the preferred stock were within the control of the Company. In addition, the Company has concluded that the conversion feature qualifies for the scope exception of ASC 815 as it is clearly and closely related to the Preferred Stock instrument.

Additionally, the Company reviewed ASC 480 – Distinguishing Liabilities From Equity and determined that, since the preferred instruments are not mandatorily redeemable, that no obligation to repurchase the instruments exists and that there is no obligation to issue a variable amount of common shares, these instruments are permanent equity.

Issuances of the Preferred Stock are as follows:

Series D Preferred Stock

Lenfest Credit Facility

On April 24, 2009, the Company paid to H.F. Lenfest (“Lenfest”) an origination fee of 1% of the committed amount of the Lenfest Credit Facility. The value of the origination fee was \$55,000. The origination fee was paid in 55 shares of Series D Preferred Stock, which have a conversion price of \$0.94 per share, equating 58,511 shares of the Company’s Common Stock.

PNC Credit Facility

In connection with the execution of the 2009 PNC Financing Documents, ETC paid to Lenfest an origination fee of 100 shares of Series D Preferred Stock, which is equal to one percent (1%) of the market value of the \$10,000,000 in marketable securities pledged by Lenfest to PNC Bank to secure ETC’s obligations to PNC Bank. The 100 shares of Series D Preferred Stock have a stated value of \$1,000 per share, or \$100,000 in the aggregate. These shares of Series D Preferred Stock have a conversion price per share equal to \$1.11, which price equaled the average closing price of ETC’s common stock during the 120 days prior to the issuance of such shares and would convert into 90,090 shares of ETC’s Common Stock.

Interest Payment

On October 6, 2010, the Company issued to Lenfest 231 shares of Series D Preferred stock with a stated value of \$1,000 in payment of \$231,000 of interest due under Lenfest Pledge Agreement for the period July 2, 2009 through August 27, 2010. The 231 shares have a conversion price per share equal to \$3.02 which price equaled the average closing price of ETC’s Common Stock during the 120 days prior to the issuance of such shares, and would convert into 76,490 shares of ETC Common Stock.

As of February 25, 2011, the Series D Preferred Stock totaled \$386,000 and was convertible into 225,091 shares of the Company’s Common Stock. The Company has paid all Series D Preferred Stock dividends accruing through February 25, 2011.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Series E Preferred Stock

In July, 2009, the Company issued 23,741 shares of Series E Preferred Stock to Lenfest in connection with the Series E Exchange transaction. The shares of Series E Preferred Stock are convertible to Common Stock at a conversion price per share equal to \$2.00 and would convert into 11,870,500 shares of ETC Common Stock.

As of February 25, 2011, the Series E Preferred Stock totaled \$21,741,000 (reflecting the repurchases) and was convertible into 10,870,500 shares of the Company's Common Stock. The Company has paid all Series E Preferred Stock dividends accruing through February 25, 2011.

Repurchase and Retirement of Series E Preferred Stock

On March 10, 2010, August 12, 2010, and February 9, 2011, ETC entered into three separate agreements with Lenfest to repurchase and retire a total of 2,000 shares of Series E Preferred Stock owned by Lenfest. In the three agreements, the repurchases were made at the stated price of \$1,000 per share for a total of \$2,000,000.

Common Stock Warrants

In February 2009, in connection with a \$2 million loan made by Lenfest to the Company, the Company issued to Lenfest 200,000 warrants to purchase 143,885 shares of ETC Common Stock (the \$2 Million Loan Warrant), which shares were equal in value to 10% of the \$2 million note. The warrants are exercisable for seven years following issuance at an exercise price of \$1.39, which price equaled the average closing price of ETC Common Stock during the 120 days prior to the issuance of the warrant.

In July 2009, in consideration of Lenfest entering into the Amended and Restated Guaranty, ETC issued to Lenfest 500,000 warrants to purchase 450,450 shares of ETC common stock (the \$5 million Warrant), which shares were equal in value to ten percent (10%) of the amount of the \$5,000,000 increase under the 2007 PNC Bank Credit Facility. The warrants are exercisable for seven years following issuance at an exercise price per share equal to \$1.11, which price equaled the average closing price of ETC Common Stock during the 120 days prior to the issuance of the warrant. On January 4, 2011, the Company entered into amendments to each of the warrants issued to Lenfest (*i.e.*, the \$2 Million Loan Warrant and the \$5 Million Warrant) pursuant to which Lenfest agreed to remove a provision in each of the warrants which provided anti-dilution protection in the event the Company issued securities at a price below the exercise price set forth in the warrants.

Lenfest Promissory Note

On February 20, 2009, Lenfest made a loan to ETC in the principal amount of \$2,000,000 (the "\$2 Million Loan"), which amount was considered as advanced under the Lenfest Credit Facility. The \$2 Million Loan was used by ETC solely to support ETC's requirements under a proposal for a U.S. Government bid.

In connection with the \$2 Million Loan, the Company issued the \$2 Million Warrant. Consequently, the Company recorded a debt discount of \$109,000 associated with these warrants using the Black-Scholes options-pricing model. Additionally, the Company issued 20,000 shares of the Company's Common Stock as part of this transaction. The value of the stock issued, \$19,000, has been recorded as a loan origination fee. The \$2,000,000 in proceeds from the \$2 Million Loan was included in Restricted Cash Consolidated Balance Sheets as of February 27, 2009. On September 1, 2009, the Company repaid the \$2 Million Loan in full. The unamortized portion of the original debt discount, \$91,000, was expensed during the fiscal quarter ended November 27, 2009, and is reflected as extinguishment of debt on the accompanying Condensed Consolidated Statement of Operations for the period ended February 26, 2010.

Bank Credit and Facility

Increased PNC Bank Credit Facility and Issuance of New Guarantee

On April 24, 2009, PNC Bank agreed to increase the amount of financing available under the 2007 PNC Credit Facility from \$15,000,000 to \$20,000,000, subject to the condition that Lenfest continue to personally guarantee all of ETC's obligations to PNC Bank (the "Lenfest Guaranty") and that Lenfest continue his pledge of \$10,000,000 in marketable securities as collateral security for his guarantee (the "Lenfest Pledge").

Following the receipt of the Shareholder Approvals on July 2, 2009, ETC and PNC Bank entered into the Amended and Restated Credit Agreement (the "Amended and Restated PNC Credit Agreement") and the Second Amended and Restated Reimbursement Agreement for Letters of Credit (the "Amended and Restated Reimbursement Agreement"). The 2007 promissory note was cancelled and replaced with the Amended and Restated Promissory Note in the principal amount of \$20,000,000 (the "Amended and Restated PNC Note").

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

In connection with the execution of the 2009 PNC Financing Documents, ETC paid to Lenfest an origination fee of 100 shares of Series D Convertible Preferred Stock of the Company, which is equal to one percent (1%) of the market value of the \$10,000,000 in marketable securities pledged by Lenfest to PNC Bank to secure ETC's obligations to PNC Bank. The 100 shares of Series D Preferred Stock have a stated value of \$1,000 per share, or \$100,000 in the aggregate. These shares of Series D Preferred Stock have a conversion price per share equal to \$1.11, which price equaled the average closing price of ETC Common Stock during the 120 days prior to the issuance of such shares. Additionally, ETC will pay Lenfest annual interest equal to 2% of the amount of the Lenfest Pledge, payable in Series D Preferred Stock.

In consideration of Lenfest entering into the Amended and Restated Guaranty, ETC issued to Lenfest warrants to purchase shares of ETC common stock equal to 10% of the amount of the \$5,000,000 increase in funding available under the Amended and Restated PNC Credit Agreement (the "\$5 Million Warrant"). The warrants are exercisable for seven years following issuance at an exercise price per share equal to \$1.11, which was equal to the average price of ETC common stock for the 120 trading days immediately preceding the date of this warrant.

The Company has recorded a loan origination deferred charge associated with these warrants of \$487,000 using the Black-Scholes options-pricing model with the following weighted average assumptions: expected volatility of 91.9%; risk-free interest rate of 0.49%; and an expected life of seven years.

Amendments to the Credit Agreement

On August 18, 2010, ETC and PNC Bank executed a Second Amendment to the Amended and Restated PNC Credit Agreement which extended the expiration date from June 30, 2011 to June 30, 2013.

As of February 25, 2011, the Company's availability under the PNC Credit Agreement was approximately \$15,688,000. This reflected cash borrowings under the PNC Credit Agreement of \$3,041,000 and outstanding letters of credit of approximately \$1,271,000.

On October 1, 2009, the PNC Credit Agreement was amended to extend the maturity date and to adjust the affirmative covenants. The Consolidated Tangible Net Worth covenant was modified to reflect the impact on the Company's balance sheet of the Lenfest Financing Transaction. Effective with each fiscal quarter ending after October 1, 2009, the Company must maintain a minimum Consolidated Tangible Net Worth of at least \$10,000,000. The EBITDA covenant was changed for fiscal periods beginning after December 1, 2009. Beginning with the first fiscal quarter ending after December 1, 2009, and for each fiscal quarter ending thereafter, the Company must maintain a minimum cumulative aggregate EBITDA of \$4,000,000 for the fiscal quarter then ending and the three preceding fiscal quarters.

In September 2008 ETC entered into an interest rate swap agreement with PNC Bank which converted a portion of our floating rate bank borrowings to a fixed rate through June 30, 2010. Under the generally accepted accounting principle for accounting for derivative instruments and hedging activities, any gain or loss on the agreement at any period of time would be recorded as Comprehensive gain or loss on the Consolidated Balance Sheets. The agreement expired in June 2010. At February 26, 2010, ETC recorded a Comprehensive Loss of \$85,000.

Due to the Company's accumulated deficit, all dividends accruing for the previous Series B and C and current Series D and E Preferred Stock issuances have been recorded in the accompanying financial statements as a reduction in additional paid-in capital.

Dedicated Line of Credit Agreement with PNC Bank

On November 16, 2009, the Company and PNC Bank entered into a Letter Agreement, Reimbursement Agreement, Pledge Agreement, and Amendment to Subordination Agreement (collectively, the "Dedicated Line of Credit Agreement"), pursuant to which the Company had received a committed line of credit in the amount of \$5,422,405 (the "Line of Credit"), which the Company used to satisfy performance bond and repayment guarantee requirements in a contract with an existing customer. Use of this dedicated line of credit was restricted to funding contract requirements under this specific contract.

As security for the Line of Credit, ETC and Lenfest were each required to provide PNC Bank with the equivalent of \$2,711,000 in the form of cash or other financial instruments. To meet this requirement, ETC has deposited cash in this amount in a restricted bank account with PNC Bank. Lenfest has guaranteed the Company's obligations under the Dedicated Line of Credit Agreement, and has pledged to PNC Bank \$2,711,000 in certificated securities. ETC was required by August 19, 2010, to place additional cash funds of \$2,711,000 with PNC Bank, at which time the Lenfest guarantee would be terminated and the Lenfest securities would be returned to Lenfest.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

During fiscal 2011, the Company fulfilled its requirement to fund the balance of the security to collateralize the committed line of credit by depositing approximately \$2,711,000 in a certificate of deposit. Mr. Lenfest's security was returned and his guarantee to cover the \$5.4 million line was terminated.

Subordinated Convertible Debt

As part of the Lenfest Financing Transaction, subordinated convertible debt, which had a face-value of \$10 million, was exchanged for Series E Preferred Stock on July 2, 2009. The unamortized portion of the original debt discount of \$224,000 is reflected as extinguishment of debt on the accompanying Condensed Consolidated Statement of Operations.

At the Company's option, the quarterly interest payments due on this convertible debt were deferred and added to the outstanding principal. As part of the Lenfest Financing Transaction, \$2,275,000 in accrued interest was exchanged for Series E Preferred Stock.

ETC-PZL Project Financing

In September 2009, ETC-PZL, located in Warsaw, Poland, entered into a project financing agreement with a Warsaw bank to fund a research and development contract with the Polish government. The amount of this facility is \$604,000 and it is being repaid in quarterly installments of approximately \$70,000 which commenced in September 2009. This facility will expire in September 2011. Use of this line of credit is restricted to funding contract requirements under a specific research and development contract with the Polish government.

Long-term obligations at February 25, 2011 and February 26, 2010 consist of the following:

	February 25, 2011	February 26, 2010
	(amounts in thousands)	
Note payable to bank	\$ 3,041	\$ 9,600
ETC-PZL project financing	213	486
Automobile loan	-	7
Equipment lease	49	-
Total debt obligations	3,303	10,093
Less current maturities	219	285
Long-term obligations, net of current maturities	\$ 3,084	\$ 9,808

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

2011	\$ 219
2012	-
2013 and thereafter	3,084
Total future obligations	\$ 3,303

8. 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 non-cancelable operating leases having a remaining term expiring after one fiscal year as of February 25, 2011 are \$196,000 in 2012; \$44,000 in 2013; \$25,000 in 2014; \$1,000 in 2015 and thereafter. Total rental expense for all operating leases for the fiscal years ended February 25, 2011 and February 26, 2010 was \$265,000 and \$256,000, respectively.

9. Income Taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carryforwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the potential realization of the related deferred tax asset.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Valuation allowances had been recorded against the entire deferred tax asset as of February 27, 2009 due to an uncertainty of sustaining an appropriate level of profitability in future periods. As of February 25, 2011, the Company has reviewed the components of its deferred tax asset and has determined, based upon all available information, that its current and expected future operating income will more likely than not result in the realization of a portion of its deferred tax assets relating primarily to its net operating loss carryforwards. As of February 25, 2011, the Company had approximately \$30.7 million of federal net loss carry forwards available to offset future income tax liabilities, beginning to expire in 2025. In addition, the Company has the ability to offset deferred tax assets against deferred tax liabilities created for such items as depreciation and amortization.

As a result of the Company's analysis, an income tax benefit of \$7,665,000 has been recorded in the Consolidated Statement of Income for the fiscal year ended February 25, 2011.

	(in thousands)	
	<u>Fiscal Year Ended February 25, 2011</u>	<u>Fiscal Year Ended February 26, 2010</u>
(receivable)/payable		
Current:		
Federal	\$ 92	\$ 133
State	-	-
Foreign taxes	53	23
	<u>145</u>	<u>156</u>
Deferred:		
Federal	(6,480)	(1,598)
State	(1,330)	(377)
Foreign taxes	-	-
	<u>(7,810)</u>	<u>(1,975)</u>
	<u>\$ (7,665)</u>	<u>\$ (1,819)</u>

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

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

	Fiscal year ended February 25, 2011	Fiscal year ended February 26, 2010
Tax/(benefit)		
Statutory income tax	34.0%	34.0%
State income tax, net of federal tax benefit	0.1	3.8
Research and experimentation and other tax credits	-	(3.1)
Foreign and foreign-source income or loss	(0.1)	.6
Change in valuation allowance	(164.1)	(73.4)
Other, net	18.6	(1.1)
	<u>(111.5)%</u>	<u>(39.2)%</u>

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

	February 25, 2011	February 26, 2010
	(amounts in thousands)	
Deferred tax assets:		
Net operating loss and credits	\$ 12,533	\$ 15,607
Vacation reserve	91	80
Inventory reserve	479	880
Receivable reserve	149	156
Warranty reserve	101	117
Compensation and other reserves	246	32
Other, net	65	74
	<u>13,664</u>	<u>16,946</u>
Valuation reserve	(678)	(11,963)
Total current deferred tax asset	<u>12,986</u>	<u>4,983</u>
Deferred tax liabilities:		
Amortization of capitalized software	363	350
Depreciation/other	2,897	2,716
Total non-current deferred tax liability	<u>3,260</u>	<u>3,066</u>
Net deferred tax asset	<u>\$ 9,726</u>	<u>\$ 1,917</u>

During the fiscal years ended February 25, 2011 and February 26, 2010, the Company did not have any unrecognized tax benefits and accordingly did not recognize interest expense or penalties related to unrecognized tax benefits. The Company or one of its subsidiaries files income tax returns in U.S. federal jurisdiction, various states and foreign jurisdiction. The Company is no longer subject to U.S. federal tax examinations by tax authorities for the fiscal years before 2007. The Company's majority-owned subsidiary, ETC-PZL, is no longer subject to tax examinations in Poland for tax periods prior to December 31, 2006.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

10. Business Segment Information:

The Company operates in two business segments – Training Services Group (“TSG”) and Control Systems Group (“CSG”). Core technologies include the design, manufacture and sale of training services which includes (1) software driven products and services used to create and monitor the physiological effects of flight; (2) high performance jet tactical flight simulation, and; (3) driving and disaster simulation systems, and control systems which includes: (1) steam and gas sterilization; (2) testing and simulation devices for the automotive industry, and; (3) hyperbaric and hypobaric chambers. Product categories included in TSG are Aircrew Training Systems (ATS) and flight simulators and disaster management systems. CSG includes sterilizers, environmental control devices and hyperbaric chambers along with parts and service support.

The following segment information reflects the accrual basis of accounting.

Fiscal 2011	Training Services Group (TSG)	Control Systems Group (CSG)	Corporate	Company Total
	(amounts in thousands)			
Net sales	\$ 36,767	\$ 18,684	\$ -	\$ 55,451
Interest expense	562	262	-	824
Depreciation and amortization	912	442	-	1,354
Operating income (loss)	7,185	3,989	(2,884)	8,290
Income tax benefit	-	-	(7,665)	(7,665)
Identifiable assets	25,032	8,242	20,777	54,051
Expenditures for segment assets	575	290	-	865

Fiscal 2010				
Net sales	\$ 26,035	\$ 16,236	\$ -	\$ 42,271
Interest expense	1,023	285	-	1,308
Depreciation and amortization	728	581	-	1,309
Operating income (loss)	6,128	1,727	(1,255)	6,600
Income tax benefit	-	-	(1,819)	(1,819)
Identifiable assets	31,177	4,928	15,624	51,729
Expenditures for segment assets	1,206	240	378	1,824

	2011	2010
Reconciliation to consolidated net income:		
Operating income	\$ 8,290	\$ 6,600
Interest expense	(824)	(1,308)
Loss on extinguishment of debt	-	(315)
Other, net	(589)	(347)
Income tax benefit	7,665	1,819
Income/ (loss) attributable to the noncontrolling interest	8	(4)
Net income attributable to ETC	<u>\$ 14,534</u>	<u>\$ 6,453</u>

Segment operating income consists of net sales less applicable costs and expenses relating to these revenues. Unallocated expenses including general corporate expenses, letter of credit fees and income taxes have been excluded from the determination of the total profit for segments. For presentation purposes, income, expenses and assets not specifically identifiable to an individual business group or applicable to all groups and general corporate expenses, primarily central administrative office expenses, are reflected in the Corporate category. Property, plant, and equipment associated with the Company’s NASTAR Center are included in the TSG segment; the remaining property, plant and equipment are not identified with specific business segments because most of these assets are used in each of the segments.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

In fiscal 2011, international sales totaling at least \$500,000 per country, listed in order of magnitude, were made to customers in South Korea, Saudi Arabia, Malaysia and Japan. In fiscal 2010, international sales totaling a least \$500,000 per country were made to customers in Saudi Arabia, South Korea, Malaysia and Turkey. Fluctuations in sales to international countries from year to year primarily reflect revenue recognition on the level and stage of development and production on multi-year long-term contracts.

In fiscal 2011, three customers, (two with U.S. defense agencies and one with an international customer), each in the ATS division, represented 10% or more of total sales. In fiscal 2010, two customers, both in the ATS division, each represented 10% or more of total sales.

Included in the segment information for the fiscal years ended February 25, 2011 and February 26, 2010 are export sales of \$19,999,000 and \$21,690,000, respectively. Sales to the U.S. government and its agencies aggregated \$23,271,000 and \$7,711,000 for the fiscal years ended February 25, 2011 and February 26, 2010, respectively.

11. Stock Options:

A summary of the status of the Company's Stock Option Plans as of and for the fiscal years ended:

	February 25, 2011		February 26, 2010	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	269,185	\$ 4.53	157,652	\$ 5.90
Granted	-	-	113,000	2.64
Exercised	-	-	-	-
Forfeited	(8,264)	7.29	(1,467)	6.07
Outstanding at end of year	<u>260,921</u>	4.44	<u>269,185</u>	4.53
Options exercisable at year end	185,587		156,185	
Weighted average fair value of options granted during the year		\$ -		\$ 2.64

The following information applies to options outstanding at February 25, 2011:

Fiscal 2011	Options outstanding		Options exercisable		
	Number outstanding at February 25, 2011	Weighted average remaining contractual life (years)	Weighted average Exercise price	Number exercisable at February 25, 2011	Weighted average exercise price
Range of exercise prices:					
\$ 2.64	113,000	8.75	\$ 2.64	37,666	\$ 2.64
\$ 5.12	80,000	6.00	5.12	80,000	5.12
\$ 6.07 to \$7.24	<u>67,921</u>	5.05	6.73	<u>67,921</u>	6.66
Total	<u>260,921</u>			<u>185,587</u>	

The cost for stock option compensation was \$98,000 and \$33,000 for the years ended February 25, 2011 and February 26, 2010, respectively. At February 25, 2011, the Company had two stock-based compensation plans.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Employee, Director and Consultant Stock Plan:

In July 2009, the Company adopted the 2009 Employee, Director and Consultant Stock Plan. This Plan authorizes the Board of Directors (or a committee appointed under the Board) to grant option awards for the purchase of Common Stock or Common Stock awards of up to 1,000,000 shares of Common Stock to employees, officers, directors, consultants and advisors of the Company and its Subsidiaries. The plan allows for the establishment of an exercise price at the time each option is granted. The exercise price shall not be less than the fair market value (or in the case of a ten percent owner, 110%) of a share of the Company's Common Stock on the date of grant of such option. The plan also allows the Board or its appointed committee to establish the exercise period(s) of any option awards. Granted options have a maximum term of 10 years. This Plan was approved by the shareholders on July 2, 2009. As of February 25, 2011, there were 887,000 shares available to be granted under this Plan. At February 26, 2010, there were 67,921 options outstanding under the 1999 Incentive Stock Option Plan, which expired in August 2008.

Non-employee Director Stock Plan:

In September 2005, the Company adopted a stock option plan which allows for the granting to non-employee members of ETC's Board of Directors of options to purchase up to 600,000 shares of Common Stock. The plan provides that option price shall not be less than 100% of the current market price of the stock on the date of the grant. The amount of each individual award and the vesting period are determined by the Board of Directors or its appointed committee. Granted options have a maximum term of 10 years. The Plan shall remain in effect until terminated by the Board of Directors. At February 25, 2011, there were 520,000 shares available to be granted under this Plan.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model, though no options were granted in fiscal 2011. There were no grants in fiscal 2011 and 113,000 grants of stock options in fiscal 2010.

12. Other Related Party Transactions

ETC purchases industrial products from Industrial Instruments Corp. which is owned by Christine and Charles Walter, the daughter and son-in-law of William F. Mitchell, ETC's President and Chief Executive Officer. During fiscal 2011 and 2010, the Company purchased \$492,000 and \$626,000, respectively, from Industrial Instruments. ETC also rents office space to Industrial Instruments at ETC's corporate headquarters. During fiscal 2011 and 2010, Industrial Instruments paid to ETC rent in the amounts of \$7,800 and \$5,200, respectively.

ETC purchases travel accommodations from Jet Set, a company that employs Kathleen Mahon, the daughter of Mr. Mitchell. During fiscal 2011 and 2010, ETC purchased travel through Jet Set totaling \$293,000 and \$317,000, respectively, and Ms. Mahon received approximately \$10,000 in fiscal 2011 and \$9,000 in fiscal 2010 from her employer in commissions on account of such purchases. Ms. Mahon is also engaged by ETC as a consultant to review expense reports submitted by Company employees. During fiscal 2011 and 2010, Ms. Mahon received \$20,000 and \$17,000, respectively, in consideration of such services.

ETC also employs William F. Mitchell, Jr., the son of Mr. Mitchell, as its Vice President, Contracts/Purchasing, and David Mitchell, the son of Mr. Mitchell, as its Business Unit Manager for Sterilizers. In fiscal 2011, Mr. William F. Mitchell, Jr. received \$167,000 and Mr. David Mitchell received \$179,000 in compensation from ETC.

13. Commitments and Contingencies

Mends International, Ltd.

On May 29, 2008, a Request for Arbitration was filed against the Company with the Secretariat of the International Court of Arbitration by Mends International Ltd. ("Mends"). Mends' Request for Arbitration arose out of a February 3, 1999 contract between the Company and Mends wherein Mends purchased aeromedical equipment for sale to the Nigerian Air Force. Mends asserted a claim for breach of contract and demanded \$797,486, plus interest and costs. On September 16, 2008, Mends filed an Amended Request for Arbitration, adding tort claims for conversion and breach of fiduciary duty and seeking punitive damages. In response, the Company asserted a counterclaim seeking damages for other disputes with Mends that have arisen under the contract that Mends has put at issue in this arbitration. On July 1, 2010 and October 18, 2010, the International Court of Arbitration issued a Partial Final Award and an Award on Costs which have been fully accrued and did not have a material adverse effect on the Company's financial condition or results of operation.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

In September 2010, a second arbitration involving ETC and Mends was heard by the International Court of Arbitration. In the second arbitration, the Company alleged the breach of a separate contract between the parties and sought monetary damages. This second arbitration may affect the ultimate payment due in the above-referenced First Arbitration. The second arbitration award is expected in the coming months, and it is not expected that any award adverse to the Company would have a material effect on the Company's financial position or results of operations.

Subsequent to February 25, 2011, the Company submitted an initial notification of voluntary disclosure to the Directorate of Defense Trade Controls within the U.S. Department of State (DDTC) concerning the potential export of technical data and defense services to foreign persons. The services at issue (which constitute less than 0.5% of the Company's total annual sales) consisted of the provision of low gravitational force training in a human-rated centrifuge. The human-rated centrifuge is subject to the jurisdiction of DDTC in accordance with the International Traffic in Arms Regulations (ITAR). The Company filed the initial notification because we determined that the training programs may be subject to the jurisdiction of the ITAR. In approximately one month, we will provide a full disclosure to DDTC. At this time it is not possible to determine whether any fines or other penalties will be asserted against the Company or the materiality of any outcome.

Other Matters

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against us. We believe, after consultation with legal counsel handling these specific matters, 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 be expected to have a significant effect on our financial position or results of operations if determined adversely against us.

14. Employee Benefit Plans

The Company maintains a retirement savings 401(k) plan for eligible employees. The Company's contributes 100% to the plan based on the first 4% of the employees' qualifying contributions. The Company's contributions totaled \$330,000 and \$177,000 in fiscal 2011 and fiscal 2010, respectively.

The Company has an Employee Stock Purchase Plan, which was adopted by the Board of Directors on November 3, 1987. All employees meeting service requirements, except officers, directors and 10% shareholders, are eligible to voluntarily purchase Common Stock through payroll deductions up to 10% of salary. The Company makes a matching contribution of 20% of the employee's contribution. The Company originally reserved 270,000 shares for issuance under this plan, of which 183,578 shares are still remaining.

15. Subsequent Events

The Company had one subsequent event, relating to the potential export of technical data and defense services to foreign persons, which is set forth in Section 13 (Commitments and Contingencies).

List of Subsidiaries

<u>Name</u>	<u>Jurisdiction</u>	<u>% Ownership</u>
ETC International Corporation	Barbados	100%
ETC-PZL Aerospace Industries	Poland	9.5%
ETC-Europe	Great Britain	9.9%
ETC-Delaware	Delaware	100%
NASTAR Center Holdings Corporation	Delaware	100%
NASTAR Center LLC	Delaware	100%

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements Form S-8 (File No. 333-131322, effective January 27, 2006, File No. 333-65469, effective October 8, 1998 and File No. 333-161737, effective September 4, 2009) of Environmental Tectonics Corporation and Subsidiaries, of our report, dated May 26, 2011.

/s/ Friedman LLP

East Hanover, New Jersey

May 26, 2011

CERTIFICATION PURSUANT TO RULE 13A-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934

I, William F. Mitchell, certify that:

1. I have reviewed this Annual Report on Form 10-K of Environmental Tectonics Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 26, 2011

By: /s/ William F. Mitchell
William F. Mitchell
President and Chief Executive Officer

CERTIFICATION PURSUANT TO RULE 13A-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934

I, Duane D. Deaner, certify that:

1. I have reviewed this Annual Report on Form 10-K of Environmental Tectonics Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 26, 2011

By: /s/ Duane D. Deaner
Duane D. Deaner
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Environmental Tectonics Corporation (the "Company") for the fiscal year ended February 25, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William F. Mitchell, Chief Executive Officer of the Company, and I, Duane D. Deaner, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: May 26, 2011

/s/ William F. Mitchell

William F. Mitchell
Chief Executive Officer

/s/ Duane D. Deaner

Duane D. Deaner
Chief Financial Officer

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed to be filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
