QUALITY THROUGH
INTEGRITY AND TECHNOLOGY

ENVIRONMENTAL TECTONICS CORPORATION

ANNUAL REPORT 2014

The Sum of our Parts.

ETCUSA.com

We are confident that our ATFS motion platform is a viable, highly-advantageous alternative to live aircraft for tactical flight training.

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LETTER TO THE SHAREHOLDERS

William F. Mitchell
Chairman and Chief Executive Officer

Robert L. Laurent, Jr.
President and Corporate Secretary

Fiscal 2014 was a challenging year for ETC.

The Company entered the year with a backlog of 35% below the prior year, which was reflected in reduced net sales of 23%. Much of this reduction, as well as lower orders during fiscal 2014, was a result of budget sequestration within the U.S. and a tightening of budgets for the militaries of various European countries. In response to this challenge, the Company reduced its selling, general and administrative expenses by 25%, and lowered its cost of capital through a financial restructuring late in fiscal 2013. With these expense reductions implemented, the Company was able to break even and had positive EBITDA of $4 million.

Despite these budgetary challenges, we are seeing positive trends. An international response to U.S. budget reductions includes higher levels of orders and activities in countries that are increasing defense spending to lessen their risk of exposure to a smaller U.S. defense umbrella. This is particularly true in the Middle East and Asia, where spending on training and modernized training equipment is increasing. This is reflected in ETC being awarded significant projects within these regions since fiscal year end.

Smaller U.S. defense budgets also means greater focus on more cost-effective spending for training and readiness. In January 2013, the U.S. Congress included a provision in the National Defense Authorization Act that required an independent study on the implications of simulator-based training for fighter aircraft in a sustained gravity environment. This study is to be submitted to Congress in the near future. Although we do not know the results of the study, we are confident that our ATFS motion platform is a viable, highly advantageous alternative to live aircraft for tactical flight training purposes that would significantly reduce fighter aircraft training costs. We continue to believe that ETC is uniquely positioned to deliver this simulator-based training, and the full acceptance of it by the U.S. Department of Defense would be a tremendous business opportunity for ETC, and a cost-savings opportunity for the U.S. military.

BOARD OF DIRECTORS

William F. Mitchell, Chairman (1969)
George K. Anderson, M.D. (2003)
Linda J. Brent Ed.D (2010)
Roger Colley (2011)
H.F. Lenfest (2003)
Michael D. Malone (2012)
George A. Sawyer (2009)
Winston E. Scott (2010)

CORPORATE OFFICERS

William F. Mitchell
Chairman and Chief Executive Officer

Robert L. Laurent, Jr.
President and Corporate Secretary

Mark Prudenti
Chief Financial Officer

Thomas G. Loughlin
Chief Operating Officer

William F. Mitchell, Jr.
Vice President, Contracts / Purchasing

James R. Wells
Vice President, General Counsel

Yum! Brands and CH Aviation, Upset Prevention and Recovery / Altitude Awareness Training Programs. *April 15-16, 2014*

The GYROLAB GL-2000 simulator replicates the dynamics of an upset condition.

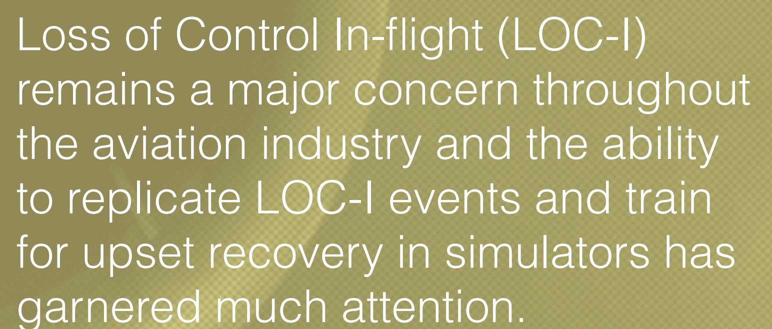
Altitude chamber training prepares you to cope with the rigors of high-altitude flight.

COMMERCIAL AVIATION

Another significant opportunity for ETC is within commercial aviation. Loss of Control In-flight (LOC-I) remains a major concern throughout the aviation industry, and the ability to replicate LOC-I events and train for upset recovery in simulators has garnered much attention. The Federal Aviation Administration (FAA) and International Civil Aviation Organization (ICAO) have determined that LOC-I (due to upsets) is the number one cause of transport category fatal accidents. As a result of Colgan Air Flight 3407, the FAA revised 14 CFR Part 121, to provide guidance and best practices for training, testing and checking of pilots to ensure they respond correctly to both impending stalls, full stalls and upset conditions.

The FAA specifically amended the training requirements for stalls and upset training for air carriers. The inability of current FAA approved flight simulators to replicate positive and negative G's is specifically mentioned in the *FAA Airplane Upset Recovery Training Aid*. Classic large transport simulators, which include an enclosed full cockpit mounted on a large hydraulically-actuated platform, provide excellent simulation of the normal flight environment. However, due to the dynamic nature of LOC-I and upset events, these traditional devices are not capable of providing the sustained G forces and sustained motion cues needed in order to provide accurate, complex, and challenging upset recovery training.

ETC has developed an upset recovery program based on two research programs; one with the FAA Civil Aerospace Medical Institute and one with NASA Langley, conducted at ETC's NASTAR Center using the GYROLAB GL-2000 sustained G simulator. This device can replicate the dynamics of an upset condition to include sustained positive and negative G's, as well as sustained motion in a safe, controlled, and flight realistic environment. Trainees who have gone through the training program have benefited from their experience. As the program evolves, continuous G motion-based simulation will become an important aspect of pilot LOC-I training. This creates opportunities for training; NASTAR enrollment to train in its GYROLAB GL-2000 is up 72% through just the first several weeks of fiscal 2015 compared to all of fiscal 2014. This will also create opportunities for GYROLAB equipment sales.



Loss of Control In-flight (LOC-I) remains a major concern throughout the aviation industry and the ability to replicate LOC-I events and train for upset recovery in simulators has garnered much attention.

Our NASTAR Center provides supplemental STEM education to the next generation of aerospace enthusiasts.

During fiscal 2014, our Advanced Disaster Management Simulator made solid strides, as we received orders from Indonesia and multiple European countries. Fiscal 2015 is starting off well with a first time order in China and significant university orders.

ETC's Advanced Disaster Management Simulator made solid strides in fiscal 2014.

Within our Commercial/Industrial Systems segment, both the Sterilizer business, where ETC is recognized as the world leader in industrial sterilizer systems, and the Environmental Testing Systems business, which has a growing portfolio of product offerings for the automotive, heavy duty diesel, and aircraft engine markets where we have a solid customer base, had strong orders during fiscal 2014. This was offset in part by weak hyperbaric chamber orders. Hyperbaric orders were affected by uncertainty within the medical device market created by the Affordable Care Act, which has had the affect of slowing equipment orders.

Our commitment to integrity includes outreach to the community in which we work. Our NASTAR Center provides supplemental STEM education through summer camps for students in grades two through twelve, as well as classes for teachers. We are proud of our work in the development of knowledge and excitement in the next generation of aerospace enthusiasts.

Your Company continues to invest in research and development, where breakthroughs in software have continued to improve the technological capabilities of our ATFS-400 and in Hypobaric chambers where we have completed the first of its kind, state-of-the-art FALCON altitude chamber for the Spanish Air Force.

We would like to express our gratitude to the global ETC team for helping us through this challenging period, and our shareholders for their continued and unwavering support. We hope you share in our excitement for the upcoming prospects for ETC.

William F. Mitchell
Chairman and CEO

Robert L. Laurent, Jr.
President and Corporate Secretary

FINANCIAL REVIEW

(in thousands, except per share information)	Fiscal year ended February 28, 2014	Fiscal year ended February 22, 2013
Net sales	$ 48,274	$ 62,773
Gross profit	14,559	24,869
Operating income	2,461	9,944
Net income attributable to Environmental Tectonics Corporation	599	4,948
Per share information:		
Basic earnings per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.17
Undistributed earnings per share:		
Common	$ 0.01	$ 0.19
Preferred	$ 0.01	$ 0.19
Diluted earnings per share	$ 0.01	$ 0.19
Working capital	$ 26,536	$ 25,135
Total long-term debt obligations	21,483	22,185
Total assets	56,192	60,568
Total shareholders' equity	24,326	24,219
Weighted average common and participating shares:		
Basic	15,246	18,212
Diluted	15,477	18,375

When used in this Annual Report to Shareholders, except where the context otherwise requires, the terms “we”, “us”, “our”, “ETC”, and the “Company” refer to Environmental Tectonics Corporation and its subsidiaries.

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

Dividends on the Company's Preferred Stock, as declared, are accrued according to the terms of the Preferred Stock and when paid, are paid in cash. All Preferred Stock dividends accrued as of February 22, 2013 were paid in April 2013.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FORWARD-LOOKING STATEMENTS

Discussions of some of the matters contained in this Annual Report to Shareholders include forward-looking statements that may involve risks and uncertainties. Some of these discussions are contained under the caption "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 foreign currency fluctuations, (ii) statements of our plans and objectives of the Company or its management or the Company's Board of Directors (the "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 that 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.

The Company's fiscal year is the fifty-two week or fifty-three week annual accounting period ending the last Friday in February. References to fiscal 2013 are references to the fifty-two week period ended February 22, 2013. References to fiscal 2014 are references to the fifty-three week period ended February 28, 2014. References to fiscal 2015 are references to the fifty-two week period ending February 27, 2015. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2014.

Overview

ETC was incorporated in 1969 in Pennsylvania. For over four decades, we have provided our customers with products, service, and support. Innovation, continuous technological improvement and enhancement, and product quality are core values that are critical to our success. We are a significant supplier and innovator in the following product areas: (i) software driven products and services used to create and monitor the physiological effects of flight, including high performance jet tactical flight simulation, upset recovery and spatial disorientation, and both suborbital and orbital commercial human spaceflight; collectively, Aircrew Training Systems ("ATS"); (ii) altitude (hypobaric) chambers; (iii) Advanced Disaster Management Simulators ("ADMS"); (iv) steam and gas (ethylene oxide) sterilizers; (v) environmental testing and simulation devices; and (vi) hyperbaric (100% oxygen) chambers for one person (monoplace chambers). We operate in two primary business segments, Aerospace Solutions ("Aerospace") and Commercial/Industrial Systems ("CIS").

Aerospace encompasses the design, manufacture, and sale of: (i) Aircrew Training Systems; (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); and (iv) ADMS, as well as integrated logistics support ("ILS") for customers who purchase these products or similar products manufactured by other parties. These products and services provide customers with an offering of comprehensive solutions for improved readiness and reduced operational costs. Sales of our Aerospace products are made principally to U.S. and foreign government agencies.

Specific products within Aerospace include:

- Authentic Tactical Fighting System ("ATFS") Motion Platforms;
  - ATFS-400-31 PHOENIX High Performance Human Centrifuge
  - ATFS-400-25 PHOENIX High Performance Human Centrifuge
- Cockpit Modules;
- Turn-Key Aeromedical Centers;
- GYROLAB GL-6000 GRYPHON High-G Disorientation Training and Research Device;
- GYROLAB GL-4000;
- GYROLAB GL-2500;
- GYROLAB GL-2000;
- GYROLAB GL-1500;
- GYRO Integrated Physiological Trainer, Generation 3, Extended Field of View ("GYRO IPT3 EFOV");
- GYRO IPT II;
- GyroFlight;
- HeloFlight;
- GAT II Fixed Wing General Aviation Trainer;
- GAT II Helo;
- G-LAB Motion Platform;
- Integrated Avionics Maintenance Trainer ("IAMT");
- FALCON Altitude (Hypobaric) Chambers;
- Multiplace Hyperbaric Chambers;

- Vestibular Illusion Demonstrator (“VID”);
- Ejection Seat Simulator (“ESS”);
- Pilot Selection System (“PSS”);
- Water Survival Training equipment;
- Night Vision Training System (“NVTS”);
- Night Vision Goggle Training System (“NVGTS”);
- Aviation Gymnastics Equipment (“GTEP”); and
- ADMS line of products (ADMS-AIRBASE, ADMS-COMMAND, ADMS-CONTROL, etc.).

Specific services within Aerospace include:
- Tactical flight training;
- High-G training;
- Hypoxia training;
- Situational awareness and spatial disorientation training;
- Suborbital and orbital commercial human spaceflight training;
- Upset prevention and recovery training (“UPRT”);
- Aeromedical training;
- Advanced pilot training;
- Basic pilot training;
- Pilot selection;
- Emergency response training; and
- Integrated logistics support.

CIS encompasses the design, manufacture, and sale of:
- Steam and gas (ethylene oxide) sterilizers;
- Environmental testing and simulation devices;
- Hyperbaric (100% oxygen) chambers for one person (monoplace chambers); and
- Parts and service support.

Sales of our CIS products are made principally to the healthcare, pharmaceutical and automotive industries.

Net sales, operating income, identifiable assets, and other financial information regarding our segments may be found in Note 9 – Business Segment Information.

We presently have two operating subsidiaries. ETC-PZL Aerospace Industries Sp. z o.o. (“ETC-PZL”), our 95%-owned subsidiary in Warsaw, Poland, manufactures certain simulators and provides software to support products manufactured domestically within our Aerospace segment. Environmental Tectonics Corporation (Europe) Limited (“ETC-Europe”), our 99% owned subsidiary, functions as a sales office in the United Kingdom.

We utilize both employees and independent representatives to market our products and services. At February 28, 2014, approximately thirty-six (36) employees were committed to sales and marketing functions. In addition to our two operating subsidiaries, we have employees stationed in Egypt, Turkey, United Arab Emirates, India, China, South Korea, Thailand, and Malaysia. In certain countries outside the United States, we have relationships with independent sales representatives and distributors.

We sell 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 Aerospace segment, we offer integrated Aircrew Training Systems to commercial, governmental, and military defense agencies, and training devices to governmental and 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. We also provide integrated logistics support for customers who purchase these products or similar products manufactured by other parties.

In the CIS segment, we sell our sterilizers to pharmaceutical and medical device manufacturers. We sell our environmental testing and simulation devices primarily to commercial automobile manufacturers and heating, ventilation, and air conditioning (“HVAC”) manufacturers. We sell our hyperbaric products (primarily “monoplace” chambers) to hospitals and clinics. We also provide upgrade, maintenance, and repair services for our products and similar products manufactured by other parties.

Significant Impacts and Transactions during Fiscal 2014

The following items had a material impact on our financial performance, cash flow, and financial position during fiscal 2014:

Additional work required on several contracts

Gross profit for fiscal 2014 decreased by $10.3 million, or 41.5%, compared to fiscal 2013. The significant decrease in gross profit was a combination of both lower net sales and lower gross profit margin percentage due to inefficiencies as a result of additional work required on several contracts, for which we are currently pursuing recovery. As disclosed in Note 15 – Subsequent Events, on April 24, 2014, we reached a favorable settlement on the first of these recoveries that partially offset the effects of the additional work. Although we expect to reach additional favorable settlements, they are currently in the early stages of discussion, and under accounting principles generally accepted in the United States of America, there is a requirement that the settlement is probable before recovery is recorded.

Market for our Monoplace Chambers

Our monoplace chambers are sold primarily to hospitals and clinics, both of which appear to be delaying purchases in response to the Affordable Care Act (“ACA”). Although domestic sales of monoplace chambers only decreased by $0.5 million, or 20.7%, during fiscal 2014 compared to fiscal 2013, domestic bookings of monoplace chambers decreased by 58.9% during fiscal 2014 compared to fiscal 2013. Given the current uncertainty created in the healthcare sector by the ACA, fiscal 2015 domestic sales of monoplace chambers are not expected to outperform fiscal 2014 domestic sales.

Continued investments to enhance and market worldwide our ATFS and other technologies

During the past two fiscal years, we have spent $2.7 million (including $1.4 million in fiscal 2014) for capital improvements and software development. Most of this investment has been related to enhancement and promotion of our ATS products and related training, and includes both engineering costs to improve the technical abilities of our ATFS line of products and enhance upset prevention and recovery training ("UPRT"). This investment is in addition to several full-time employees and consultants whose main responsibilities are to support ATFS business development. Going forward, we expect to continue to invest in new capabilities of our ATFS line of products.

Critical Accounting Policies

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 estimates, 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 that involve significant engineering and software development;
- percentage-of-completion ("POC") accounting for long-term, construction-type contracts;
- legal reserves and contingencies;
- valuations of long-lived assets, including equipment housed within our National Aerospace Training and Research Center (the "NASTAR Center") and intangible assets such as capitalized software;
- forecasting our effective income tax rate, including our future ability to value and utilize tax credits and to realize the 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 the Board of Directors, and the Audit Committee has reviewed the disclosure presented below.

Revenue Recognition

We recognize revenue, which is recorded net of any applicable sales tax, using three methods:

On long-term contracts, with a contract value over $250,000 and a minimum completion period of six months, the 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 cumulative amount of revenue to be recognized, from which previously recognized revenue would be subtracted to determine revenue to be 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 (i.e. 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 that 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. Some of our long-term contracts contain provisions that require us to pay liquidated damages if we are responsible for the failure to meet specified contractual milestone dates and the applicable customer asserts a claim under these provisions. Management uses its best judgment to estimate not only the cost to perform the work, but also the price we will eventually be paid on such contracts.

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

Because of the nature of our business, 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 2014 versus Fiscal 2013

Summary Table of Results

(in thousands, except per share information)	Fiscal 2014	Fiscal 2013	Variance $	Variance %
Net sales:				
Domestic sales	$ 11,610	$ 19,049	$ (7,439)	(39.1)
U.S. Government sales	12,119	22,217	(10,098)	(45.4)
International sales	24,545	21,507	3,037	14.1
Net sales total	48,274	62,773	(14,499)	(23.1)
Gross profit	14,559	24,869	(10,310)	(41.5)
Gross profit margin %	*30.2%*	*39.6%*	*-9.4%*	*-23.7%*
Operating expenses:				
Selling and marketing expenses	4,591	5,570	(979)	(17.6)
General and administrative expenses	5,777	8,186	(2,409)	(29.4)
Research and development expenses	1,730	1,169	561	48.0
Operating expenses total	12,098	14,925	(2,827)	(18.9)
Operating income	2,461	9,944	(7,483)	(75.3)
Operating margin %	*5.1%*	*15.8%*	*-10.7%*	*-67.7%*
Interest expense, net	808	1,005	(197)	(19.6)
Other expense, net	381	118	263	222.9
Income before income taxes	1,272	8,821	(7,549)	(85.6)
Pre-tax income margin %	*2.6%*	*14.1%*	*-11.5%*	*-81.6%*
Provision for income taxes	670	3,859	(3,189)	(82.6)
Net income	602	4,962	(4,360)	(87.9)
Income attributable to non-controlling interest	(3)	(14)	11	(78.6)
Net income attributable to ETC	**$ 599**	**$ 4,948**	**$ (4,349)**	**(87.9)**
Per share information:				
Basic earnings per common and participating share:				
Distributed earnings per share:				
Common	$ -	$ -	$ -	
Preferred	$ 0.08	$ 0.17	$ (0.09)	(52.9)
Undistributed earnings per share:				
Common	$ 0.01	$ 0.19	$ (0.18)	(94.7)
Preferred	$ 0.01	$ 0.19	$ (0.18)	(94.7)
Diluted earnings per share	**$ 0.01**	**$ 0.19**	**$ (0.18)**	**(94.7)**

Net income attributable to ETC

Net income attributable to ETC was $0.6 million, or $0.01 per diluted share, in fiscal 2014 versus $4.9 million, or $0.19 per diluted share, in fiscal 2013; a decrease of $4.3 million, or 87.9%. The decrease in net income attributable to ETC reflects a decrease in income before income taxes of $7.5 million, or 85.6%, due primarily to a $10.3 million decrease in gross profit, resulting from a combination of both lower net sales and lower gross profit margin percentage, offset by a $2.8 million decrease in operating expenses, resulting primarily from an on-going effort to reduce non-revenue generating expenses.

Net sales

The following schedule presents the Company's net sales (in thousands) by segment, business unit, and geographic area:

	Fiscal 2014				Fiscal 2013			
	Domestic	U.S. Gov't	International	Total	Domestic	U.S. Gov't	International	Total
Aerospace Solutions								
ATS	$ 431	$ 1,726	$ 10,640	$ 12,797	$ 306	$ 9,553	$ 12,249	$ 22,108
Chambers	-	9,751	5,333	15,084	-	12,664	1,680	14,344
Simulation (ADMS)	555	149	1,371	2,075	1,181	-	1,263	2,444
ETC-PZL and other	151	-	4,171	4,322	236	-	3,163	3,399
Subtotal	1,137	11,626	21,515	34,278	1,723	22,217	18,355	42,295
Commercial/Industrial Systems								
Sterilizers	5,564	-	1,184	6,748	9,993	-	901	10,894
Environmental	1,049	493	-	1,542	3,035	-	496	3,531
Hyperbaric	1,761	-	1,840	3,601	2,220	-	1,643	3,863
Service and spares	2,099	-	6	2,105	2,078	-	112	2,190
Subtotal	10,473	493	3,030	13,996	17,326	-	3,152	20,478
Net sales total	**$ 11,610**	**$ 12,119**	**$ 24,545**	**$ 48,274**	**$ 19,049**	**$ 22,217**	**$ 21,507**	**$ 62,773**

Net sales for fiscal 2014 were $48.3 million, a decrease of $14.5 million, or 23.1%, from fiscal 2013. The reduction reflects decreased sales within our Aerospace segment to the U.S. Government and decreased sales of sterilizers and environmental testing and simulation devices to Domestic customers, offset in part, by increased sales within our Aerospace segment to International customers. Given the current progress made on U.S. Government contracts in the Company's sales backlog, the Company anticipates the concentration of sales to the U.S. Government will continue to lessen in fiscal 2015.

In fiscal 2014, two customers, (one U.S. defense agency and one international customer), each in the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling $21.7 million represented 45.0% of total net sales. In fiscal 2013, two customers, (one U.S. defense agency and one international customer), each in the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling $29.9 million represented 47.7% of total net sales. Within the Company's February 28, 2014 sales backlog of $30.7 million for work to be performed and revenue to be recognized under written agreements after such date, two contracts (one with a U.S. defense agency and one with a domestic customer), each representing at least 10% of the total sales backlog, together constituted $7.3 million or 23.7% of the total sales backlog. ATS backlog was $13.6 million, or 44.3%, of the total sales backlog; Chambers backlog was $4.8 million, or 15.7%, of the total sales backlog; and Sterilizers backlog was $6.4 million, or 20.9%, of the total sales backlog.

We have historically experienced significant variability in our sales performance. This reflects the existing sales backlog, product mix, nature of contracts (size and performance time), manufacturing cycle, installation time, customer acceptance, and certain factors not in our control such as customer delays and the time required to obtain U.S. Government export approvals. A small number of contracts may account for a substantial percentage of our net sales in any period.

Domestic sales

Domestic sales in fiscal 2014 were $11.6 million, a decrease of $7.4 million, or 39.1%, compared to fiscal 2013, and represented 24.1% of total net sales, compared to 30.3% in fiscal 2013. The decrease in Domestic sales is primarily a result of a $4.4 million, or 44.3%, decrease in sales of Sterilization Systems and a $2.0 million, or 65.4%, decrease in the sales of Environmental Testing and Simulation Systems. Although both the Sterilizers and Environmental business units had fairly robust bookings during fiscal 2014, $8.1 million and $3.7 million, respectively, the majority of these bookings occurred late in the fiscal year and remained in backlog as of February 28, 2014.

U.S. Government sales

U.S. Government sales in fiscal 2014 were $12.1 million, a decrease of $10.1 million, or 45.4%, from fiscal 2013, as a result of our U.S. Government contracts transitioning into the testing phase. U.S. Government sales represented 25.1% of total net sales in fiscal 2014 compared to 35.4% in fiscal 2013. Given the existing progress made on U.S. Government contracts in the Company's sales backlog, the Company anticipates the concentration of sales with the U.S. Government will continue to lessen in fiscal 2015.

International sales

International sales in fiscal 2014, including those of the Company's foreign subsidiaries, were $24.5 million, an increase of $3.0 million, or 14.1%, from fiscal 2013, due primarily to a $3.7 million, or 217.4%, increase in the sales of Chambers, and a $1.0 million increase in ETC-PZL sales. These increases were offset by a $1.6 million, or 13.1%, decrease in the sales of ATS products. In aggregate, International sales represented 50.8% of the Company's total net sales in fiscal 2014 compared to 34.3% in fiscal 2013. In fiscal 2014, International sales totaling at least $500,000 were made to customers in nine (9) different countries; in fiscal 2013, International sales totaling at least $500,000 were made to customers in eight (8) different countries. 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

Aerospace sales were $34.3 million in fiscal 2014, a decrease of $8.0 million, or 19.0%, from sales of $42.3 million in fiscal 2013. This decrease was primarily due to less revenue recorded on our U.S. Government contracts as they transition into the testing phase, offset in part, by an increase in International sales. Sales of Aerospace products accounted for 71.0% of our total net sales in fiscal 2014 versus 67.4% in fiscal 2013. Sales in our CIS segment decreased $6.5 million, or 31.7%, and constituted 29.0% of our total net sales in fiscal 2014 compared to 32.6% in fiscal 2012. The decrease was due primarily to the sales of Sterilization Systems and Environmental Testing and Simulation Systems domestically due to the majority of fiscal 2014 bookings being skewed towards later in the fiscal year.

Given the Company's sales backlog as of February 28, 2014, it is anticipated that our Aerospace segment will continue to generate the majority of its revenues from International contracts, while sales within our CIS segment are expected to be positively affected by an increased sales backlog entering fiscal 2015.

Gross profit

Gross profit for fiscal 2014 decreased by $10.3 million, or 41.5%, compared to fiscal 2013. The significant decrease in gross profit was a combination of both lower net sales and lower gross profit margin percentage due to inefficiencies as a result of additional work required on several contracts, for which we are currently pursuing recovery. As disclosed in Note 15 – Subsequent Events, on April 24, 2014, we reached a favorable settlement on the first of these recoveries that partially offset the effects of the additional work. Gross profit margin as a percentage of net sales decreased to 30.2% in fiscal 2014 compared to 39.6% in fiscal 2013.

Selling and marketing expenses

Selling and marketing expenses for fiscal 2014 of $4.6 million decreased by $1.0 million, or 17.6%, compared to fiscal 2013. This decrease is primarily the result of an on-going effort to reduce non-revenue generating expenses, as well as lower commissions due to lower net sales. As a percentage of net sales, selling and marketing expenses increased to 9.5% in fiscal 2014 from 8.9% in fiscal 2013 due primarily to lower net sales in fiscal 2014.

General and administrative expenses

General and administrative expenses for fiscal 2014 of $5.8 million decreased by $2.4 million, or 29.4%, from fiscal 2013. The decrease is primarily the result of an on-going effort to reduce non-revenue generating expenses. As a percentage of net sales, general and administrative expenses decreased to 12.0% in fiscal 2014 compared to 13.0% in fiscal 2013 despite lower net sales in fiscal 2014.

Research and development expenses

Research and development expenses include spending for potential new products and technologies, and work performed internationally under government grant programs. This spending, net of grant payments from the Polish and Turkish governments, totaled $1.7 million for fiscal 2014 compared to $1.2 million in fiscal 2013, an increase of $0.5 million, or 48.0%. The increase was a result of less grant payments to offset expenses in fiscal 2014. 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. As a percentage of net sales, research and development expenses increased to 3.6% in fiscal 2014 compared to 1.9% in fiscal 2013.

Operating income

Operating income decreased by $7.4 million, or 75.3%, to $2.5 million for fiscal 2014 compared to $9.9 million in fiscal 2013. The decrease was primarily due to a combination of both lower net sales and lower gross profit margin percentages, offset in part, by a decrease in operating expenses.

On a segment basis, Aerospace had operating income of $4.0 million for fiscal 2014, a $5.1 million, or 55.7%, decrease in operating income compared to $9.1 million in fiscal 2013. CIS had operating income of $0.4 million for fiscal 2014, a $3.5 million, or 89.1%, decrease in operating income compared to $3.9 million in fiscal 2013. These segment operating results were offset, in part, by unallocated corporate expenses.

Interest expense, net

Interest expense, net for fiscal 2014 was $0.8 million compared to $1.0 million in fiscal 2013, a decrease of $0.2 million, or 19.6%, despite a higher level of bank borrowing due primarily to the results of the 2012 Financial Restructuring.

Other expense, net

Other expense, net for fiscal 2014 was $0.4 million compared to other expense, net of $0.1 million in fiscal 2013, an increase of $0.3 million. Other expense, net consists primarily of bank and letter of credit fees, as well as foreign currency exchange gains and losses.

Income taxes

As of February 28, 2014, the Company reviewed the components of its deferred tax assets 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 to its federal net operating loss carry forwards. The Company has a net deferred tax asset related primarily to its federal net operating loss carry forwards of $3.8 million. Income tax provisions of $0.7 million were recorded in fiscal 2014 compared to $3.9 million in fiscal 2013, as a result of decreased income before income taxes.

Effective tax rates were 52.7% and 43.7% for fiscal 2014 and fiscal 2013, respectively. Our effective fiscal 2014 tax rate was higher than fiscal 2013 primarily due to the combined effect of an increase in federal deferred tax expense as a percentage of income before income taxes and a decrease in the ratio of domestic income before income taxes to the reserve for foreign net operating loss carryforwards.

As of February 28, 2014, the Company had approximately $12.4 million of federal net loss carry forwards available to offset future income tax liabilities, which begin 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

On March 8, 2013, the Company made an accelerated payment on the Term Loan in the amount of $1.2 million with cash received from a partial reduction in its certificate of deposit securing a dedicated line of credit in the amount of $5.4 million with PNC Bank. The certificate of deposit was able to be reduced in conjunction with the reduction of a Repayment Guarantee Bond associated with one of our international contracts for multiple Aerospace products.

On April 9, 2013, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided an enhanced investment and borrowing sweep feature that allows ETC to increase returns on idle cash balances and minimize interest expense on the Company's Line of Credit with PNC Bank ("PNC Line of Credit"). With the sweep feature, excess cash in ETC's checking account is invested and automatically liquidated as needed to cover daily transactions.

On October 11, 2013, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the following:

(i) the PNC Line of Credit was increased from $15.0 million to $15.5 million.

(ii) availability under the PNC Line of Credit was increased by approximately $1.2 million as a currently outstanding letter of credit supporting a bid bond shall no longer reduce availability under the PNC Line of Credit so long as it remains outstanding.

(iii) the Term Loan, which is currently guaranteed by H.F. Lenfest ("Mr. Lenfest"), a major shareholder and member of the Board of Directors, through March 31, 2015, will be collateralized by Mr. Lenfest through that period, or until the Company's Operating Leverage Ratio using all Senior Funded Debt in place of Adjusted Senior Funded Debt is less than 3.00 to 1, whichever occurs first. Adjusted Senior Funded Debt is defined as the sum of Senior Funded Debt minus the then outstanding principal amount of the Term Loan, and will be used for calculating Operating Leverage Ratio while the collateral is in place.

(iv) until such time the Company's Fixed Charge Coverage Ratio is at least 1.10 to 1, the Company cannot declare new dividends, pay any dividends on, or make any distribution with respect to any class of its Preferred Stock, or purchase, redeem, retire, or otherwise acquire any such Preferred Stock.

(v) the Company received a waiver as of the fiscal quarter ended August 30, 2013 for exceeding the permitted maximum Operating Leverage Ratio of 3.00 to 1 under the September 28, 2012 Loan Agreement and December 19, 2012 Export Import Loan Agreement. Going forward, ETC must maintain an Operating Leverage Ratio (i.e., ratio of Adjusted Senior Funded Debt to EBITDA, which is defined as earnings before interest, taxes, depreciation, and amortization) of less than 3.50 to 1 from November 29, 2013 through February 28, 2014. This ratio was

reduced to 3.25 to 1 from March 1, 2014 through May 30, 2014, was further reduced to 3.00 to 1 on May 31, 2014, and will remain at that level at all times thereafter.

(vi) ETC must maintain as of the end of each fiscal quarter, on a rolling four quarters basis, a Fixed Charge Coverage Ratio (i.e. ratio of EBITDA, increased by an amount equal to the EBITDA Addback specified for such fiscal quarter end date, divided by the sum of the defined fixed charges) of at least 1.00 to 1 from November 29, 2013 through August 29, 2014. This ratio will increase to 1.10 to 1 on August 30, 2014, and will remain at that level at all times thereafter.

(vii) effective as of the date of this amendment, the interest rate on the Line of Credit Note, the Term Loan Note, and the Ex-Im Line of Credit will be based on the PNC Daily Libor Rate (currently 0.15%) plus a margin of 3.00%.

As of February 28, 2014, the Company's availability under the PNC Line of Credit was $2.4 million. This reflected cash borrowings of $11.7 million and net outstanding letters of credit of approximately $1.4 million. As of May 13, 2014, the Company's availability under the PNC Line of Credit increased to $7.5 million. Working capital was $26.5 million and $25.1 million as of February 28, 2014 and February 22, 2013, respectively. The increase in working capital was primarily the result of the Company reducing its current liabilities.

With unused availability under the PNC Line of Credit, anticipated availability under the Ex-Im Line of Credit, and the conversion of costs and estimated earnings in excess of billings on uncompleted long-term POC contracts into cash, the Company anticipates its sources of liquidity will be sufficient to fund its operating activities, anticipated capital expenditures, and debt repayment obligations throughout fiscal 2015. Under POC revenue recognition, costs and estimated earnings in excess of billings on uncompleted long-term POC contracts represent the timing differences of spending on production activities versus collecting on long-term POC contracts.

Cash flows from operating activities

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

During fiscal 2014, as a result of an increase in costs and estimated earnings in excess of billings on uncompleted long-term POC contracts and decreases in accounts payable, customer deposits, and other accrued liabilities, the Company used $0.6 million of cash in operating activities compared to $7.3 million of cash provided by operating activities in fiscal 2013.

Cash flows from investing activities

Cash used for investing activities primarily relates to funds used for capital expenditures in property, plant, and equipment and software development. The Company's fiscal 2014 investing activities used $1.4 million, which consisted primarily of equipment and software enhancements for our ATFS technology, and costs to upgrade CIS demonstration equipment and existing information technology systems. This is an increase of $0.1 million from cash used in investing activities in fiscal 2013.

Cash flows from financing activities

The Company's financing activities generated $0.1 million during fiscal 2014 as compared to using $6.4 million in fiscal 2013. The principal uses of cash were $4.4 million of payments on the Term Loan and $0.4 million in Preferred Stock dividends. These were offset by $3.7 million in borrowings under the Company's various lines of credit and a $1.2 million reduction in restricted cash.

Outlook

We expect to use our cash, cash equivalents, and credit facilities for working capital and general corporate purposes, products, technologies, property, plant, and equipment, the payment of contractual and other legal obligations, including scheduled interest payments on credit facilities and dividends on Preferred Stock, the potential 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, combined with availability under our lines of credit and the conversion of costs and estimated earnings in excess of billings on uncompleted long-term POC contracts into cash, should continue to provide us sufficient funds for fiscal 2015. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated results in fiscal 2016 and beyond because of factors such as the degree of market acceptance, the impact of competition, the effectiveness of our sales and marketing efforts, and the outcome of our efforts to develop new products.

Off-Balance Sheet Arrangements

There were no unconsolidated legal entities, “special purpose” entities, or other off-balance sheet arrangements during either fiscal 2014 or fiscal 2013 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 shareholders.

Board of Directors Actions

As disclosed in Note 15 – Subsequent Events, on May 28, 2014, the Board of Directors unanimously approved a resolution to amend and restate the Company’s bylaws to, among other things, amend certain governance provisions to reflect recent changes at the Company (e.g., bifurcation of the roles of Chief Executive Officer and President and no longer being an SEC reporting company), to update the bylaws under the Pennsylvania Business Corporation Law, and to make certain other conforming and technical changes. Some of these amendments relate to the composition of the Board of Directors and its committees, advance notice provisions for shareholder meetings, indemnification, and action by written consent. The Board of Directors also approved an amendment to Section 8(b) of the Statement With Respect to Shares of the Series E Preferred Stock of the Company, clarifying the composition of the Board of Directors. These amendments were also approved by the written consent of the holder of all of the Series E Preferred Stock and holders of Common Stock.

MANAGEMENT'S REPORT

Management is responsible for the preparation as well as the integrity and objectivity of the Environmental Tectonics Corporation financial statements. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and necessarily include amounts which represent the best estimates and judgments of management.

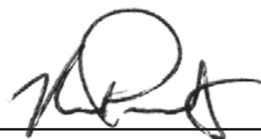
Environmental Tectonics Corporation maintains an accounting system of internal controls to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that financial records are reliable for preparing financial statements and maintaining accountability for assets. Reasonable assurance recognizes that the cost of a system of internal controls should not exceed its benefits and that the evaluation of these factors requires estimates and judgments by management. The internal control system includes the selection and training of management and supervisory personnel; an organizational structure providing for delegation of authority and establishment of responsibilities; communication of requirements for compliance with approved accounting control and business practices throughout the organization; and business planning and review.

McGladrey LLP, our independent auditor, is engaged to audit and report on these financial statements. Their audit is conducted in accordance with auditing standards generally accepted in the United States of America. Those standards require that they plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

The Audit Committee of the Board of Directors meets regularly with management, and the independent auditors to review matters relating to financial reporting, internal controls and auditing. Management and the independent auditors each have direct and confidential access to this committee.

William F. Mitchell
Chairman and Chief Executive Officer

Robert L. Laurent, Jr.
President



Mark Prudenti
Chief Financial Officer

Independent Auditor's Report

To the Board of Directors
Environmental Tectonics Corporation
Southampton, Pennsylvania

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Environmental Tectonics Corporation and Subsidiaries (the "Company") which comprise the consolidated balance sheets as of February 28, 2014 and February 22, 2013 and the related consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 28, 2014 and February 22, 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

McGladrey LLP

Blue Bell, Pennsylvania
June 3, 2014

Member of the RSM International network of independent accounting, tax and consulting firms.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share information)	February 28, 2014	February 22, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 935	$ 2,877
Restricted cash	4,954	6,162
Accounts receivable, net	5,974	6,666
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	21,637	19,949
Inventories, net	3,645	3,727
Deferred tax assets, current	2,090	2,193
Prepaid expenses and other current assets	526	1,297
Total current assets	39,761	42,871
Property, plant and equipment, at cost, net	14,342	14,609
Capitalized software development costs, net	274	378
Deferred tax assets, non-current, net	1,751	2,619
Other assets	64	91
Total assets	**$ 56,192**	**$ 60,568**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt obligations	$ 3,250	$ 3,600
Accounts payable, trade	2,769	4,431
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	2,922	2,662
Customer deposits	1,789	2,818
Accrued taxes	124	280
Accrued interest and dividends	552	483
Other accrued liabilities, current	1,819	3,462
Total current liabilities	13,225	17,736
Long-term obligations, less current portion:		
Credit facility payable to bank	11,664	7,585
Term loan	6,569	11,000
Total long-term debt obligations, less current portion	18,233	18,585
Other accrued liabilities, non-current	408	28
Total liabilities	31,866	36,349
Commitments and contingencies		
Shareholders' equity:		
Cumulative convertible participating Preferred Stock, Series E, $0.05 par value, 25,000 shares authorized; 12,127 shares outstanding as of February 28, 2014 and February 22, 2013, respectively	12,127	12,127
Common Stock, $0.05 par value, 50,000,000 shares authorized; 9,185,161 and 9,180,161 shares issued and outstanding as of February 28, 2014 and February 22, 2013, respectively	459	459
Additional paid-in capital	9,954	9,924
Retained earnings	2,357	2,251
Accumulated other comprehensive loss	(629)	(597)
Total shareholders' equity before non-controlling interest	24,268	24,164
Non-controlling interest	58	55
Total shareholders' equity	24,326	24,219
Total liabilities and shareholders' equity	**$ 56,192**	**$ 60,568**

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

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(in thousands, except per share information)	Fiscal year ended February 28, 2014	Fiscal year ended February 22, 2013
Net sales	$ 48,274	$ 62,773
Cost of goods sold	33,715	37,904
Gross profit	14,559	24,869
Operating expenses:		
Selling and marketing	4,591	5,570
General and administrative	5,777	8,186
Research and development	1,730	1,169
Operating expenses total	12,098	14,925
Operating income	2,461	9,944
Other expenses:		
Interest expense, net	808	1,005
Other expense, net	381	118
Other expenses total	1,189	1,123
Income before income taxes	1,272	8,821
Provision for income taxes	670	3,859
Net income	602	4,962
Income attributable to non-controlling interest	(3)	(14)
Net income attributable to Environmental Tectonics Corporation	**599**	**4,948**
Foreign currency translation adjustment and unrealized loss on cash flow hedge	(32)	(92)
Comprehensive income	$ 567	$ 4,856
Preferred Stock dividends	(493)	(1,511)
Income attributable to common and participating shareholders	$ 106	$ 3,437
Per share information:		
Basic earnings per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.17
Undistributed earnings per share:		
Common	$ 0.01	$ 0.19
Preferred	$ 0.01	$ 0.19
Diluted earnings per share	**$ 0.01**	**$ 0.19**
Basic weighted average common and participating shares:		
Common weighted average number of shares	9,183	9,149
Participating preferred shares	6,063	9,063
Total basic weighted average common and participating shares	15,246	18,212
Diluted weighted average shares:		
Basic weighted average common and participating shares	15,246	18,212
Dilutive effect of stock warrants and options	231	163
Total diluted weighted average shares	15,477	18,375

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

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands, except share information)	Preferred Stock	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	(Accumulated Deficit) / Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, February 24, 2012	$ 22,127	9,134,403	$ 456	$ 9,892	$ (1,186)	$ (505)	$ 30,825
Less: Prior year non-controlling interest	-	-	-	-	-	-	(41)
Net income attributable to Environmental Tectonics Corporation	-	-	-	-	4,948	-	4,948
Foreign currency translation adjustment	-	-	-	-	-	(64)	(64)
Unrealized loss on cash flow hedge	-	-	-	-	-	(28)	(28)
Preferred Stock dividends	-	-	-	-	(1,511)	-	(1,511)
Stock compensation expense	-	-	-	69	-	-	69
Issuance of stock under employee stock purchase plan and as Board of Director's compensation	-	45,758	3	66	-	-	69
Repurchase of Series D Preferred Stock	(386)	-	-	-	-	-	(386)
Repurchase of Series E Preferred Stock	(9,614)	-	-	-	-	-	(9,614)
Preferred Stock repurchase costs	-	-	-	(103)	-	-	(103)
Balance before non-controlling interest, February 22, 2013	12,127	9,180,161	459	9,924	2,251	(597)	24,164
Non-controlling interest	-	-	-	-	-	-	55
Balance, February 22, 2013	**12,127**	**9,180,161**	**459**	**9,924**	**2,251**	**(597)**	**24,219**
Less: Prior year non-controlling interest	-	-	-	-	-	-	(55)
Net income attributable to Environmental Tectonics Corporation	-	-	-	-	599	-	599
Foreign currency translation adjustment	-	-	-	-	-	(47)	(47)
Unrealized gain on cash flow hedge	-	-	-	-	-	15	15
Preferred Stock dividends	-	-	-	-	(493)	-	(493)
Stock compensation expense	-	-	-	20	-	-	20
Issuance of stock as Board of Director's compensation	-	5,000	-	10	-	-	10
Balance before non-controlling interest, February 28, 2014	12,127	9,185,161	459	9,954	2,357	(629)	24,268
Non-controlling interest	-	-	-	-	-	-	58
Balance, February 28, 2014	**$ 12,127**	**9,185,161**	**$ 459**	**$ 9,954**	**$ 2,357**	**$ (629)**	**$ 24,326**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Fiscal year ended February 28, 2014	Fiscal year ended February 22, 2013
Cash flows from operating activities:		
Net income	$ 602	$ 4,962
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,803	1,843
Deferred tax assets	909	3,458
Increase in valuation allowance for deferred tax assets	62	90
Decrease in allowance for inventory obsolescence	(925)	(18)
Accretion of loan origination deferred charge and deferred financing costs	35	145
Stock compensation expense	20	69
Issuance of Common Stock	10	69
Changes in operating assets and liabilities:		
Accounts receivable	692	4,029
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	(1,688)	(1,183)
Inventories	1,007	436
Prepaid expenses and other assets	773	(533)
Accounts payable, trade	(1,662)	(1,208)
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	260	(3,857)
Customer deposits	(1,029)	(607)
Accrued taxes	(156)	132
Accrued interest and dividends	(17)	(458)
Other accrued liabilities	(1,248)	(103)
Net cash (used in) provided by operating activities	**(552)**	**7,266**
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(1,315)	(1,278)
Capitalized software development costs	(117)	(26)
Net cash used in investing activities	**(1,432)**	**(1,304)**
Cash flows from financing activities:		
Proceeds from the Term Loan	-	15,000
Borrowing (repayments) under line of credit	3,729	(8,531)
Payments of Preferred Stock dividends	(407)	(1,511)
Decrease (increase) in restricted cash	1,208	(162)
Payments on the Term Loan and of other debt obligations	(4,431)	(1,008)
Payments of deferred financing and Preferred Stock repurchase costs	(10)	(234)
Repurchase of Series D Preferred Stock	-	(386)
Repurchase of Series E Preferred Stock	-	(9,614)
Net cash provided by (used in) financing activities	**89**	**(6,446)**
Effect of exchange rate changes on cash	(47)	(64)
Net decrease in cash and cash equivalents	(1,942)	(548)
Cash and cash equivalents at beginning of period	2,877	3,425
Cash and cash equivalents at end of period	**$ 935**	**$ 2,877**
Supplemental schedule of cash flow information:		
Interest paid	$ 823	$ 1,102
Income taxes paid	$ 201	$ 225
Supplemental information on non-cash operating and investing activities:		
Accrued Preferred Stock dividends	$ 493	$ 407
Unrealized (gain) loss on cash flow hedge	$ (15)	$ 28

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

Description of Business

ETC was incorporated in 1969 in Pennsylvania. For over four decades, we have provided our customers with products, service, and support. Innovation, continuous technological improvement and enhancement, and product quality are core values that are critical to our success. We are a significant supplier and innovator in the following product areas: (i) software driven products and services used to create and monitor the physiological effects of flight, including high performance jet tactical flight simulation, upset recovery and spatial disorientation, and both suborbital and orbital commercial human spaceflight; collectively, Aircrew Training Systems ("ATS"); (ii) altitude (hypobaric) chambers; (iii) Advanced Disaster Management Simulators ("ADMS"); (iv) steam and gas (ethylene oxide) sterilizers; (v) environmental testing and simulation devices; and (vi) hyperbaric (100% oxygen) chambers for one person (monoplace chambers).

We operate in two primary business segments, Aerospace Solutions ("Aerospace") and Commercial/ Industrial Systems ("CIS"). Aerospace encompasses the design, manufacture, and sale of: (i) Aircrew Training Systems; (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); and (iv) ADMS, as well as integrated logistics support for customers who purchase these products or similar products manufactured by other parties. These products and services provide customers with an offering of comprehensive solutions for improved readiness and reduced operational costs. Sales of our Aerospace products are made principally to U.S. and foreign government agencies. CIS encompasses the design, manufacture, and sale of: (i) steam and gas (ethylene oxide) sterilizers; (ii) environmental testing and simulation devices; and (iii) hyperbaric (100% oxygen) chambers for one person (monoplace chambers), as well as parts and service support for customers who purchase these products or similar products manufactured by other parties. Sales of our CIS products are made principally to the healthcare, pharmaceutical, and automotive industries. Net sales, operating income, identifiable assets, and other financial information regarding our segments may be found in Note 9 – Business Segment Information.

The Company's fiscal year is the fifty-two week or fifty-three week annual accounting period ending the last Friday in February. References to fiscal 2013 are references to the fifty-two week period ended February 22, 2013. References to fiscal 2014 are references to the fifty-three week period ended February 28, 2014. References to fiscal 2015 are references to the fifty-two week period ending February 27, 2015. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2014.

Sales Backlog

Below is a breakdown of the Company's February 28, 2014 sales backlog (amounts in thousands, except percentages):

	Business segment			
Geographic area	**Aerospace**	**CIS**	**Total**	**%**
Domestic	$ 943	$ 8,711	$ 9,654	31.5%
U.S. Government	7,717	20	7,737	25.2
International	12,704	559	13,263	43.3
Total	**$ 21,364**	**$ 9,290**	**$ 30,654**	**100.0%**
% of Total	69.7%	30.3%	100.0%	

Our sales backlog as of February 28, 2014, for work to be performed and revenue to be recognized under written agreements after such dates, was $30,654. Of the February 28, 2014 sales backlog, three product lines (ATS, Chambers, and Sterilizers) represented at least 10% of the total backlog (ATS was $13,592, or 44.3%, of the total sales backlog; Chambers was $4,823, or 15.7%, of the total sales backlog; Sterilizers was $6,402, or 20.9%, of the total sales backlog). Of the February 28, 2014 sales backlog, $7,271, or 23.7%, represents two contracts (one with a U.S. defense agency and one with a domestic customer). Approximately 91.0% of the U.S. Government sales backlog relates to three contracts.

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of ETC, ETC-PZL Aerospace Industries Sp. z o.o ("ETC-PZL"), our 95%-owned subsidiary in Warsaw, Poland, and our 99%-owned subsidiary Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"). "ETC-SH" refers to the Company's corporate headquarters and main production plant located in Southampton, Pennsylvania, USA. All significant intercompany 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 of America, 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 income taxes.

Fair Value of Financial Instruments

The carrying amounts of cash, accounts receivable, accounts payable, and bank debt approximate fair value because of the short maturity associated with each of these instruments. Other assets and liabilities that are measured at fair value on a recurring basis include the unrealized gains or losses on interest rate swap contracts. For these assets and liabilities, we use significant other observable market data or assumptions (Level 2 inputs as defined in the accounting guidance) that we believe market participants would use in pricing similar assets or liabilities, including assumptions about counterparty risk. Our fair value estimates reflect an income approach based on the terms of the interest rate contracts and inputs corroborated by observable market data including interest rate curves.

Revenue Recognition

Revenue, which is recorded net of any applicable sales tax, is recognized using three methods:

On long-term contracts, with a contract value over $250 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 cumulative amount of revenue to be recognized, from which previously recognized revenue would be subtracted to determine revenue to be 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 (i.e. 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 that 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. Some of our long-term contracts contain provisions that require us to pay liquidated damages if we are responsible for the failure to meet specified contractual milestone dates and the applicable customer asserts a claim under these provisions. Management uses its best judgment to estimate not only the cost to perform the work, but also the price that will eventually be paid by our customers on such contracts.

For contracts under $250, 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.

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. During each fiscal year, the Company periodically has cash and cash equivalents in excess of insured amounts.

Restricted Cash

Restricted cash was $4,954 as of February 28, 2014 compared to $6,162 as of February 22, 2013. Restricted cash is comprised primarily of collateral for a dedicated line of credit in the amount of $4,241 with PNC Bank (the “Dedicated Line of Credit”), which the Company uses to satisfy performance bond and repayment guarantee requirements for an international contract. Use of this Dedicated Line of Credit is restricted to funding contract performance and repayment guarantee requirements under this specific contract. As security for this Dedicated Line of Credit, the Company has deposited $4,241 in a certificate of deposit with PNC Bank. ETC is obligated to pay a fee, due quarterly, of three percent (3%) per year for the Dedicated Line of Credit. The decrease in restricted cash was due to a partial reduction in the certificate of deposit securing the Dedicated Line of Credit. The certificate of deposit was able to be reduced in conjunction with the reduction of a Repayment Guarantee Bond associated with one of our international contracts for multiple Aerospace products.

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. Terms are cash upon delivery, except where satisfactory open account credit is established, in which case terms are generally payment net thirty (30) days from the date of the invoice. Accounts receivable are deemed past due if payment is not received by the payment due date. Overdue payments are subject to interest penalty of the delinquent amount at the rate of one and one-half percent (1.5%) per month. The Company continuously monitors collections and payments from its customers, and maintains a provision for estimated credit losses based on historical experience and any specific customer collection issues that are 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 $751 or 12.6%, of total net accounts receivable as of February 28, 2014. Subsequent to fiscal year end and prior to June 3, 2014, the date of issuance of our consolidated financial statements, all of these receivables have been collected. See Note 2 – Accounts Receivable for additional disclosures related to our accounts receivable.

Inventories

Inventories are valued at the lower of cost or market. Cost is determined principally by the first-in, first-out method ("FIFO method"). The costs of finished goods and work-in-process inventories include material, direct engineering, manufacturing labor, and overhead components. Overhead costs allocated to inventory 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.

In accordance with accounting principles generally accepted in the United States of America, the Company may capitalize certain costs of simulation equipment into property, plant, and 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

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost, and are depreciated over their estimated useful lives using 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 both research and demonstration purposes to support its sales effort and is not listed for sale, although sales of such demonstration equipment are not precluded. The gross value of demonstration equipment was $14,117 and $13,419 as of February 28, 2014 and February 22, 2013, respectively. The net book value of demonstration equipment was $9,259 and $9,398 as of February 28, 2014 and February 22, 2013, respectively. Upon sale of such 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. In fiscal 2013, $347 of machinery and equipment primarily associated with ETC-PZL, all of which was fully depreciated, was retired. No such retirements occurred in fiscal 2014.

Capitalized Software Development Costs

The Company capitalizes the qualifying costs of developing software contained in certain products. Capitalization of such costs commences when technological feasibility has been established in accordance with the Financial Accounting Standards Board's ("FASB") guidance on accounting for the costs of computer software to be sold, leased, or otherwise marketed. Technological feasibility is defined as the point in time when the Company has completed all planning, designing, coding, and testing activities that are necessary to establish that a software product can be produced to meet its design specifications, including functions, features, and technical performance requirements. When the software is ready for commercial release, capitalization of development costs cease and amortization commences on a straight-line basis over a period ranging from three (3) to five (5) years, depending upon the life of the product. The establishment of technological feasibility and the ongoing assessment of the recoverability of these costs require considerable judgment by management with respect to certain external factors including, but not limited to, anticipated future gross product revenue, estimated economic product lives, and changes in software and hardware technology. Software amortization totaled $221 and $314 in fiscal 2014 and fiscal 2013, respectively. Estimated software amortization, which is based on existing capitalized software, for each of the next five (5) fiscal years is as follows: $154 in fiscal 2015; $88 in fiscal 2016; $30 in fiscal 2017; $2 in fiscal 2018, and $0 in fiscal 2019 and beyond.

Research and Development Costs

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. During fiscal 2014 and fiscal 2013, the Company was involved with two (2) and five (5) such grants, respectively. Payments received under these grants are recorded as a reduction of research and development costs. Such payments totaled $555 in fiscal 2014 and $1,167 in fiscal 2013. Research and development expenses, which totaled $2,285 in fiscal 2014 and $2,336 in fiscal 2013, include spending for potential new products and technologies and work performed under government grant programs, both in the United States and internationally. This spending, net of grant payments from the United States, and the governments of Poland and Turkey, as detailed above, was $1,730 for fiscal 2014 compared to $1,169 for fiscal 2013.

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.

Long-Lived Assets

The Company reviews its property, plant, 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. There were no impairment losses recorded in either fiscal 2014 or fiscal 2013.

Share-Based Compensation

Share-based compensation expense is measured at the stock option grant date, based on the fair value of the award, and is recorded primarily to general and administrative expense. The Company uses the Black-Scholes option-pricing model and the straight-line attribution approach to determine the fair value of share-based awards in accordance with Accounting Standards Codification ("ASC") 718, Compensation. This option-pricing model requires the input of highly subjective assumptions, including the option's expected term, the price volatility of the underlying stock, risk-free rates of return, dividend yield, and expected forfeitures. The expected term of an award is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility is based on the Company's historical stock prices. 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-pricing model as it does not anticipate paying cash dividends in the near future. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense for only those awards that are 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. There were 151,500 options granted in fiscal 2014; there were no options granted in fiscal 2013.

Advertising Costs

The Company expenses advertising costs, which include trade shows, as incurred. Advertising costs were $420 and $444 in fiscal 2014 and fiscal 2013, respectively.

Warranty Costs

The Company provides warranties against defects in materials and workmanship in our products. Warranty periods for our products generally range from ninety (90) days to two (2) years. The Company maintains 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.

Earnings per Share

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

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

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

At both February 28, 2014 and February 22, 2013, there was $12,127 of cumulative convertible participating Series E Preferred Stock convertible at an exercise price of $2.00 per share, equating to 6,063,321 shares of Common Stock, issued in July 2009.

On February 20, 2009, in connection with the issuance of a $2,000 promissory note, the Company issued 200,000 warrants to purchase 143,885 shares of the Company's Common Stock at $1.39 per share. Additionally, on July 2, 2009, in consideration of an increase of the guarantee on the 2007 PNC Credit Facility (as defined in Note 6 – Long-Term Obligations and Credit Arrangements), the Company issued 500,000 warrants to purchase 450,450 shares of the Company's Common Stock at $1.11 per share. On January 4, 2011, the Company entered into amendments to these warrants to remove a provision in each of the warrants which provided anti-dilution protection in the event the Company issued securities at a price below the exercise price set forth in the warrants.

As of February 28, 2014 and February 22, 2013, there were outstanding options to purchase the Company's Common Stock totaling 354,406 and 219,917 shares at an average price of $3.34 and $4.23 per share, respectively. Due to the conversion price of certain Common Stock options, 354,406 and 219,917 shares were excluded from the calculation of diluted earnings per share as of February 28, 2014 and February 22, 2013, respectively, because the effect of their conversion would be antidulutive.

Recent Accounting Pronouncements

In February 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Income, which requires reclassification adjustments from other comprehensive income to be presented either in the financial statements or in the notes to the financial statements. ASU 2013-02 will be effective for our fiscal 2015, which began on March 1, 2014. We do not expect it to have a significant impact on our consolidated financial statements.

In March 2013, the FASB issued ASU No. 2013-05, Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity (a consensus of the FASB Emerging Issues Task Force), which requires an entity to release into net income the entire amount of a cumulative translation adjustment related to its investment in a foreign entity when as a parent it either sells a part or all of its investment in the foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets within the foreign entity. ASU 2013-05 will be effective for our fiscal 2015, which began on March 1, 2014. We do not expect it to have a significant impact on our consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force), which requires a liability related to an unrecognized tax benefit to be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward if certain criteria are met. ASU 2013-11 will be effective for our fiscal 2015, which began on March 1, 2014, and should be applied prospectively to unrecognized tax benefits that exist at the effective date. We do not expect it to have a significant impact on our consolidated financial statements.

2. Accounts Receivable

The components of accounts receivable are as follows:

	February 28, 2014	February 22, 2013
U.S. Government	$ 2,708	$ 3,075
U.S. Commercial	1,396	1,904
International	2,270	2,088
	6,374	7,066
Less: allowance for doubtful accounts	(400)	(400)
Accounts receivable, net	**$ 5,974**	**$ 6,666**

3. Costs and Estimated Earnings on Uncompleted Contracts

The following is a summary of long-term contracts in progress:

	February 28, 2014	February 22,2013
Cost incurred on uncompleted long-term contracts	$ 124,626	$ 103,790
Estimated earnings	70,138	62,258
	194,764	166,048
Less: billings to date	(176,049)	(148,761)
	$ 18,715	**$ 17,287**

Included in accompanying balance sheets under the following captions:

	February 28, 2014	February 22, 2013
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	$ 21,637	$ 19,949
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	2,922	2,662
	$ 18,715	**$ 17,287**

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 in both fiscal 2014 and fiscal 2013.

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

4. Inventories

Inventories are valued at the lower of cost or market using the FIFO method and consist of the following:

	February 28, 2014	February 22, 2013
Raw materials	$ 132	$ 152
Work in progress	3,513	3,575
Inventories, net	**$ 3,645**	**$ 3,727**

Inventory is presented net of an allowance for obsolescence of $214 (raw material $47 and work in process $167), and $1,139 (raw material $41 and work in process $1,098) as of February 28, 2014 and February 22, 2013, respectively.

In accordance with accounting principles generally accepted in the United States of America, the Company may capitalize certain costs of simulation equipment into property, plant, and 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.

5. Property, Plant, and Equipment

The following is a summary of property, plant and equipment, at cost, and estimated useful lives

	February 28, 2014	February 22, 2013
Land	$ 100	$ 100
Buildings and building additions	3,851	3,851
Machinery and equipment	11,698	11,410
Demonstration equipment	14,117	13,419
Office furniture and equipment	1,319	1,316
Building improvements	3,096	3,057
Construction in process	408	121
	34,590	33,275
Less: accumulated depreciation	(20,248)	(18,666)
Property, plant, and equipment, net	**$ 14,342**	**$ 14,609**

Depreciation expense for fiscal 2014 and fiscal 2013 was $1,582 and $1,529, respectively.

As of both February 28, 2014 and February 22, 2013, substantially all of the Company's long-lived assets were located in the United States of America.

6. Long-Term Obligations and Related Equity Arrangements

2009 Lenfest Financing Transaction

On April 24, 2009, the Company entered into a transaction (the "2009 Lenfest Financing Transaction") with H.F. Lenfest ("Mr. Lenfest"), a major shareholder and member of the Company's Board of Directors (the "Board of Directors"), that provided for, among other things, the following:

(i) a $7,500 credit facility provided by Mr. Lenfest to ETC (the "Lenfest Credit Facility"), which has expired;

(ii) the exchange of the senior subordinated convertible promissory note in the original principal amount of $10,000 issued by ETC to Mr. Lenfest on February 18, 2003, together with all accrued interest and warrants issuable under the note, and all Series B Preferred Stock and Series C Preferred Stock held by Mr. Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock, the terms of which are described below; and

(iii) the guarantee by Mr. Lenfest of all of ETC's obligations to PNC Bank in connection with an increase of the existing $15,000 revolving line of credit with PNC Bank (the "2007 PNC Credit Facility") to $20,000, and in connection with this guarantee, the pledge by Mr. Lenfest to PNC Bank of $10,000 in marketable securities to secure ETC's obligations to PNC Bank (the "Lenfest Pledge").

2012 Financial Restructuring

On September 28, 2012, the Company entered into transactions, collectively the 2012 Financial Restructuring, that provided for, among other things, the following:

(i) the Company's Line of Credit with PNC Bank ("PNC Line of Credit") was reduced from $20,000 to $15,000; however, the term of the Line of Credit was extended twenty-eight (28) months, from June 30, 2013 to October 31, 2015.

(ii) PNC Bank provided to the Company a new five (5) year $15,000 Term Loan. The Company used $10,000 of the proceeds from the Term Loan to repurchase and retire 10,000 shares of its Series D and Series E Preferred Stock owned by Mr. Lenfest at the stated price of $1,000 per share. The remaining $5,000 was used to partially decrease the amount outstanding on the PNC Line of Credit and to pay Mr. Lenfest $417 of interest due under the Lenfest Pledge, in cash, in lieu of Series D Preferred Stock. The $10,000 in marketable securities associated with the Lenfest Pledge was returned to Mr. Lenfest and the Lenfest Pledge was terminated; therefore, as of both February 28, 2014 and February 22, 2013, no interest has been accrued for under the Lenfest Pledge.

(iii) the PNC Line of Credit is no longer guaranteed by Mr. Lenfest. Instead, the Line of Credit and Term Loan are secured by substantially all of the Company's assets. In addition, the Term Loan is guaranteed by Mr. Lenfest for a period of thirty (30) months, (i.e., until March 31, 2015), after which the guarantee will be removed.

(iv) following the close of the transactions on September 28, 2012, and as approved by the Company's Common Stock shareholders at the 2013 Annual Meeting of Shareholders, the dividend rate on the Series D and Series E Preferred Stock was reduced from ten percent (10%) to four percent (4%).

The material agreements providing for these transactions are described below:

September 28, 2012 Loan Agreement

Effective September 28, 2012, ETC and PNC Bank entered into a Loan Agreement, which included ETC executing a Line of Credit Note and a Term Loan Note (as defined below). As set forth in the Loan Agreement, borrowings under the PNC Line of Credit will be available for working capital and other general business purposes and for issuances of letters of credit. Amounts borrowed under the PNC Line of Credit may be borrowed, repaid, and re-borrowed from time to time until October 31, 2015. The Company's obligation to repay the advances under the PNC Line of Credit is set forth in the Amended and Restated Committed Line of Credit Note (the "Line of Credit Note"). The Company is also obligated to pay a fee of 0.25% for unused but available funds under the Line of Credit. As of February 28, 2014, the Company's availability under the PNC Line of Credit was $2,448. This reflected cash borrowing under the PNC Line of Credit of $11,664 and outstanding letters of credit of approximately $1,388. As of May 13, 2014, the Company's availability under the PNC Line of Credit increased to $7,474. The Term Loan is guaranteed by Mr. Lenfest for a period of thirty (30) months, (i.e., until March 31, 2015), after which the guarantee will be removed. The Company's obligation to repay the principal on the Term Loan, including interest, on a monthly basis is set forth in a Term Loan Note (the "Term Loan Note").

As security for repayment of the Line of Credit Note and the Term Loan Note, as noted above, the Company also concurrently entered into the Third Amended and Restated Reimbursement Agreement for Letters of Credit between ETC and PNC Bank dated September 28, 2012, a Security Agreement between ETC and PNC Bank dated September 28, 2012, a Pledge Agreement executed by ETC on September 28, 2012 in favor of PNC Bank ("Pledge Agreement"), an Amended and Restated Guaranty and Suretyship Agreement executed by Mr. Lenfest on September 28, 2012 in favor of PNC Bank, and an Open-End Mortgage and Security Agreement between ETC and PNC Bank dated September 28, 2012. Pursuant to the Pledge Agreement, the Company pledged to PNC as collateral the Company's ownership interest in certain subsidiaries of the Company.

The Loan Agreement contains both affirmative and negative covenants that are customary for transactions of this type, including such financial covenants as a minimum net worth, a maximum operating leverage ratio, and a minimum fixed charge coverage ratio, as well as limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business, and transactions with affiliates. The Loan Agreement also provides for customary events of default, including the failure to pay any principal or interest when due, failure to comply with covenants, material misrepresentations, certain bankruptcy, insolvency or receivership events, imposition of certain judgments, and the liquidation of ETC. Upon an event of default under the Loan Agreement, including the non-payment of principal or interest, the obligations of the Company under the Loan Agreement may be accelerated and the assets securing the obligations secured. As disclosed in Note 15 – Subsequent Events, on June 2, 2014, the Company received a waiver as of the fiscal quarter ended February 28, 2014 for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. See "Fiscal 2014 Amendments to the September 28, 2012 Loan Agreement" below for current financial covenant requirements.

Interest Rate Swap Agreement

On September 28, 2012, the Company entered into an interest rate swap agreement to protect against certain interest rate fluctuations of the LIBOR interest rate initially on $5,000 of the $15,000 variable rate Term Loan. The effective date of the interest rate swap was September 28, 2012, and it is scheduled to expire on September 28, 2017. The notional amount of $5,000 will decrease ratably over the duration of the interest rate swap agreement. The interest rate swap effectively fixes our LIBOR interest rate on the notional amount at a rate of 0.74% in excess of the margin. We have recorded an unrealized gain of $15 and an unrealized loss of $28 in fiscal 2014 and fiscal 2013, respectively, related to the fair value of our interest rate swap, with the corresponding entry to other accrued liabilities, non-current. We have designated our current interest rate swap as a cash flow hedge instrument. As of February 28, 2014, we have determined the hedge to be effective. See Note 14 – Fair Value Measurements and Interest Rate Swap for additional disclosures related to the interest rate swap.

Preferred Stock Repurchase Agreement

Effective September 28, 2012, ETC and Mr. Lenfest entered into a Preferred Stock Repurchase and Financial Restructuring Agreement. Immediately following the closing of the Loan Agreement with PNC Bank, the Company purchased from Mr. Lenfest, at the stated price of $1,000 per share, (i) 386 shares of Series D Preferred Stock, representing all of the Company's issued and outstanding shares of Series D Preferred Stock, and (ii) 9,614 shares of Series E Preferred Stock, representing a significant portion of the Company's issued and outstanding Series E Preferred Stock. Mr. Lenfest is the only holder of the outstanding Series E Preferred Stock, and 12,127 shares of Series E Preferred Stock remain outstanding as of both February 28, 2014 and February 22, 2013. Following the execution of the Preferred Stock Repurchase and Financial Restructuring Agreement, and as approved by the Company's Common Stock shareholders at the 2013 Annual Meeting of Shareholders, the dividend rate on the Series D and Series E Preferred Stock was reduced from ten percent (10%) to four percent (4%).

Termination of Certain Lenfest Agreements

On September 28, 2012, upon the execution of the Preferred Stock Repurchase and Financial Restructuring Agreement described above, the following prior agreements between ETC and Mr. Lenfest were terminated: (i) Secured Credit Facility and Warrant Purchase Agreement between the Company and Mr. Lenfest, dated as of April 24, 2009; (ii) the Security Agreement, dated February 18, 2009, by the Company in favor of Mr. Lenfest; (iii) the Security Agreement, dated April 24, 2009, among the Company, Entertainment Technology Corporation, a defunct Pennsylvania corporation and once wholly-owned subsidiary of the Company ("ETC Entertainment"), and Mr. Lenfest; (iv) the Guaranty,

dated April 24, 2009, by ETC Entertainment in favor of Mr. Lenfest; and (v) the Amended and Restated Open-End Mortgage and Security Agreement, dated April 24, 2009, by the Company in favor of Mr. Lenfest. These Agreements were entered into as part of, or directly related to, the 2009 Lenfest Financing Transaction. As part of the 2012 Financial Restructuring, the $10,000 in marketable securities associated with the Lenfest Pledge has been returned to Mr. Lenfest and the Lenfest Pledge has been terminated.

The warrants ETC issued to Mr. Lenfest as part of the 2009 Lenfest Financing Transaction were, however, not terminated. See "Common Stock Warrants" below.

Fiscal 2014 Amendments to the September 28, 2012 Loan Agreement

On April 9, 2013, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided an enhanced investment and borrowing sweep feature that allows ETC to increase returns on idle cash balances and minimize interest expense on the PNC Line of Credit. With the sweep feature, excess cash in ETC's checking account is invested and automatically liquidated as needed to cover daily transactions.

On October 11, 2013, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the following:

(i) the PNC Line of Credit was increased from $15,000 to $15,500.

(ii) availability under the PNC Line of Credit was increased by approximately $1,203 as a currently outstanding letter of credit supporting a bid bond shall no longer reduce availability under the PNC Line of Credit so long as it remains outstanding.

(iii) the Term Loan, which is currently guaranteed by Mr. Lenfest through March 31, 2015, will be collateralized by Mr. Lenfest through that period, or until the Company's Operating Leverage Ratio using all Senior Funded Debt in place of Adjusted Senior Funded Debt is less than 3.00 to 1, whichever occurs first. Adjusted Senior Funded Debt is defined as the sum of Senior Funded Debt minus the then outstanding principal amount of the Term Loan, and will be used for calculating Operating Leverage Ratio while the collateral is in place.

(iv) until such time the Company's Fixed Charge Coverage Ratio is at least 1.10 to 1, the Company cannot declare new dividends, pay any dividends on, or make any distribution with respect to any class of its Preferred Stock, or purchase, redeem, retire, or otherwise acquire any such Preferred Stock.

(v) the Company received a waiver as of the fiscal quarter ended August 30, 2013 for exceeding the permitted maximum Operating Leverage Ratio of 3.00 to 1 under the September 28, 2012 Loan Agreement and December 19, 2012 Export Import Loan Agreement. Going forward, ETC must maintain an Operating Leverage Ratio (i.e., ratio of Adjusted Senior Funded Debt to EBITDA, which is defined as earnings before interest, taxes, depreciation, and amortization) of less than 3.50 to 1 from November 29, 2013 through February 28, 2014. This ratio was reduced to 3.25 to 1 from March 1, 2014 through May 30, 2014, was further reduced to 3.00 to 1 on May 31, 2014, and will remain at that level at all times thereafter.

(vi) ETC must maintain as of the end of each fiscal quarter, on a rolling four quarters basis, a Fixed Charge Coverage Ratio (i.e. ratio of EBITDA, increased by an amount equal to the EBITDA Addback specified for such fiscal quarter end date, divided by the sum of the defined fixed charges) of at least 1.00 to 1 from November 29, 2013 through August 29, 2014. This ratio will increase to 1.10 to 1 on August 30, 2014, and will remain at that level at all times thereafter.

(vii) effective as of the date of this amendment, the interest rate on the Line of Credit Note, the Term Loan Note, and the Ex-Im Line of Credit will be based on the PNC Daily Libor Rate (currently 0.15%) plus a margin of 3.00%.

Preferred Stock

Presently, the Company has two classes of Cumulative Convertible Participating Preferred Stock authorized: Series D (11,000 shares authorized) and Series E (25,000 shares authorized) (together, the "Preferred Stock"). The Preferred Stock was authorized by the Board of Directors in April 2009 as part of the 2009 Lenfest Financing Transaction. 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 currently entitled to receive cumulative dividends at the rate of four percent (4%) 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, provided that the Company's Fixed Charge Coverage Ratio is at least 1.10 to 1 as stipulated in the October 11, 2013 amendment to the September 28, 2012 Loan Agreement. 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 Preferred Stock and Series E Preferred Stock, 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 accounting principles generally accepted in the United States of America applicable to the Preferred Stock; specifically, the Company has reviewed both ASC 480 – Distinguishing Liabilities from Equity and ASC 815 – Derivatives and Hedging. Upon its review, the Company determined that the Preferred Stock is within the control of the Company and that the attributes of the Preferred Stock

are more akin to equity than debt. The specific attributes considered by the Company include the designation of the instruments, the conversion of the instruments to the Company's Common Stock, the participation feature, the non-mandatory conversion, the voting rights, and the ability to appoint directors. Secondly, the Company determined that the Preferred Stock qualifies as permanent equity because the Preferred Stock is not mandatorily redeemable, and there is no obligation to either repurchase the instruments or issue a variable amount of common shares. Lastly, the Company determined that the conversion feature qualifies for the scope exception of ASC 815 – Derivatives and Hedging as it is clearly and closely related to the Preferred Stock instrument.

Due to the Company's accumulated deficit as of February 24, 2012, all dividends accruing through this date for the Series D and Series E Preferred Stock issuances were recorded in the accompanying financial statements as a reduction in additional paid-in capital. During fiscal 2013, the Company entered into a position of retained earnings; thus, all $493 and $1,511 of dividends recorded during fiscal 2014 and fiscal 2013, respectively, have been recorded as a reduction to retained earnings.

Issuances of the Preferred Stock are as follows:

Series D Preferred Stock

On September 28, 2012, as part of the 2012 Financial Restructuring and immediately following the closing of the Loan Agreement with PNC Bank, the Company purchased from Mr. Lenfest, at the stated price of $1,000 per share, 386 shares of Series D Preferred Stock , representing all of the Company's issued and outstanding shares of Series D Preferred Stock. Since there were no outstanding shares of Series D Preferred Stock for the period September 28, 2012 through February 28, 2014, there were no dividends accrued during this period. All Series D Preferred Stock dividends accrued as of September 28, 2012, which totaled $13 and represented dividends accrued during the period May 26, 2012 through September 28, 2012, were paid in cash subsequent to November 23, 2012; $10 was paid in December 2012 and $3 was paid in April 2013.

Series E Preferred Stock

On July 2, 2009, the Company issued 23,741 shares of Series E Preferred Stock to Mr. Lenfest in connection with the 2009 Lenfest Financing 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 have converted into 11,870,391 shares of the Company's Common Stock.

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

On September 28, 2012, as part of the 2012 Financial Restructuring and immediately following the closing of the Loan Agreement with PNC Bank, the Company purchased from Mr. Lenfest, at the stated price of $1,000 per share, 9,614 shares of Series E Preferred Stock, representing a significant portion of the Company's issued and outstanding Series E Preferred Stock. Mr. Lenfest is the only holder of the outstanding Series E Preferred Stock, and 12,127 shares of Series E Preferred Stock remain outstanding as of February 22, 2013.

As of both February 28, 2014 and February 22, 2013, the Series E Preferred Stock totaled $12,127 and was convertible into 6,063,321 shares of the Company's Common Stock. All Series E Preferred Stock dividends accrued as of February 22, 2013, which totaled $404, were paid in cash in April 2013. Series E Preferred Stock dividends accrued as of February 28, 2014, which totaled $493, remained unpaid as of June 3, 2014, the date of issuance of our consolidated financial statements, per the restrictions stipulated in the October 11, 2013 amendment to the September 28, 2012 Loan Agreement.

Common Stock Warrants

On February 28, 2009, in connection with a $2,000 loan made by Mr. Lenfest to the Company, the Company issued to Mr. Lenfest warrants to purchase 143,885 shares of ETC Common Stock, which shares were equal in value to ten percent (10%) of the $2,000 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.

On July 2, 2009, in consideration of Mr. Lenfest's agreement to guarantee the $5,000 increase to the 2007 PNC Credit Facility, ETC issued to Mr. Lenfest warrants to purchase 450,450 shares of ETC Common Stock, which shares were equal in value to ten percent (10%) of the amount of the $5,000 increase. The warrants are exercisable for seven years following issuance at an exercise price per share equal to $1.11, equaling the average closing price of ETC Common Stock during the 120 days preceding the issuance of the warrant.

On January 4, 2011, the Company entered into amendments to each of the warrants issued to Mr. Lenfest pursuant to which Mr. 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.

Dedicated Line of Credit Agreement with PNC Bank

The Company has a Dedicated Line of Credit in the amount of $4,241 with PNC Bank. The Company uses the Dedicated Line of Credit to satisfy performance bond and repayment guarantee requirements for an international contract. Use of this Dedicated Line of Credit is restricted to funding contract performance and repayment guarantee requirements under this specific contract.

As security for the Dedicated Line of Credit, the Company originally deposited $5,422 in a certificate of deposit with PNC Bank. ETC is obligated to pay a fee of three percent (3%) per year for the Dedicated Line of Credit. On March 8, 2013, the Company made an accelerated payment on the Term Loan in the amount of $1,181 with cash received from a partial reduction in its certificate of deposit securing the Dedicated Line

of Credit. The certificate of deposit was able to be reduced in conjunction with the reduction of a Repayment Guarantee Bond associated with one of our international contracts for multiple Aerospace products. As of February 28, 2014, $4,241 remains deposited in a certificate of deposit with PNC as security for the Dedicated Line of Credit.

Export Import Committed Line of Credit Agreement with PNC Bank

On December 19, 2012, the Company entered into an Export Import Loan Agreement through PNC Bank, whereby the Company has an Ex-Im Line of Credit through which it may borrow against eligible export inventory and eligible export accounts receivable up to a maximum of $2,000. The agreement expires on October 31, 2015. Interest on advances under the agreement will be based on the PNC Daily Libor Rate (currently 0.15%) plus a margin of 3.00%. The agreement includes covenants that are generally consistent with the PNC Line of Credit. The amount borrowed under the Ex-Im Line of Credit was $250 and $600 as of February 28, 2014 and February 22, 2013, respectively.

ETC-PZL Line of Credit Agreement

On November 23, 2012, ETC-PZL entered into a loan agreement with a bank in Warsaw, Poland, whereby ETC-PZL has line of credit ("ETC-PZL Line of Credit") to fund current activity. As of February 28, 2014, availability under the ETC-PZL Line of Credit was $700. Availability will decrease by approximately $125 at the end of each calendar quarter until the agreement eventually expires on November 14, 2014 (i.e. availability as of March 31, 2014 was $575, availability as of June 30, 2014 will be $450, and availability as of September 30, 2014 will be $325). As of both February 28, 2014 and February 22, 2013, there were no outstanding borrowings under the ETC-PZL Line of Credit.

Summary of Long-Term Debt Obligations

Long-term debt obligations consist of the following as of:

	February 28, 2014	February 22, 2013
Credit facility payable to bank	$ 11,664	$ 7,585
Term Loan	9,569	14,000
Borrowed under Ex-Im Line of Credit	250	600
Total long-term debt obligations	21,483	22,185
Less: current portion of long-term debt obligations	(3,250)	(3,600)
Total long-term debt obligations, less current portion	**$ 18,233**	**$ 18,585**

The amounts of future long-term debt obligations maturing in each of the next five (5) fiscal years are as follows:

Fiscal Year	Amount
Fiscal 2015	$ 3,250
Fiscal 2016	14,664
Fiscal 2017	3,000
Fiscal 2018	569
Fiscal 2019	-
Total future long-term debt obligations	**$ 21,483**

7. Leases

The Company leases certain premises and office equipment under operating leases, which expire over the next five (5) years. Future minimum rental payments required under non-cancelable operating leases having a remaining term expiring after one fiscal year as of February 28, 2014 are $303 in fiscal 2015; $307 in fiscal 2016; $105 in fiscal 2017; $65 in fiscal 2018; and $66 in fiscal 2019 and beyond. Total rental expense for all operating leases for fiscal 2014 and fiscal 2013 was $372 and $382, respectively.

8. 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.

As of February 28, 2014, the Company reviewed the components of its deferred tax assets 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 to its federal net operating loss carryforwards; all foreign net operating loss carryforwards available as of February 28, 2014 have been fully reserved. The Company has a net deferred tax asset related primarily to its federal net operating loss carryforwards of $3,841. Income tax provisions of $670 and $3,859 were recorded in fiscal 2014 and fiscal 2013, respectively.

As of February 28, 2014, the Company had approximately $12,388 of federal net loss carry forwards available to offset future income tax liabilities, which will begin 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.

Income tax expense consists of the following:

	Fiscal year ended	
	February 28, 2014	**February 22, 2013**
Current tax expense:		
U.S. Federal	$ 20	$ 172
U.S. State	(87)	51
Foreign	(234)	131
Total current	**(301)**	**354**
Deferred tax expense:		
U.S. Federal	$ 869	$ 3,361
U.S. State	(3)	89
Foreign	105	55
Total deferred	**971**	**3,505**
Total income tax expense	**$ 670**	**$ 3,859**

Effective tax rates were 52.7% and 43.7% for fiscal 2014 and fiscal 2013, respectively. Our effective fiscal 2014 tax rate was higher than fiscal 2013 primarily due to the combined effect of an increase in federal deferred tax expense as a percentage of income before income taxes and a decrease in the ratio of domestic income before income taxes to the reserve for foreign net operating loss carryforwards.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. The Company is no longer subject to U.S. federal tax examinations by tax authorities for the fiscal years before and including 2010. ETC-PZL is no longer subject to tax examinations in Poland for tax periods prior to December 31, 2008; ETC-Europe is no longer subject to tax examinations in the United Kingdom for tax periods prior to fiscal 2012. We are, however, subject to examination in various other foreign and state jurisdictions for fiscal years 2004-2014. We believe appropriate provisions for all outstanding tax issues have been made for all jurisdictions and all open years.

Significant components of our net deferred tax assets are as follows:

	February 28, 2014	February 22, 2013
Deferred tax assets:		
Net operating loss and credits	$ 7,001	$ 7,179
Foreign	279	375
Vacation accrual	178	211
Inventory reserve	75	412
Receivable reserve	141	145
Warranty reserve	32	51
Compensation and other reserves	12	193
Other, net	191	103
	7,909	8,669
Valuation allowance	(558)	(496)
Total deferred tax assets	**7,351**	**8,173**
Deferred tax liabilities:		
Depreciation	3,106	2,974
Amortization of capitalized software	132	173
Foreign	102	95
APB 23 liability	170	119
Total deferred tax liabilities	**3,510**	**3,361**
Total net deferred tax assets	**$ 3,841**	**$ 4,812**

As of February 28, 2014 and February 22, 2013, we have provided for U.S. deferred income taxes and foreign withholding tax in the amount of $170 and $119, respectively, for all undistributed earnings not considered permanently reinvested in our non-U.S. subsidiaries since during fiscal 2013 our non-U.S. subsidiaries entered into a position of earnings and profit.

As of February 28, 2014, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $25 and penalties of $25. As of February 22, 2013, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $34 and penalties of $72. The interest and penalties recorded during both fiscal 2014 and fiscal 2013 primarily related to domestic state tax and foreign tax issues.

As of February 28, 2014 and February 22, 2013, the total amount of unrecognized tax benefits was $395 and $715, respectively, of which $162 would affect the effective tax rate, if recognized. These amounts, which are recorded on the Company's balance sheet within other accrued liabilities, are primarily associated with U.S. federal tax issues such as the amount of research and development tax credits claimed and taxation of foreign earnings. Also included in these amounts are accruals for domestic state tax issues such as the allocation of income among various state tax jurisdictions.

9. Business Segment Information

We operate in two primary business segments, Aerospace and CIS. Aerospace encompasses the design, manufacture, and sale of: (i) Aircrew Training Systems; (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); and (iv) ADMS, as well as integrated logistics support for customers who purchase these products or similar products manufactured by other parties. These products and services provide customers with an offering of comprehensive solutions for improved readiness and reduced operational costs. Sales of our Aerospace products are made principally to U.S. and foreign government agencies. CIS encompasses the design, manufacture, and sale of: (i) steam and gas (ethylene oxide) sterilizers; (ii) environmental testing and simulation devices; and (iii) hyperbaric (100% oxygen) chambers for one person (monoplace chambers), as well as parts and service support for customers who purchase these products or similar products manufactured by other parties. Sales of our CIS products are made principally to the healthcare, pharmaceutical, and automotive industries.

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 Aerospace 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.

In fiscal 2014, International sales totaling at least $500 were made to customers in nine (9) different countries; in fiscal 2013, International sales totaling at least $500 were made to customers in eight (8) different countries. 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 2014, two customers, (one U.S. defense agency and one international customer), each in the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling $21,731 represented 45.0% of total net sales. In fiscal 2013, two customers, (one U.S. defense agency and one international customer), each in the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling $29,926 represented 47.7% of total net sales.

Included in the segment information for fiscal 2014 and fiscal 2013 are export sales of $24,544 and $21,507, respectively. Sales to the U.S. Government and its agencies aggregated to $12,119 and $22,217 for fiscal 2014 and fiscal 2013, respectively.

The following segment information reflects the accrual basis of accounting:

	Aerospace	CIS	Corporate	Company Total
Fiscal 2014:				
Net sales	$ 34,278	$ 13,996	$ -	$ 48,274
Interest expense, net	574	234	-	808
Depreciation and amortization	1,258	481	64	1,803
Operating income (loss)	4,037	423	(1,999)	2,461
Provision for income taxes	-	-	670	670
Identifiable assets	38,904	5,929	11,359	56,192
Expenditures for segment assets	748	470	214	1,432
Fiscal 2013:				
Net sales	$ 42,295	$ 20,478	$ -	$ 62,773
Interest expense, net	677	328	-	1,005
Depreciation and amortization	1,264	527	52	1,843
Operating income (loss)	9,121	3,887	(3,064)	9,944
Provision for income taxes	-	-	3,859	3,859
Identifiable assets	36,713	7,700	16,155	60,568
Expenditures for segment assets	1,006	73	225	1,304

Reconciliation to consolidated net income attributable to Environmental Tectonics Corporation:

	Fiscal 2014	Fiscal 2013
Operating income	$ 2,461	$ 9,944
Interest expense, net	(808)	(1,005)
Other expense, net	(381)	(118)
Provision for income taxes	(670)	(3,859)
Income attributable to non-controlling interest	(3)	(14)
Net income attributable to Environmental Tectonics Corporation	**$ 599**	**$ 4,948**

10. Stock Option Plans

The following is a summary of the status of the Company's Stock Option Plans:

	Fiscal year ended			
	February 28, 2014		February 22, 2013	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	219,917	$ 4.23	270,921	$ 4.35
Granted	151,500	$ 2.00	-	$ -
Exercised	-	$ -	-	$ -
Forfeited	(17,011)	$ 2.94	(51,004)	$ 4.90
Outstanding at end of year	354,406	$ 3.34	219,917	$ 4.23
Options exercisable at fiscal year end	199,573		213,250	
Weighted average fair value of options granted during the fiscal year		$ 0.71		$ -

The following information applies to options outstanding as of February 28, 2014:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding as of February, 28 2014	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at February 28, 2014	Weighted average exercise price
Less than $2.64	247,500	8.07	$2.22	92,667	$2.59
$5.12	50,000	1.99	$5.12	50,000	$5.12
$6.07 to $7.24	56,906	1.61	$6.62	56,906	$6.62
Total	**354,406**			**199,573**	

The Company uses the Black-Scholes option-pricing model and the straight-line attribution approach to determine the fair value of share-based awards in accordance with ASC 718, Compensation. This option-pricing model requires the input of highly subjective assumptions, including the option's expected term, the price volatility of the underlying stock, risk-free rates of return, dividend yield, and expected forfeitures. The expected term of an award (10 years for options granted in fiscal 2014) is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility (27.4% for options granted in fiscal 2014) is based on the Company's historical stock prices. The risk-free interest rate (0.6% for options granted in fiscal 2014) 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-pricing model as it does not anticipate paying cash dividends in the near future. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense for only those awards that are 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. There were 151,500 options granted in fiscal 2014; there were no options granted in fiscal 2013.

The cost for stock option compensation was $20 and $69 in fiscal 2014 and fiscal 2013, respectively. As of February 28, 2014, there were 56,906 options outstanding under the 1998 Incentive Stock Option Plan, which expired in August 2008.

As of February 28, 2014, the Company had two stock-based compensation plans:

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 of Directors) 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 (10%) owner, one-hundred and ten percent (110%), of a share of the Company's Common Stock on the date of grant of such option. The plan also allows the Board of Directors or its appointed committee to establish the exercise period(s) of any option awards. Granted options have a maximum term of ten (10) years. This Plan was approved by the shareholders on July 2, 2009. As of February 28, 2014, there were 752,500 shares available to be granted under this Plan.

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 the Board of Directors of options to purchase up to 600,000 shares of Common Stock. The Plan provides that the exercise price shall not be less than one-hundred percent (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 ten (10) years. The Plan shall remain in effect until terminated by the Board of Directors. As of February 28, 2014, there were 550,000 shares available to be granted under this Plan.

11. Other Related Party Transactions

ETC purchases industrial products from Industrial Instruments and Supplies, Inc. ("Industrial Instruments"), 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 ("Mr. Mitchell"). During fiscal 2014 and fiscal 2013, the Company purchased $361 and $668, respectively, from Industrial Instruments. As of February 28, 2014, ETC owed $90 to Industrial Instruments. ETC also rents office space to Industrial Instruments at ETC's corporate headquarters. During both fiscal 2014 and fiscal 2013, Industrial Instruments paid to ETC rent in the amounts of $8.

ETC purchases travel accommodations from Jet Set Travels, a company that employs Kathleen Mahon, the daughter of Mr. Mitchell. During fiscal 2014 and fiscal 2013, ETC purchased travel through Jet Set Travels totaling $338 and $478, respectively, and Ms. Mahon received approximately $18 in fiscal 2014 and $25 in fiscal 2013 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 both fiscal 2014 and fiscal 2013, Ms. Mahon received $18 and $20, respectively, in consideration of such services.

ETC 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 of ETC Sterilization Systems. In fiscal 2014, Mr. William F. Mitchell, Jr. received $161 and Mr. David Mitchell received $196 in compensation from ETC. In fiscal 2013, Mr. William F. Mitchell, Jr. received $183 and Mr. David Mitchell received $187 in compensation from ETC.

ETC uses two properties owned by Mr. Mitchell. During both fiscal 2014 and fiscal 2013, ETC paid $60 to Mr. Mitchell in connection with ETC's use of these properties.

12. Commitments and Contingencies

There are no material pending legal proceedings to which ETC or any of its subsidiaries is a party or of which any of their property is the subject.

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.

13. Employee Benefit Plans

The Company maintains a 401(k) retirement savings plan for eligible employees. The Company historically contributed one-hundred percent (100%) to the plan based on the first four percent (4%) of the employees' qualifying contributions; however, effective January 1, 2013, the Company now contributes one-hundred percent (100%) to the plan based on the first four percent (4%) of the employees' qualifying contributions plus an additional fifty percent (50%) of the next two percent (2%) of the employees' qualifying contributions. The Company's contributions totaled $463 and $451 in fiscal 2014 and fiscal 2013, respectively.

The Company had an Employee Stock Purchase Plan, which was originally adopted by the Board of Directors on November 3, 1987, but was subsequently terminated by the Board of Directors effective January 1, 2013. The Company originally reserved 270,000 shares for issuance under this plan, of which 163,406 shares were still remaining as of the effective termination date of January 1, 2013.

14. Fair Value Measurements and Interest Rate Swap

Our assets and liabilities that are measured at fair value on a recurring basis include the unrealized gains or losses on interest rate swap contracts. We use significant other observable market data or assumptions (Level 2 inputs as defined in the accounting guidance) that we believe market participants would use in pricing similar assets or liabilities, including assumptions about counterparty risk. Our fair value estimates reflect an income approach based on the terms of the interest rate contracts and inputs corroborated by observable market data including interest rate curves.

As of both February 28, 2014 and February 22, 2013, we had one interest rate swap contract in place to reduce our exposure to fluctuations in interest rates on our Term Loan. The swap converts the variable interest rate to a fixed interest rate initially on $5,000 of our $15,000 Term Loan. The effective date of the interest rate swap was September 28, 2012, and it is scheduled to expire on September 28, 2017. The notional amount of $5,000 will decrease ratably over the duration of the interest rate swap agreement. The interest rate swap effectively fixes our LIBOR interest rate on the notional amount at a rate of 0.74% in excess of the margin. We have recorded an unrealized gain of $15 and an unrealized loss of $28 in fiscal 2014 and fiscal 2013, respectively, related to the fair value of our interest rate swap, with the corresponding entry to other accrued liabilities, non-current.

We recognize any differences between the variable interest rate payments and the fixed interest rate settlements from our swap counterparty as an adjustment to interest expense over the life of the swap. We have designated the swap as a cash flow hedge and we record the changes in the estimated fair value of the swap to accumulated other comprehensive loss. If our interest rate swap became ineffective, we would immediately recognize the change in the estimated fair value of our swap in earnings. Since inception, we have not recognized any gains or losses on these swaps through income and there has been no effect on income from hedge ineffectiveness.

Failure of our swap counterparty would result in the loss of any potential benefit to us under our swap contracts. In this case, we would still be obligated to pay the variable interest payments underlying the Term Loan. Additionally, failure of our swap counterparty would not eliminate our obligation to continue to make payments under our existing swap contract if we continue to be in a net pay position.

15. Subsequent Events

The Company has evaluated subsequent events through June 3, 2014, the date of issuance of its consolidated financial statements, and determined that there were no material subsequent events other than disclosed below requiring adjustment to, or disclosure in, the consolidated financial statements for the fiscal year ended February 28, 2014.

On April 24, 2014, the Company reached a favorable settlement on the first of several recoveries that we are currently seeking for inefficiencies as a result of additional work required on several contracts.

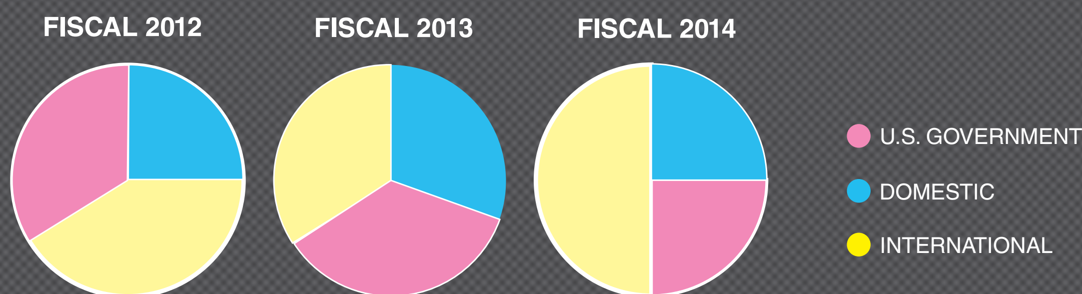
On May 28, 2014, the Board of Directors unanimously approved a resolution to amend and restate the Company's bylaws to, among other things, amend certain governance provisions to reflect recent changes at the Company (e.g., bifurcation of the roles of Chief Executive Officer and President and no longer being an SEC reporting company), to update the bylaws under the Pennsylvania Business Corporation Law, and to make certain other conforming and technical changes. Some of these amendments relate to the composition of the Board of Directors and its committees, advance notice provisions for shareholder meetings, indemnification, and action by written consent. The Board of Directors also approved an amendment to Section 8(b) of the Statement With Respect to Shares of the Series E Preferred Stock of the Company, clarifying the composition of the Board of Directors. These amendments were also approved by the written consent of the holder of all of the Series E Preferred Stock and holders of Common Stock.

On June 2, 2014, the Company received a waiver as of the fiscal quarter ended February 28, 2014 for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. The waiver also temporarily replaces the Fixed Charge Coverage Ratio with a required minimum EBITDA, as adjusted by the addition of an EBITDA Addback, on a rolling four quarters basis for the fiscal quarter ended May 30, 2014.

FIVE YEAR SUMMARY

(in thousands, except per share information)	Fiscal 2010	Fiscal 2011	Fiscal 2012	Fiscal 2013	Fiscal 2014
Net sales	$ 42,271	$ 55,451	$ 66,294	$ 62,773	$ 48,274
Gross profit	18,824	21,790	23,531	24,869	14,559
Gross profit margin %	*44.5%*	*39.3%*	*35.5%*	*39.6%*	*30.2%*
Operating income	6,600	8,290	8,137	9,944	2,461
Operating margin %	*15.6%*	*15.0%*	*12.3%*	*15.8%*	*5.1%*
Income before income taxes	4,630	6,877	7,488	8,821	1,272
Pre-tax income margin %	*11.0%*	*12.4%*	*11.3%*	*14.1%*	*2.6%*
Income tax (benefit) provision	(1,819)	(7,665)	2,620	3,859	670
Net income	6,449	14,542	4,868	4,962	602
Expense (income) attributable to non-controlling interest	4	(8)	5	(14)	(3)
Net income attributable to ETC	6,453	14,534	4,873	4,948	599
Preferred Stock dividends	(1,885)	(2,278)	(2,208)	(1,511)	(493)
Income attributable to common and participating shareholders	$ 4,568	$ 12,256	$ 2,665	$ 3,437	$ 106
Diluted earnings per share	$ 0.26	$ 0.59	$ 0.13	$ 0.19	$ 0.01
Working capital	$ 15,326	$ 20,242	$ 27,786	$ 25,135	$ 26,536
Total long-term debt obligations	10,093	3,303	16,724	22,185	21,483
Total assets	51,729	54,051	67,786	60,568	56,192
Total shareholders' equity	17,414	28,129	30,825	24,219	24,326
Capital expenditures	1,824	865	2,144	1,304	1,432
Depreciation and amortization	1,309	1,354	1,760	1,843	1,803
Interest expense, net	1,308	824	734	1,005	808
EBITDA	**$ 7,247**	**$ 9,055**	**$ 9,982**	**$ 11,669**	**$ 3,913**

Net Sales by Fiscal Year by Geographic Area



The CIS segment serves hospitals and clinics, pharmaceutical and medical device manufacturers, commercial automobile manufacturers, and HVAC.

Corporate Governance

The Board of Directors is comprised of eight (8) members, six (6) of whom who are considered "independent" directors (not an employee, not affiliated with the Company's auditors, and not part of an interlocking directorate). Directors are nominated based on their individual qualifications and experience, the overall balance of the Board of Directors' background and experience, and each individual's willingness to fulfill their obligations and to contribute appropriately.

The Board of Directors meets four times per year in addition to various Board committee meetings held throughout the year. Standing committees consist of the Audit Committee, the Compensation Committee, and the Nominating and Governance Committee. These committees each have defined charters that address the committees' purpose, goals, and responsibilities. All committees meet on a scheduled basis. Please refer to the Investors section of our website (www.etcusa.com) for more information on corporate governance.

	AUDIT COMMITTEE	COMPENSATION COMMITTEE	NOMINATING AND GOVERNANCE COMMITTEE
George K. Anderson, M.D.	-	Member	Chairperson
Linda J. Brent Ed.D	Member	-	Member
Roger Colley	Chairperson	Member	-
Michael D. Malone	Member	-	Member
George A. Sawyer	Member	Chairperson	-
Winston E. Scott	-	Member	Member

ETC's BARA-MED *Select* Hyperbaric Chamber

ETC Sterilization Systems entered the small and medium-sized sterilizer market in 2014

ETC Testing & Simulation Systems Drive-In Test Chamber

Company Affiliates and Locations

The consolidated financial statements include the accounts of ETC, our 95%-owned subsidiary ETC-PZL, and our 99%-owned subsidiary ETC-Europe. ETC does not have any unconsolidated legal entities, "special purpose" entities, or other off balance sheet arrangements 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 shareholders. As of February 28, 2014, we had 316 full-time employees, compared to 336 full-time employees as of February 22, 2013, of which 6 were employed in executive positions,137 were engineers, engineering designers, or draftspersons, 57 were administrative (sales, sales support, accounting, or general administrative) or clerical personnel, and 116 were engaged principally in production, operations, or field support. A total of 141 employees were stationed in Southampton, Pennsylvania, a northern suburb of Philadelphia, Pennsylvania.

We are an ISO 9001 certified manufacturer. We are also ISO 13485 certified for our medical devices. We operate in four major locations consisting of manufacturing facilities, product development, and administration:

Southampton, Pennsylvania

92,000 (approx.) sq. ft | Manufacturing (64,000 sq. ft), NASTAR Center (22,000 sq. ft.), and Corporate Headquarters (6,000 sq. ft.) | Owned | Aerospace & CIS Segment

The NASTAR Center, which is included in the Company's Southampton, Pennsylvania owned property, includes the following aerospace training and research equipment:

- *ATFS-400-25 PHOENIX High Performance Human Centrifuge;*
- *GYROLAB GL-2000 Advanced Spatial Disorientation Trainer;*
- *Altitude (Hypobaric) Chamber;*
- *Ejection Seat Simulator; and*
- *Night Vision Training System and Night Vision Goggle Training System.*

Orlando, Florida

8,700 (approx.) sq. ft | Product development and administration | Leased | Aerospace Segment

Warsaw, Poland

28,000 (approx.) sq. ft | Manufacturing, product development and administration | Leased | Aerospace Segment

Ankara, Turkey

5,700 (approx.) sq. ft | Software Development | Leased | Aerospace & CIS Segment

Reporting Requirements

The Company is not currently required to register with the SEC and therefore is not subject to the reporting requirements of a public company; however, the Company issues periodic press releases, quarterly unaudited statements, and an annual report with audited financial statements.

Interim Consolidated Financial Statements

Interim consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto for fiscal 2014. The results for any interim period are not necessarily indicative of results for the full fiscal year. Certain information and footnote disclosures normally included in audited financial statements have been omitted. As mentioned previously, the Company is not subject to SEC reporting requirements and therefore its quarterly interim consolidated financial statements are not subject to an interim review by Independent Auditors as prescribed by the SEC.

Investor and Shareholder Information

Shareholder Inquiries

Questions concerning your account, address changes, consolidation of duplicate accounts, lost certificates, and other related matters should be addressed to ETC's transfer agent:

American Stock Transfer & Trust Company, LLC
6201 15th Avenue
Brooklyn, NY 11219
Toll Free: (800) 937-5449
Telephone: (718) 921-8124
Website: www.amstock.com

Stock Exchange Listing

The Common Stock of ETC is traded under the symbol "ETCC" on the electronic Pink Sheets and is listed by the OTC Markets Group, Inc., reporting service for over-the-counter stocks. Stock quotation information is available through stock reporting services on the Internet at www.otcmarkets.com.

Annual Meeting

The Company's Annual Meeting of Shareholders is scheduled for 10:00 a.m. on Tuesday, July 15, 2014, to be held at the Company's headquarters in Southampton, PA.

Corporate Data

Environmental Tectonics Corporation, 125 James Way, Southampton, PA 18966. For further information, contact Mark Prudenti, Chief Financial Officer. Telephone: (215) 355-9100 x1531

You can access Company information including press releases, earnings announcements, history, and other information through the Internet by visiting the ETC website at www.etcusa.com.

With products spanning four decades of innovation, ETC is unparalleled in creating products that simulate environments for training, testing and R&D.

TRAINING

The National Aerospace Training and Research (NASTAR) Center

The National AeroSpace Training And Research (NASTAR) Center is the premier commercial air and space training, research and educational facility. It combines state-of-the-art flight simulation with physiology-based courseware to optimize human performance in extreme environments. *NASTARcenter.com*

AeroMedical Training Institute (AMTI)

AMTI offers the most advanced aeromedical training for military, fixed-wing, helicopter and commercial/general aviation pilots in the world. *AeromedicalTraining.com*

ETC Advanced Pilot Training

Realistic, hands-on upset prevention and recovery, spatial disorientation, situational awareness. accident prevention and altitude awareness training for commercial pilots and crew in authentic training environments. *etcAdvancedPilotTraining.com*

ETC Simulation

ETC Simulation's flagship product is the Advanced Disaster Management Simulator (ADMS), a realistic, virtual emergency management simulation training system. Based in Orlando, Fla., ETC Simulation offers the most thorough training for incident command and disaster management teams *etcSimulation.com*

PRODUCTS

ETC Aircrew Training Systems

For over four decades, ATS has provided clients in over 80 countries with simulation systems designed for high–G, SD, SA, aircraft egress, night vision, hypoxic environment, tactical aviation, avionics maintenance, helicopter flight and water survival training and research applications. *etcAircrewTraining.com*

ETC Sterilization Systems

Specializing in medium to large (30 to 6000 cubic feet) EO and steam sterilizers, ETC Sterilization Systems serves the pharmaceutical, biotech, medical device and life sciences market with unique design solutions for any challenge. *etcSterilization.com*

ETC Testing and Simulation Systems

TSS has designed, manufactured and installed state-of-the-art environmental simulation systems for the automotive-testing and HVAC industries since 1969. Offering a complete line of industry-leading test equipment developed for clients' needs, TSS offers the most customized equipment available for optimizing R&D, test and validation programs. *TestingAndSimulation.com*

ETC BioMedical Systems

Founded in 1971, ETC BioMedical Systems is the world's first provider of computer-driven HBOT chambers. Groundbreaking innovations include the O.S.C.A.R. computerized control system and our exclusive undercarriage gurney storage solution for optimized space. *etcHyperbaricChambers.com*

SERVICE

ETC International Logistics Support

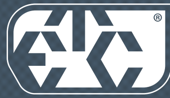
Equipment maintenance, training and upgrades for domestic and foreign commercial accounts, civilian agencies and militaries. *SimulatorSupport.com*

ETC Sterilizer Support

Provides service and support for all Sterilizers. *SterilizerSupport.com*

ETC Environmental Service & Support

Refurbish, upgrade or modify any type of Environmental System and Chamber. *EnvironmentalServiceSupport.com*



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