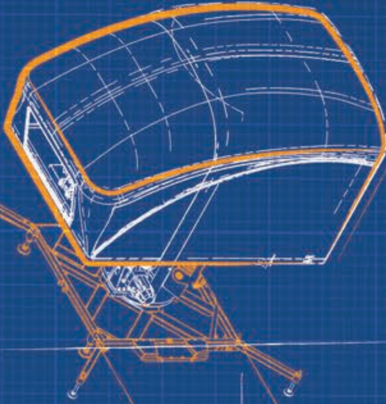
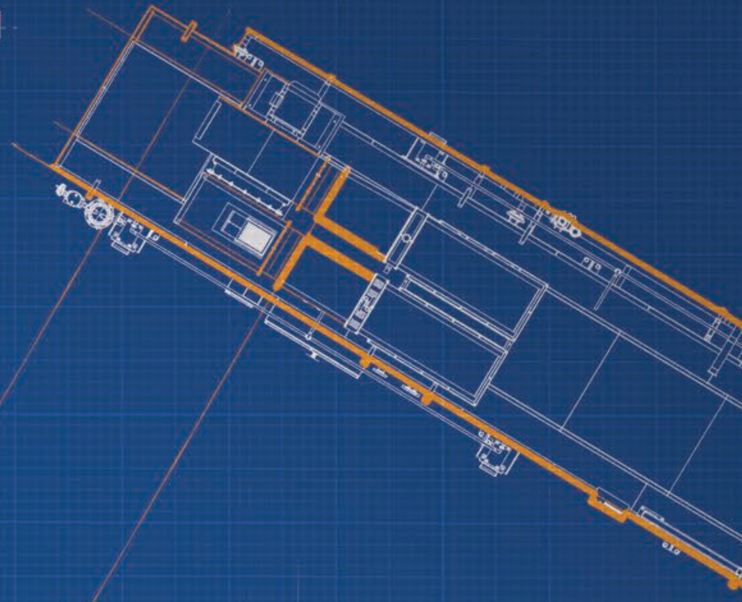
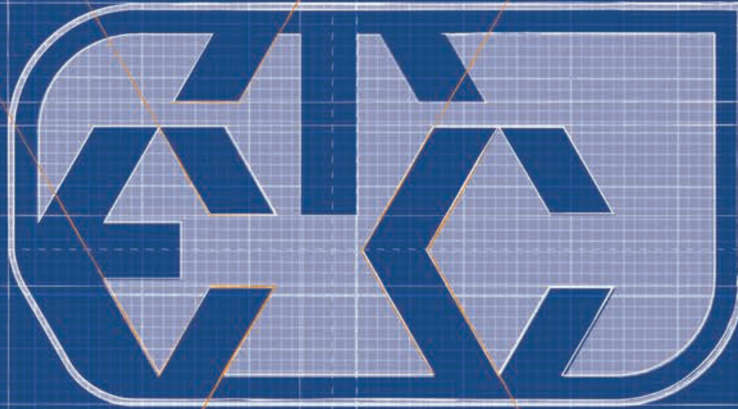
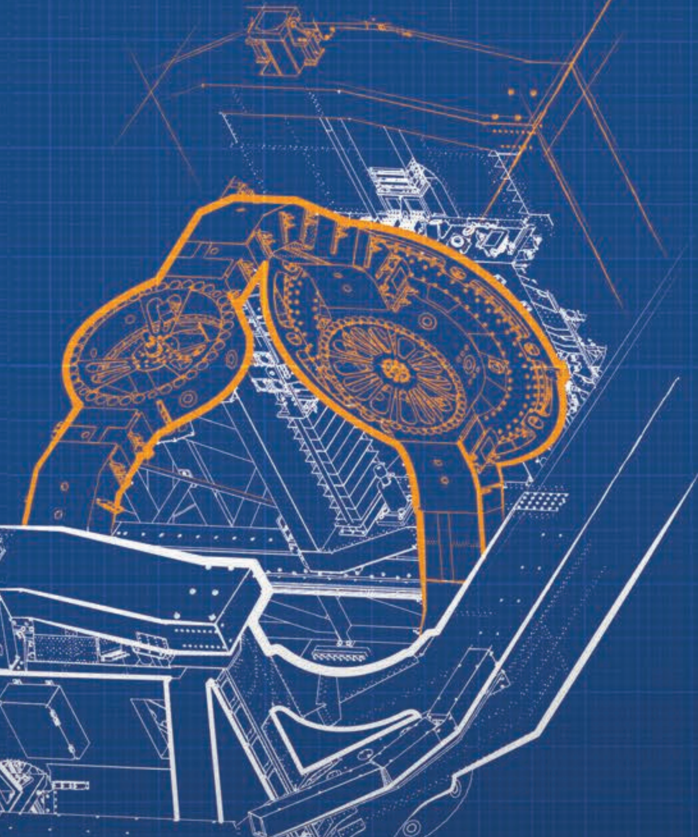
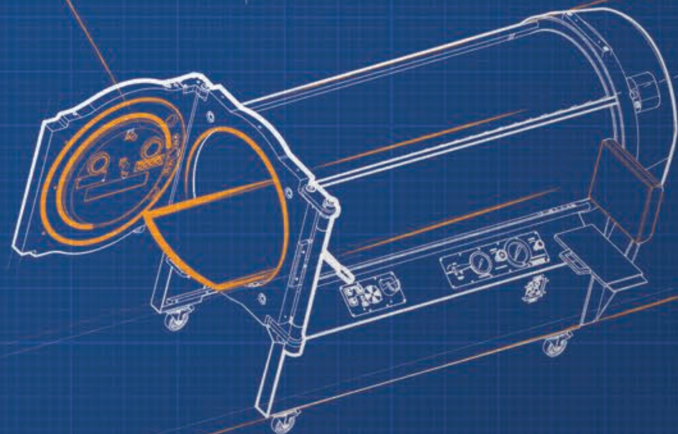
2015 ENVIRONMENTAL TECTONICS CORPORATION ANNUAL REPORT

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ETC GLOBAL LOCATIONS

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ETC-PZL Aerospace Industries Sp. z o.o.
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ETC Turkey
ODTU Teknokent, Gumus Bloklar A Blok
Zemin Kat Bati Cephe Suite 1
06531 ODTU Ankara, Turkey
(+90) 312.210.17.80

TRANSFER AGENT

American Stock Transfer,
New York, New York

BOARD OF DIRECTORS

H.F. Lenfest (2003)
Chairman

George K. Anderson, M.D. (2003)
Vice Chairman

Linda J. Brent, Ed.D (2010)

Roger Colley (2011)

Robert L. Laurent, Jr. (2014)

Michael D. Malone (2012)

Winston E. Scott (2010)

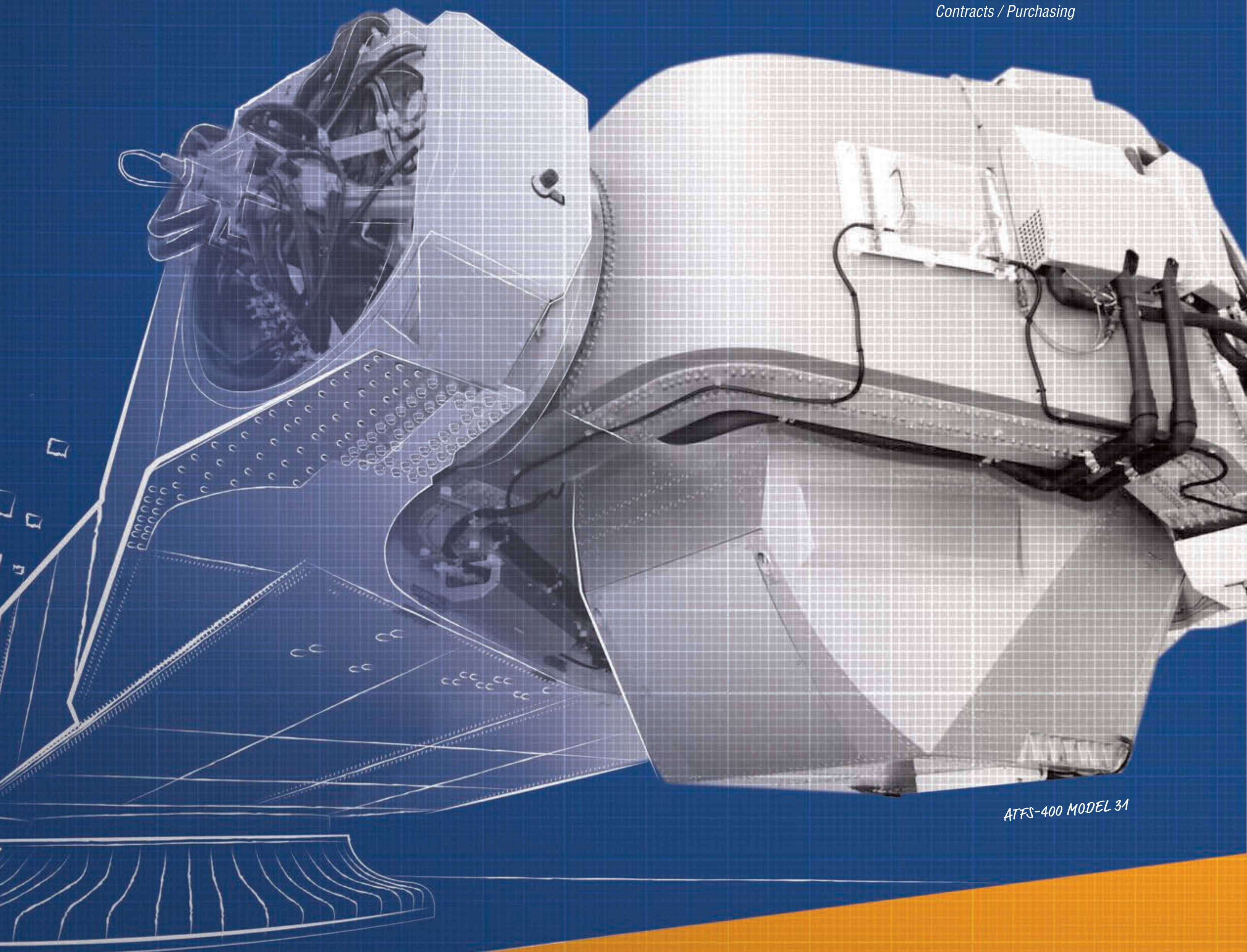
CORPORATE OFFICERS

Robert L. Laurent, Jr.
Chief Executive Officer and President

Mark Prudenti
Chief Financial Officer

Thomas G. Loughlin
Chief Operating Officer

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

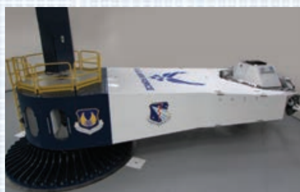


ATFS-400 MODEL 31

FISCAL 2015 WAS A YEAR OF TRANSITION FOR ETC.

AFTER FORTY-FIVE YEARS AT THE HELM OF ETC, FOUNDER AND LONGTIME CHAIRMAN AND CEO, MR. WILLIAM F. MITCHELL RETIRED. WE THANK BILL FOR HIS VISION AND STEWARDSHIP OF THE COMPANY THROUGHOUT THE YEARS.

Upon Mr. Mitchell's retirement, the Board of Directors chose to separate the Chairmanship from the Chief Executive role. Accordingly, Mr. H.F. "Gerry" Lenfest, majority-owner and a non-executive of the Company, was elected Chairman of the Board of Directors of ETC, and I, Mr. Robert L. Laurent, Jr., was elected to the Board of Directors and promoted to the role of Chief Executive Officer and President. Dr. George Anderson, a director of ETC for nine years and former Surgeon General of the U.S. Air Force, was elected to the newly created role of Vice Chairman of the Board.



We are pleased to report the tremendous progress made on our three large U.S. Government contracts at Wright-Patterson Air Force Base ("WPAFB"). It has been very exciting to see our visions become reality. Installation of the U.S. Air Force Centrifuge is complete and the device is currently in testing. A suite of four U.S. Air Force Research Altitude Chambers have been delivered, installed, and are about to begin testing. Finally, a sophisticated U.S. Navy Spatial Disorientation device is also fully installed and currently in testing. We look forward during the next several months for these devices to become fully operational in their important functions for the men and women of our armed forces.

Although work on these devices will begin to wind down, U.S. Government revenues will remain steady through fiscal 2016. In addition to the maintenance contracts on both U.S. Air Force devices, the Air Force Life Cycle Management Center ("AFLCMC") placed an order for five (5) GYRO IPT II's (Integrated Physiological Trainers). These devices will be delivered to five (5) different domestic U.S. Air Force bases by the end of fiscal 2016. Further, ETC's Simulation Division, located in Orlando, FL, was awarded a contract by the United States Air Force Civil Engineering Center ("AFCEC") located at Tyndall Air Force Base to deliver an Airfield Damage Repair ("ADR") Simulator.

GYRO IPT-II

AEROSPACE SOLUTIONS

AS STRONG AS OUR U.S. GOVERNMENT PRESENCE CURRENTLY IS, OUR INTERNATIONAL PRESENCE HAS THE ABILITY TO BE EVEN STRONGER.

From the latter part of the fiscal 2015 third quarter through the beginning of the fiscal 2016 first quarter, ETC's Aircrew Training Systems ("ATS") business unit was awarded multiple contracts totaling $45M for customers in the Middle East, Europe, and Southeast Asia. As significant as these contracts are, we believe that due to several factors, including the international response to U.S. budget reductions, there are even greater opportunities on the horizon, for which ETC is well-positioned to secure. As we transition into fiscal 2016 and beyond, these projects will begin to rebuild the backlog, which had declined over the last few years as our U.S. Government contracts wound down.

Our fiscal 2015 Aerospace Solutions bookings were up 92% compared to fiscal 2014. This increase was due in large part to the contracts described above, as well as some of the items highlighted below. Upset recovery training enrollment at ETC's NASTAR Center in fiscal 2015 was up nearly 350% compared to fiscal 2014 due in large part to our unique ability to 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 realistic flight environment. ETC's Simulation Division's fiscal 2015 bookings, which included several new markets and products, were up 139% compared to fiscal 2014. Exclusive of any one-time large contracts that would have skewed the data, each of these business units had their most successful fiscal year to date from a bookings perspective. ETC-PZL Aerospace Industries Sp. z o.o. ("ETC-PZL"), our 95%-owned subsidiary in Warsaw, Poland, also contributed to the significant increase in Aerospace Solutions bookings with two separate contracts for aviation and ejection seat simulators.

COMMERCIAL / INDUSTRIAL SYSTEMS

FISCAL 2015 COMMERCIAL / INDUSTRIAL SYSTEMS ("CIS") REVENUES WERE UP NEARLY 9% COMPARED TO FISCAL 2014.

While most of the fiscal 2015 revenues were generated from sales of our industrial sterilizer systems, most of the fiscal 2015 bookings stemmed from sales of our Pro-GENESIS Advantage™ 100% Ethylene Oxide sterilizer control systems. Our investment in control system technology has put ETC's Sterilization Systems business unit at the front of the market for new controls at a time when older legacy systems have reached the end of their useful life. Including fiscal 2015 bookings, ETC will have fifty-seven (57) Advantage systems in operation and validated in the Ethylene Oxide Sterilization System industry.

ETC's Environmental Testing and Simulation Systems business unit also contributed to the increase in fiscal 2015 CIS revenues with a 167% increase compared to fiscal 2014. The majority of these sales consisted of sixteen (16) Conditioned Air Supply ("CAS") Systems, which provide air at precisely controlled temperature, humidity, pressure, and flow rate conditions to perform a variety of test applications.

On the downside, sales of our monoplace hyperbaric chambers within ETC's BioMedical business unit were negatively affected by the uncertainty in the healthcare sector; however, we have seen a recent turnaround with strong fiscal 2016 first quarter bookings of twelve (12) monoplace hyperbaric chambers, half of which were BARA-MED Selects, the most advanced unit on the market. As is the case with many of our business units, but particularly within the BioMedical business unit, we have become much more efficient and creative with our sales and marketing campaigns, the costs of which will not increase anywhere near the rate at which we expect sales to increase.

ETHYLENE OXIDE STERILIZERS

Although our fiscal 2015 results do not reflect it, this year has shown tremendous promise for the future. We have a lot of hard work ahead of us, but we are nearing the finish line on our three large U.S. Government contracts at WPAFB. Also, some of our other development-type projects will be closing soon, and a significant portion of the business will begin to shift to the more off-the-shelf type products with repeatable, robust designs that are beginning to build in our backlog. Further, the pipelines for our traditionally smaller business units look more promising than ever.

AS ALWAYS, AND SPECIFICALLY THROUGH THIS TIME OF TRANSITION,

WE WOULD LIKE TO EXTEND OUR DEEPEST GRATITUDE TO OUR SHAREHOLDERS FOR THEIR CONTINUED SUPPORT THROUGH FISCAL 2016 AND BEYOND AND PARTICULARLY TO OUR DEDICATED, HARD-WORKING, CREATIVE EMPLOYEES.

ROBERT L. LAURENT, JR
CHIEF EXECUTIVE OFFICER AND PRESIDENT

FINANCIAL REVIEW

(in thousands, except per share information)	Fiscal year ended February 27, 2015	Fiscal year ended February 28, 2014
Net sales	$ 37,340	$ 48,274
Gross profit	7,850	14,559
Operating (loss) income	(4,837)	2,461
Net (loss) income attributable to Environmental Tectonics Corporation	(3,715)	599
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed (loss) earnings per share:		
Common	$ (0.28)	$ 0.01
Preferred	$ (0.28)	$ 0.01
Diluted (loss) earnings per share	$ (0.27)	$ 0.01
Working capital	$ 8,029	$ 26,536
Total long-term debt obligations	20,621	21,483
Total assets	51,650	56,192
Total shareholders' equity	20,253	24,326
Weighted average common and participating shares:		
Basic	15,248	15,246
Diluted	15,493	15,477

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. 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. Series E Preferred Stock dividends accrued as of February 27, 2015, which totaled $977 thousand, remained unpaid as of May 28, 2015, 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.

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

FORWARD-LOOKING STATEMENTS

Discussions of some of the matters contained in this Annual Report 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 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 ended February 27, 2015. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2015.

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) hyperbaric chambers for multiple persons (multiplace chambers); (iv) Advanced Disaster Management Simulators ("ADMS"); (v) steam and gas (ethylene oxide) sterilizers; (vi) environmental testing and simulation devices; and (vii) 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 and to civil aviation organizations.

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
    - ATFS-300 Flight Simulator
- 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”); and our
- ADMS line of products (AIRBASE, COMMAND, CONTROL, DRIVE, FIRE, Aircraft Rescue and Firefighting (“ARFF”) Vehicle Simulator, 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 8 – 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. As of February 27, 2015, approximately thirty-two (32) employees were committed to sales and marketing functions. In addition to our two operating subsidiaries, we have employees stationed in Spain, the Netherlands, Egypt, Turkey, the United Arab Emirates, India, 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, including altitude (hypobaric) and multiplace chambers (“Chambers”), to governmental and military defense agencies and civil aviation organizations both in the United States and internationally. We sell our ADMS line of products to state and local governments, fire and emergency training schools, and airports. 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 and heating, ventilation, and air conditioning (“HVAC”) manufacturers. We sell our hyperbaric products (primarily “monoplace” chambers) to hospitals and wound care 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 2015

The following items had a material impact on our financial performance, cash flow, and financial position during fiscal 2015:

Additional work required on several contracts

Gross profit for fiscal 2015 decreased by $6.7 million, or 46.1%, compared to fiscal 2014. 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 out-of-scope work required on several contracts, for some of which we are pursuing recoveries. On April 24, 2014, we reached a favorable settlement agreement on the first of these recoveries that partially offset the effects of the additional work during fiscal 2014. 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. Further, the Company is now well into the testing phase with one of these contracts, and will shortly be in testing phase with the other, so any future impacts on our financial performance should be minimal in comparison to fiscal 2015.

Market for our monoplace chambers

Our monoplace chambers are sold primarily to hospitals and wound care clinics, both of which appeared to delay purchases during fiscal 2015 in response to the Affordable Care Act (“ACA”). Sales of monoplace chambers decreased by $2.2 million, or 61.6%, during fiscal 2015 compared to fiscal 2014. The uncertainty created in the healthcare sector

by the ACA appears to be diminishing, however, as orders received during just the first quarter of fiscal 2016 have already surpassed orders received during all of fiscal 2015.

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

During the past two fiscal years, we have spent $2.8 million (including $1.5 million in fiscal 2015) for capital improvements. Most of this investment has been related to the 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 and UPRT business development. Going forward, we expect to continue to invest in new capabilities for our ATFS line of products and enhance our UPRT capabilities.

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 consolidated 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;
- inventory valuation and reserves;
- 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;
- legal reserves and contingencies; and
- 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.

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 thousand 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". If at any time during performance 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. 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 thousand, 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 realizability 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 2015 versus Fiscal 2014

Summary Table of Results

(in thousands, except per share information)	**Fiscal 2015**	**Fiscal 2014**	**Variance ($)**	**Variance (%)**
Net sales:				
Domestic sales	$ 16,771	$ 11,610	$ 5,161	44.5
U.S. Government sales	7,562	12,119	(4,557)	(37.6)
International sales	13,007	24,545	(11,538)	(47.0)
Net sales total	37,340	48,274	(10,934)	(22.6)
Gross profit	7,850	14,559	(6,709)	(46.1)
Gross profit margin %	*21.0%*	*30.2%*	*-9.2%*	*-30.5%*
Operating expenses:				
Selling and marketing expenses	4,696	4,591	105	2.3
General and administrative expenses	6,656	5,777	879	15.2
Research and development expenses	1,335	1,730	(395)	(22.8)
Operating expenses total	12,687	12,098	589	4.9
Operating (loss) income	(4,837)	2,461	(7,298)	(296.5)
Operating margin %	*-13.0%*	*5.1%*	*-18.1%*	*-354.9%*
Interest expense, net	745	808	(63)	(7.8)
Other expense, net	439	381	58	15.2
(Loss) income before income taxes	(6,021)	1,272	(7,293)	(573.3)
Pre-tax margin %	*-16.1%*	*2.6%*	*-18.7%*	*-719.2%*
Income tax (benefit) provision	(2,293)	670	(2,963)	(442.2)
Net (loss) income	(3,728)	602	(4,330)	(719.3)
Loss (income) attributable to non-controlling interest	13	(3)	16	(533.3)
Net (loss) income attributable to ETC	**$ (3,715)**	**$ 599**	**$ (4,314)**	**(720.2)**
Per share information:				
Basic earnings (loss) per common and participating share:				
Distributed earnings per share:				
Common	$ -	$ -	$ -	
Preferred	$ 0.08	$ 0.08	$ -	0.0
Undistributed (loss) earnings per share:				
Common	$ (0.28)	$ 0.01	$ (0.29)	(2900.0)
Preferred	$ (0.28)	$ 0.01	$ (0.29)	(2900.0)
Diluted (loss) earnings per share	**$ (0.27)**	**$ 0.01**	**$ (0.28)**	**(2800.0)**

Net (loss) income attributable to ETC

Net loss attributable to ETC was $3.7 million, or $0.27 diluted loss per share, in fiscal 2015, compared to $0.6 million of net income attributable to ETC during fiscal 2014, or $0.01 diluted earnings per share. The $4.3 million variance reflects a decrease in income before income taxes of $7.3 million due to a $6.7 million decrease in gross profit resulting from a combination of lower net sales and lower gross profit margin percentage, as well as a $0.6 million increase in operating expenses. The $7.3 million decrease in income before income taxes was offset, in part, by a $3.0 million variance between the income tax benefit recorded in fiscal 2015 and the income tax expense recorded in fiscal 2014.

Net sales

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

	Fiscal 2015				Fiscal 2014			
	Domestic	**U.S. Gov't**	**International**	**Total**	**Domestic**	**U.S. Gov't**	**International**	**Total**
Aerospace Solutions								
ATS	$ 412	$ 4,752	$ 7,675	$ 12,839	$ 431	$ 1,726	$ 10,640	$ 12,797
Chambers	-	2,287	1,499	3,786	-	9,751	5,333	15,084
Simulation (ADMS)	1,485	511	1,539	3,535	555	149	1,371	2,075
ETC-PZL and other	185	-	1,756	1,941	151	-	4,171	4,322
Subtotal	2,082	7,550	12,469	22,101	1,137	11,626	21,515	34,278
Commercial/Industrial Systems								
Sterilizers	7,805	-	48	7,853	5,564	-	1,184	6,748
Environmental	4,062	12	43	4,117	1,049	493	-	1,542
Hyperbaric	936	-	447	1,383	1,761	-	1,840	3,601
Service and spares	1,886	-	-	1,886	2,099	-	6	2,105
Subtotal	14,689	12	538	15,239	10,473	493	3,030	13,996
Net sales total	**$ 16,771**	**$ 7,562**	**$ 13,007**	**$ 37,340**	**$ 11,610**	**$ 12,119**	**$ 24,545**	**$ 48,274**

Net sales for fiscal 2015 were $37.3 million, a decrease of $10.9 million, or 22.6%, from fiscal 2014. The reduction reflects decreased sales related to Chambers within our Aerospace segment to the U.S. Government, decreased sales in general to International customers, and decreased sales of mono-place chambers, offset in part, by increased ATS sales to the U.S. Government due primarily to an order for five (5) GYRO IPT II's, and increased sales of Environmental Testing and Simulation Systems, Sterilization Systems, and our ADMS line of products to Domestic customers. Given the current progress made on U.S. Government contracts in the Company's sales backlog, coupled with significant fiscal 2015 International bookings and the recent award of multiple International contracts totaling $45.4 million, the Company anticipates that although sales to the U.S. Government will remain steady, the concentration of sales to the U.S. Government will continue to lessen in fiscal 2016.

In fiscal 2015, one customer, a U.S. defense agency in the Aerospace segment, represented 10.0% or more of total net sales, and sales to this customer totaling $7.1 million represented 19.0% of total net sales. 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. Within the Company's February 27, 2015 sales backlog of $32.5 million for work to be performed and revenue to be recognized under written agreements after such date, two contracts (both with International customers), each representing at least 10% of the total sales backlog, together constituted $9.2 million, or 28.3%, of the total sales backlog. ATS backlog was $13.4 million, or 41.2%, of the total sales backlog; Chambers backlog was $6.9 million, or 21.3%, of the total sales backlog; and Sterilizers backlog was $5.0 million, or 15.4%, 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 2015 were $16.8 million, an increase of $5.2 million, or 44.5%, compared to fiscal 2014, and represented 44.9% of total net sales compared to 24.1% in fiscal 2014. The increase in Domestic sales is primarily a result of a $3.0 million, or 287.2%, increase in sales of Environmental Testing and Simulation Systems, a $2.2 million, or 40.3%, increase in sales of Sterilization Systems, and a $0.9 million, or 167.6%, increase in sales of our ADMS line of products.

U.S. Government sales

U.S. Government sales in fiscal 2015 were $7.6 million, a decrease of $4.6 million, or 37.6%, from fiscal 2014 as a result of our U.S. Government contracts transitioning into or near the testing phase. U.S. Government sales represented 20.3% of total net sales in fiscal 2015 compared to 25.1% in fiscal 2014. Given the current progress made on U.S. Government contracts in the Company's sales backlog, coupled with significant fiscal 2015 International bookings and the recent award of multiple International contracts totaling $45.4 million, the Company anticipates that although sales to the U.S. Government will remain steady, the concentration of sales to the U.S. Government will continue to lessen in fiscal 2016.

International sales

International sales in fiscal 2015, including those of the Company's foreign subsidiaries, were $13.0 million, a decrease of $11.5 million, or 47.0%, from fiscal 2014 due to significant decreases for all business units with the exception of Simulation (ADMS), Environmental, and Service and Spares. In aggregate, International sales represented 34.8% of the Company's total net sales in fiscal 2015 compared to 50.8% in fiscal 2014. In fiscal 2015, International sales totaling at least $500 thousand were made to customers in ten (10) different countries; in fiscal 2014, International sales totaling at least $500 thousand were made to customers in nine (9) different countries.

Segment sales

Aerospace sales were $22.1 million in fiscal 2015, a decrease of $12.2 million, or 35.5%, from sales of $34.3 million in fiscal 2014. This decrease was primarily due to fewer sales related to Chambers and less ETC-PZL sales, offset in part, by an increase in Simulation sales. Sales of Aerospace products accounted for 59.2% of our total net sales in fiscal 2015 versus 71.0% in fiscal 2014. Sales in our CIS segment increased $1.2 million, or 8.9%, and constituted 40.8% of our total net sales in fiscal 2015 compared to 29.0% in fiscal 2014. The increase was due primarily to the recognition of sales related to Environmental Testing and Simulation Systems and Sterilization Systems domestically that were recorded as bookings later in fiscal 2014.

Given the Company's sales backlog as of February 27, 2015, coupled with the recent award of multiple International contracts totaling $45.4 million, it is anticipated that our Aerospace segment will continue to generate the majority of its sales from International contracts, while the majority of sales within our CIS segment will continue to be generated domestically.

Gross profit

Gross profit for fiscal 2015 was $7.9 million compared to $14.6 million in fiscal 2014, a decrease of $6.7 million, or 46.1%. 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 out-of-scope work required on several contracts, for some of which we are pursuing recoveries. On April 24, 2014, we reached a favorable settlement agreement on the first of these recoveries that partially offset the effects of the additional work during fiscal 2014. Further, the Company is now well into the testing phase with one of these contracts, and will shortly be in testing phase with the other. Gross profit margin as a percentage of net sales decreased to 21.0% in fiscal 2015 compared to 30.2% in fiscal 2014.

Selling and marketing expenses

Selling and marketing expenses for fiscal 2015 of $4.7 million increased slightly by $0.1 million, or 2.3%, compared to fiscal 2014. The slight increase is the combined result of an increase in commissions expense as the concentration of net sales shifts away from U.S. Government, offset in part, by an on-going effort to reduce non-revenue generating expenses. As a percentage of net sales, selling and marketing expenses increased to 12.6% in fiscal 2015 from 9.5% in fiscal 2014 due primarily to both lower net sales and a lower concentration of sales to the U.S. Government in fiscal 2015.

General and administrative expenses

General and administrative expenses for fiscal 2015 of $6.7 million increased by $0.9 million, or 15.2%, from fiscal 2014. The increase is the combined result of an increase in certain reserves related to ETC-PZL, an increase in the vacation accrual due to a policy change, and an increase in legal fees associated primarily with the aforementioned recovery effort. As a percentage of net sales, general and administrative expenses increased to 17.8% in fiscal 2015 compared to 12.0% in fiscal 2014 due primarily to lower net sales in fiscal 2015.

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 $1.3 million for fiscal 2015 compared to $1.7 million in fiscal 2014, a decrease of $0.4 million, or 22.8%. The decrease is the combined result of both increased grant payments to offset expenses and more research and development employees being assigned to specific contracts; thus, expenses related to these employees were included in cost of sales in fiscal 2015. 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 remained flat at 3.6% for both fiscal 2015 and fiscal 2014.

Operating (loss) income

Operating loss in fiscal 2015 was $4.8 million compared to operating income in fiscal 2014 of $2.5 million. The $7.3 million variance is due primarily to a $6.7 million decrease in gross profit, resulting from a combination of lower net sales and lower gross profit margin percentage, as well as a $0.6 million increase in operating expenses.

On a segment basis, Aerospace posted an operating loss of $4.1 million for fiscal 2015, an $8.1 million, or 201.9%, decrease compared to operating income of $4.1 million in fiscal 2014. CIS had operating income of $0.5 million for fiscal 2015, a $0.1 million, or 13.0%, increase in operating income compared to $0.4 million in fiscal 2014. These segment operating results were offset, in part, by unallocated corporate expenses.

Interest expense, net

Interest expense, net, for fiscal 2015 was $0.7 million compared to $0.8 million in fiscal 2014, a decrease of $0.1 million, or 7.8%, due primarily to a lower level of bank borrowing throughout fiscal 2015 as a whole compared to fiscal 2014.

Other expense, net

Other expense, net remained flat at $0.4 million for both fiscal 2015 and fiscal 2014. Other expense, net consists primarily of bank and letter of credit fees, as well as realized foreign currency exchange gains and losses.

Income taxes

As of February 27, 2015, 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. The Company currently has a net deferred tax asset related primarily to its federal net operating loss carryforwards of $6.3 million. An income tax benefit of $2.3 million was recorded in fiscal 2015; whereas, an income tax provision of $0.7 million was recorded in fiscal 2014.

Effective tax rates were 38.1% and 52.7% for fiscal 2015 and fiscal 2014, respectively. Our effective fiscal 2015 tax rate was lower than fiscal 2014 and more in line with the expected normal effective tax rate primarily due to the lack of an increased federal deferred tax expense as a percentage of income before income taxes that occurred in fiscal 2014.

As of February 27, 2015, the Company had approximately $17.0 million of federal net loss carryforwards 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.

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 with PNC Bank, National Association ("PNC Bank") in the amount of $5.4 million at that time. 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 that supported a bid bond no longer reduced availability under the PNC Line of Credit so long as it remained outstanding.

(iii) The Term Loan, which was originally guaranteed by H.F. Lenfest ("Mr. Lenfest"), a major shareholder and Chairman of the Board, through March 31, 2015, was to 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 occured 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 was to 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 was to remain at that level at all times thereafter.

(vi) ETC was to 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 increased to 1.10 to 1 on August 30, 2014, and was to 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 was based on the PNC Daily Libor Rate (currently 0.185%) plus a margin of 3.00%.

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 replaced 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.

On November 5, 2014, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the following:

(i) A new $11.7 million Committed Line of Credit (the "Committed Line of Credit") under which the Company covers the majority of its existing $6.0 million in standby letters of credit and will cover any future standby letters of credit.

(ii) The Committed Line of Credit is and will continue to be collateralized by Mr. Lenfest until such time the Company is in position to pledge its own cash collateral.

(iii) The Company's existing PNC Line of Credit was decreased from $15.5 million to $13.5 million; however, $2.1 million of funds deemed to have been restricted as of August 29, 2014 is now considered unrestricted and is being used as working capital.

(iv) No monthly principal payments shall be due and payable on the existing Term Loan from September 29, 2014 through October 27, 2015. Monthly principal payments will commence on October 28, 2015, and continue for each succeeding month thereafter. Interest shall still be payable on a monthly basis, regardless of whether or not any principal payment is due. Any outstanding principal and accrued interest shall be due and payable in full on September 28, 2017, which is the current maturity date.

(v) The Company received a waiver as of the fiscal quarter ended August 29, 2014 for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. Going forward, ETC must maintain at all times a minimum Consolidated Tangible Net Worth of $20.0 million; further, commencing with the fiscal quarter ending August 28, 2015, ETC must maintain as of the end of each fiscal quarter, an Operating Leverage Ratio not greater than 3.00 to 1 and a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio will increase to 1.10 to 1 on November 27, 2015, and will remain at that level at all times thereafter.

(vi) Effective as of the date of this amendment, the interest rate on all PNC Lines of Credit, as well as the Term Loan Note, will be based on the PNC Daily Libor Rate (currently 0.185%) plus a margin of 4.00%.

As of February 27, 2015, the Company's availability under the PNC Line of Credit, which is currently scheduled to expire on October 31, 2015, was $0.8 million. This reflected cash borrowings of $12.6 million and net outstanding standby letters of credit not covered by the Committed Line of Credit of approximately $0.1 million. As of May 28, 2015, the date of issuance of our consolidated financial statements, the Company's availability under the PNC Line of Credit was approximately $1.9 million. Working capital was $8.0 million and $26.5 million as of February 27, 2015 and February 28, 2014, respectively. The decrease in working capital was primarily the result of the PNC Line of Credit now being classified as current, a decrease in costs and estimated earnings in excess of billings on uncompleted long-term POC contracts, and the decrease in restricted cash noted above. 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.

With unused availability under and expected extension of the PNC Line of Credit, anticipated availability under the Ex-Im and ETC-PZL Lines of Credit, the conversion of costs and estimated earnings in excess of billings on uncompleted long-term POC contracts into cash, and the collection of early milestone payments associated with the recent award of multiple International contracts totaling $45.4 million, the Company anticipates its sources of liquidity will be sufficient to fund its operating activities, anticipated capital expenditures, and debt repayment obligations throughout fiscal 2016.

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 2015, as a result of the significant net loss and a decrease in customer deposits, offset in part, by a decrease in costs and estimated earnings in excess of billings on uncompleted long-term POC contracts, the Company used $0.5 million of cash in operating activities compared to $0.6 million of cash used in operating activities in fiscal 2014.

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 2015 investing activities used $1.5 million, which consisted primarily of equipment and software enhancements for our ATFS technology and UPRT capabilities, 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 2014.

Cash flows from financing activities

The Company's financing activities generated $1.6 million during fiscal 2015 as compared to $0.1 million in fiscal 2014. The principal use of cash was $1.7 million of payments on the Term Loan. These were offset by $0.9 million in borrowings under the Company's various lines of credit and a $2.4 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 potential acquisition of businesses, the payment of contractual and other legal obligations, including scheduled interest payments on credit facilities and dividends on Preferred Stock and/or the purchase, redemption, or retirement of our credit facilities and Preferred Stock when allowable per the October 11, 2013 amendment to the September 28, 2012 Loan Agreement. We expect that net sales of our currently marketed products, combined with the current and anticipated future availability under our lines of credit, the conversion of costs and estimated earnings in excess of billings on uncompleted long-term POC contracts into cash, and the collection of early milestone payments associated with the recent award of multiple International contracts totaling $45.4 million, should continue to provide us sufficient funds for fiscal 2016. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated results in fiscal 2017 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 2015 or fiscal 2014 other than disclosed in Note 10 – Commitments and Contingencies 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

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 September 18, 2014, the Company announced that it made a management transition. Mr. Lenfest was named Chairman of the Board of Directors, and Robert L. Laurent, Jr. was named Chief Executive Officer, while continuing as President. The Chairman and Chief Executive Officer positions were formerly held by William F. Mitchell, Sr., who retired and resigned from the Board of Directors effective September 19, 2014. Also as part of the management transition, Mr. Laurent was appointed to the Board of Directors and George K. Anderson, M.D., a member of the Board of Directors since 2003, was appointed as Vice Chairman of the Board of Directors.

MANAGEMENT'S REPORT

Management is responsible for the preparation as well as the integrity and objectivity of the accompanying consolidated financial statements of Environmental Tectonics Corporation. These consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and necessarily include amounts that 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 consolidated 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 consolidated 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.

Robert L. Laurent, Jr.
Chief Executive Officer and 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 27, 2015 and February 28, 2014 and the related consolidated statements of operations and comprehensive (loss) 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 as of and for the years ended February 27, 2015 and February 28, 2014, 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 27, 2015 and February 28, 2014, 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
May 28, 2015

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

CONSOLIDATED BALANCE SHEETS

(in thousands, except share information)	February 27, 2015	February 28, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 611	$ 935
Restricted cash	2,516	4,954
Accounts receivable, net	5,812	5,974
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	17,698	21,637
Inventories, net	3,610	3,645
Deferred tax assets, current	1,298	2,090
Prepaid expenses and other current assets	809	526
Total current assets	32,354	39,761
Property, plant and equipment, at cost, net	14,174	14,342
Capitalized software development costs, net	125	274
Deferred tax assets, non-current, net	4,953	1,751
Other assets	44	64
Total assets	**$ 51,650**	**$ 56,192**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt obligations	$ 14,052	$ 3,250
Accounts payable, trade	2,605	2,769
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	3,014	2,922
Customer deposits	1,073	1,789
Accrued taxes	175	124
Accrued interest and dividends	1,044	552
Other accrued liabilities, current	2,362	1,819
Total current liabilities	24,325	13,225
Long-term debt obligations, less current portion:		
Credit facility payable to bank	-	11,664
Term loan	6,569	6,569
Total long-term debt obligations, less current portion	6,569	18,233
Other accrued liabilities, non-current	503	408
Total liabilities	31,397	31,866
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Cumulative convertible participating Preferred Stock, Series E, $0.05 par value, 25,000 shares authorized; 12,127 shares outstanding as of February 27, 2015 and February 28, 2014	12,127	12,127
Common Stock, $0.05 par value, 50,000,000 shares authorized; 9,185,161 share issued and outstanding as of February 27, 2015 and February 28, 2014	459	459
Additional paid-in capital	9,506	9,954
(Accumulated deficit) / Retained earnings	(1,358)	2,357
Accumulated other comprehensive loss	(526)	(629)
Total shareholders' equity before non-controlling interest	20,208	24,268
Non-controlling interest	45	58
Total shareholders' equity	20,253	24,326
Total liabilities and shareholders' equity	**$ 51,650**	**$ 56,192**

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME

(in thousands, except per share information)	Fiscal year ended February 27, 2015	Fiscal year ended February 28, 2014
Net sales	$ 37,340	$ 48,274
Cost of goods sold	29,490	33,715
Gross profit	7,850	14,559
Operating expenses:		
Selling and marketing	4,696	4,591
General and administrative	6,656	5,777
Research and development	1,335	1,730
Operating expenses total	12,687	12,098
Operating (loss) income	(4,837)	2,461
Other expenses:		
Interest expense, net	745	808
Other expense, net	439	381
Other expenses total	1,184	1,189
(Loss) income before income taxes	(6,021)	1,272
Income tax (benefit) provision	(2,293)	670
Net (loss) income	(3,728)	602
Loss (income) attributable to non-controlling interest	13	(3)
Net (loss) income attributable to Environmental Tectonics Corporation	**(3,715)**	**599**
Foreign currency translation adjustment and unrealized gain on cash flow hedge	103	(32)
Comprehensive (loss) income	$ (3,612)	$ 567
Preferred Stock dividends	(484)	(493)
(Loss) income attributable to common and participating shareholders	$ (4,199)	$ 106
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed (loss) earnings per share:		
Common	$ (0.28)	$ 0.01
Preferred	$ (0.28)	$ 0.01
Diluted (loss) earnings per share	**$ (0.27)**	**$ 0.01**
Basic weighted average common and participating shares:		
Common weighted average number of shares	9,185	9,183
Participating preferred shares	6,063	6,063
Total basic weighted average common and participating shares	15,248	15,246
Diluted weighted average shares:		
Basic weighted average common and participating shares	15,248	15,246
Dilutive effect of stock warrants and options	245	231
Total diluted weighted average shares	15,493	15,477

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	Retained Earnings / (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, February 22, 2013	$ 12,127	9,180,161	$ 459	$ 9,924	$ 2,251	$ (597)	$ 24,164
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**
Less: Prior year non-controlling interest	-	-	-	-	-	-	(58)
Net loss attributable to Environmental Tectonics Corporation	-	-	-	-	(3,715)	-	(3,715)
Foreign currency translation adjustment	-	-	-	-	-	93	93
Unrealized gain on cash flow hedge	-	-	-	-	-	10	10
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	36	-	-	36
Balance before non-controlling interest, February 27, 2015	12,127	9,185,161	459	9,506	(1,358)	(526)	20,208
Non-controlling interest	-	-	-	-	-	-	45
Balance, February 27, 2015	**$ 12,127**	**9,185,161**	**$ 459**	**$ 9,506**	**$ (1,358)**	**$ (526)**	**$ 20,253**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Fiscal year ended February 27, 2015	Fiscal year ended February 28, 2014
Cash flows from operating activities:		
Net (loss) income	$ (3,728)	$ 602
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	1,809	1,803
Deferred tax assets	(2,469)	909
Increase in valuation allowance for deferred tax assets	59	62
Decrease in allowance for doubtful accounts and inventory obsolescence	(5)	(925)
Accretion of loan origination deferred charge and deferred financing costs	38	35
Stock compensation expense	36	20
Issuance of Common Stock	-	10
Gain on sale of assets	(6)	-
Changes in operating assets and liabilities:		
Accounts receivable	167	692
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	3,939	(1,688)
Inventories	35	1,007
Prepaid expenses and other assets	(283)	773
Accounts payable, trade	(164)	(1,662)
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	92	260
Customer deposits	(716)	(1,029)
Accrued taxes	51	(156)
Accrued interest and dividends	8	(17)
Other accrued liabilities	648	(1,248)
Net cash used in operating activities	**(489)**	**(552)**
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(1,497)	(1,315)
Proceeds from sale of assets	19	-
Capitalized software development costs	(8)	(117)
Net cash used in investing activities	**(1,486)**	**(1,432)**
Cash flows from financing activities:		
Borrowings under lines of credit	888	3,729
Payments of Preferred Stock dividends	-	(407)
Decrease in restricted cash	2,438	1,208
Payments on the Term Loan and of other debt obligations	(1,750)	(4,431)
Payments of deferred financing and Preferred Stock repurchase costs	(18)	(10)
Net cash provided by financing activities	**1,558**	**89**
Effect of exchange rate changes on cash	93	(47)
Net decrease in cash and cash equivalents	(324)	(1,942)
Cash and cash equivalents at beginning of period	935	2,877
Cash and cash equivalents at end of period	**$ 611**	**$ 935**
Supplemental schedule of cash flow information:		
Interest paid	$ 761	$ 823
Income taxes paid	$ 45	$ 201
Supplemental information on non-cash operating and investing activities:		
Preferred Stock dividends accrued during each respective fiscal year	$ 484	$ 493
Unrealized gain on cash flow hedge	$ 10	$ 15

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) hyperbaric chambers for multiple persons (multiplace chambers); (iv) Advanced Disaster Management Simulators ("ADMS"); (v) steam and gas (ethylene oxide) sterilizers; (vi) environmental testing and simulation devices; and (vii) hyperbaric (100% oxygen) chambers for one person (monoplace chambers). We operate in two primary business segments, Aerospace Solutions ("Aerospace") and Commercial/Industrial Systems ("CIS"). Net sales, operating income, identifiable assets, and other financial information regarding our segments may be found in Note 8 – Business Segment Information.

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 and to civil aviation organizations. We offer integrated Aircrew Training Systems to commercial, governmental, and military defense agencies, and training devices, including altitude (hypobaric) and multiplace chambers ("Chambers"), to governmental and military defense agencies and civil aviation organizations both in the United States and internationally. We sell our ADMS line of products to state and local governments, fire and emergency training schools, and airports. We also provide integrated logistics support for customers who purchase these products or similar products manufactured by other parties.

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

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 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 ended February 27, 2015. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2015.

Sales Backlog

Below is a breakdown of the Company's February 27, 2015 sales backlog (amounts in thousands, except percentages):

	Business segment			
Geographic area	**Aerospace**	**CIS**	**Total**	**%**
Domestic	$ 1,002	$ 5,996	$ 6,998	21.5%
U.S. Government	7,553	17	7,570	23.3
International	17,900	44	17,944	55.2
Total	**$ 26,455**	**$ 6,057**	**$ 32,512**	**100.0%**
% of Total	81.4%	18.6%	100.0%	

Our sales backlog as of February 27, 2015, for work to be performed and revenue to be recognized under written agreements after such dates, was $32,512. Of the February 27, 2015 sales backlog, three product lines (ATS, Chambers, and Sterilizers) represented at least 10% of the total backlog (ATS was $13,417, or 41.2%, of the total sales backlog; Chambers was $6,921, or 21.3%, of the total sales backlog; Sterilizers was $4,999, or 15.4%, of the total sales backlog). Of the February 27, 2015 sales backlog, $9,191, or 28.3%, represents two contracts (both with International customers). As disclosed in Note 13 – Subsequent Events, on April 14, 2015, the Company's ATS business unit announced the award of multiple contracts totaling $45,400 for customers in the Middle East, Southeast Asia, and Europe, $38,000 of which would have increased the Company's sales backlog as of February 27, 2015. As of May 28, 2015, the date of issuance of our consolidated financial statements, the Company's sales backlog was approximately $65,300.

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 the consolidated 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 consolidated 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 ("POC") method, valuations of long-lived assets, inventory and legal reserves, 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 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". If at any time during performance 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. 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 $2,516 as of February 27, 2015 compared to $4,954 as of February 28, 2014. Restricted cash is comprised primarily of collateral for a dedicated line of credit in the amount of $2,131 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 $2,131 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 performance 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 $1,834 or 28.3%, of total net accounts receivable as of February 27, 2015. Subsequent to fiscal year end and prior to May 28, 2015, 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 $15,281 and $14,117 as of February 27, 2015 and February 28, 2014, respectively. The net book value of demonstration equipment was $9,520 and $9,259 as of February 27, 2015 and February 28, 2014, 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 2015, $981 of machinery and equipment, all of which was fully depreciated, was retired. In fiscal 2015, $25 of machinery and equipment, with a net book value of $13, was sold. No such retirements or sales 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 $157 and $221 in fiscal 2015 and fiscal 2014, respectively. Estimated software amortization, which is based on existing capitalized software, for each of the next five (5) fiscal years is as follows: $90 in fiscal 2016; $33 in fiscal 2017; $2 in fiscal 2018; and $0 in fiscal 2018, 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 2015 and fiscal 2014, the Company was involved with one (1) and two (2) such grants, respectively. Payments received under these grants are recorded as a reduction of research and development costs. Such payments totaled $872 in fiscal 2015 and $555 in fiscal 2014. Research and development expenses, which totaled $2,207 in fiscal 2015 and $2,285 in fiscal 2014, 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 $1,335 for fiscal 2015 compared to $1,730 for fiscal 2014.

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 2015 or fiscal 2014.

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 straightline 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 23,000 options granted in fiscal 2015; there were 151,500 options granted in fiscal 2014.

Advertising Costs

The Company expenses advertising costs, which include trade shows, as incurred. Advertising costs were $389 and $420 in fiscal 2015 and fiscal 2014, 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 one class of cumulative

convertible participating Preferred Stock, 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 27, 2015 and February 28, 2014, 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 Related Equity 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 antidilution protection in the event the Company issued securities at a price below the exercise price set forth in the warrants.

As of February 27, 2015 and February 28, 2014, there were outstanding options to purchase the Company's Common Stock totaling 254,798 and 354,406 shares at an average price of $3.18 and $3.34 per share, respectively. Due to the conversion price of certain Common Stock options, 113,298 and 354,406 shares were excluded from the calculation of diluted earnings per share as of February 27, 2015 and February 28, 2014, respectively, because the effect of their conversion would be antidulutive.

Recent Accounting Pronouncements

In May 2014, as part of its ongoing efforts to assist in the convergence of accounting principles generally accepted in the United States of America and International Financial Reporting Standards, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. Under the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 will be effective for our fiscal 2018, which began on February 25, 2017; early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We anticipate this standard will have a material impact, and we are currently evaluating the impact this standard will have on our consolidated financial statements.

In April 2015, as part of its initiative to reduce complexity in accounting standards, the FASB issued ASU No. 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs, however, are not affected. ASU 2015-03 will be effective for our fiscal 2017, which began on February 27, 2016. 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 27, 2015	February 28, 2014
U.S. Commercial ("Domestic")	$ 1,677	$ 1,396
U.S. Government	1,627	2,708
International	2,903	2,270
	6,207	6,374
Less: allowance for doubtful accounts	(395)	(400)
Accounts receivable, net	**$ 5,812**	**$ 5,974**

3. Costs and Estimated Earnings on Uncompleted Contracts

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

	February 27, 2015	February 28,2014
Cost incurred on uncompleted long-term contracts	$ 135,158	$ 124,626
Estimated earnings	56,173	70,138
	191,331	194,764
Less: billings to date	(176,647)	(176,049)
	$ 14,684	**$ 18,715**

Included in accompanying balance sheets under the following captions:

	February 27, 2015	February 28, 2014
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	$ 17,698	$ 21,637
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(3,014)	(2,922)
	$ 14,684	$ 18,715

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 2015 and fiscal 2014.

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 27, 2015	February 28, 2014
Raw materials	$ 160	$ 132
Work in process	3,315	3,513
Finished goods	135	-
Inventories, net	**$ 3,610**	**$ 3,645**

Inventory is presented net of an allowance for obsolescence of $214 (raw material $55 and work in process $159), and $214 (raw material $47 and work in process $167) as of February 27, 2015 and February 28, 2014, 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 27, 2015	February 28, 2014
Land	$ 100	$ 100
Buildings and building additions	3,851	3,851
Machinery and equipment	10,832	11,698
Demonstration equipment	15,281	14,117
Office furniture and equipment	1,323	1,319
Building improvements	3,126	3,096
Construction in process	567	408
	35,081	34,590
Less: accumulated depreciation	(20,907)	(20,248)
Property, plant, and equipment, at cost, net	**$ 14,174**	**$ 14,342**

Depreciation expense for fiscal 2015 and fiscal 2014 was $1,652 and $1,582, respectively.

As of both February 27, 2015 and February 28, 2014, 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 Chairman 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. The Company is currently participating in on-going discussions with PNC Bank to extend this line of credit prior to the current expiry date.

(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 was originally guaranteed by Mr. Lenfest for a period of thirty (30) months, (i.e., until March 31, 2015), after which the guarantee was to 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 outstanding 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 is currently participating in on-going discussions with PNC Bank to extend this line of credit prior to the current expiry date. 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 27, 2015, the Company's availability under the PNC Line of Credit was $786. This reflected cash borrowing under the PNC Line of Credit of $12,602 and outstanding standby letters of credit of approximately $112. As of May 28, 2015, the date of issuance of our consolidated financial statements, the Company's availability under the PNC Line of Credit was approximately $1,900. The Term Loan was originally guaranteed by Mr. Lenfest for a period of thirty (30) months, (i.e., until March 31, 2015), after which the guarantee was to 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. See "Fiscal 2015 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 $10 and $15 in fiscal 2015 and fiscal 2014, 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 27, 2015, we have determined the hedge to be effective. See Note 12 – 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 27, 2015 and February 28, 2014. 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 an outstanding letter of credit that supported a bid bond no longer reduced availability under the PNC Line of Credit so long as it remained outstanding.

(iii) The Term Loan, which was originally guaranteed by Mr. Lenfest through March 31, 2015, was to 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 occured 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 was to 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 was to remain at that level at all times thereafter.

(vi) ETC was to 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 increased to 1.10 to 1 on August 30, 2014, and was to 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 was based on the PNC Daily Libor Rate (currently 0.185%) plus a margin of 3.00%.

Fiscal 2015 Amendments to the September 28, 2012 Loan Agreement

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 replaced 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.

On November 5, 2014, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the following:

(i) A new $11,700 Committed Line of Credit (the "Committed Line of Credit") under which the Company covers the majority of its existing $5,960 in standby letters of credit and will cover any future standby letters of credit.

(ii) The Committed Line of Credit is and will continue to be collateralized by Mr. Lenfest until such time the Company is in position to pledge its own cash collateral.

(iii) The Company's existing PNC Line of Credit was decreased from $15,500 to $13,500; however, $2,110 of funds deemed to have been restricted as of August 29, 2014 is now considered unrestricted and is being used as working capital.

(iv) No monthly principal payments shall be due and payable on the existing Term Loan from September 29, 2014 through October 27, 2015. Monthly principal payments will commence on October 28,

2015, and continue for each succeeding month thereafter. Interest shall still be payable on a monthly basis, regardless of whether or not any principal payment is due. Any outstanding principal and accrued interest shall be due and payable in full on September 28, 2017, which is the current maturity date.

(v) The Company received a waiver as of the fiscal quarter ended August 29, 2014 for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. Going forward, ETC must maintain at all times a minimum Consolidated Tangible Net Worth of $20,000; further, commencing with the fiscal quarter ending August 28, 2015, ETC must maintain as of the end of each fiscal quarter, an Operating Leverage Ratio not greater than 3.00 to 1 and a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio will increase to 1.10 to 1on November 27, 2015, 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 all PNC Lines of Credit, as well as the Term Loan Note, will be based on the PNC Daily Libor Rate (currently 0.185%) plus a margin of 4.00%.

Preferred Stock

Presently, the Company has one class of cumulative convertible participating Preferred Stock, Series E (25,000 shares authorized) (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 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 Preferred Stock dividends accruing through this date were recorded in the accompanying consolidated financial statements as a reduction of additional paid-in capital. During fiscal 2013, the Company entered into a position of retained earnings; thus, all $1,511 and $493 of dividends recorded during fiscal 2013 and fiscal 2014, respectively, were recorded as a reduction to retained earnings. Due to the significant net loss incurred in fiscal 2015, all $484 of dividends recorded during fiscal 2015 were recorded as a reduction to retained earnings.

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 27, 2015.

As of both February 27, 2015 and February 28, 2014, 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 through February 22, 2013 have been paid in cash. Series E Preferred Stock dividends accrued during the period February 23, 2013 through February 28, 2015, which totaled $977, remained unpaid as of May 28, 2015, 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 $2,131 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. On November 5, 2014, the certificate of deposit was further reduced by $2,110 in conjunction with the reduction of a performance bond associated with the same international contract for multiple Aerospace products. As of February 27, 2015, $2,131 remains deposited in a certificate of deposit with PNC as security for the Dedicated Line of Credit.

Export Import 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 0.185%) plus a margin of 4.00%. 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 $200 and $250 as of February 27, 2015 and February 28, 2014, respectively.

ETC-PZL Line of Credit Agreement

As disclosed in Note 13 – Subsequent Events, on March 3, 2015, ETC-PZL entered into a loan agreement with a bank in Warsaw, Poland, whereby ETC-PZL obtained a $1,200 line of credit (the "ETC-PZL Line of Credit") to fund current activity. Beginning on April 30, 2015, availability will decrease by approximately $120 each month and amounts may be borrowed, repaid, and re-borrowed, subject to availability, from time to time until December 10, 2015. Any amounts outstanding as of this date must be paid back by February 15, 2016. As of both February 27, 2015 and February 28, 2014, 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 27, 2015	February 28, 2014
Credit facility payable to bank	$ 12,602	$ 11,664
Term Loan	7,819	9,569
Borrowed under Ex-Im Line of Credit	200	250
Total long-term debt obligations	20,621	21,483
Less: current portion of long-term debt obligations	(14,052)	(3,250)
Total long-term debt obligations, less current portion	**$ 6,569**	**$ 18,233**

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 2016	$ 14,052
Fiscal 2017	3,000
Fiscal 2018	3,000
Fiscal 2019	569
Fiscal 2020	-
Total future long-term debt obligations	**$ 20,621**

7. 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 27, 2015, 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; $617 of the $785 foreign net operating loss carryforwards available as of February 27, 2015 have been fully reserved. The Company currently has a net deferred tax asset related primarily to its federal net operating loss carryforwards of $6,251. An income tax benefit of $2,293 was recorded in fiscal 2015; whereas, an income tax provision of $670 was recorded in fiscal 2014.

As of February 27, 2015, the Company had approximately $17,006 of federal net loss carryforwards 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 27, 2015	**February 28, 2014**
Current tax expense (benefit):		
U.S. Federal	$ 22	$ 20
U.S. State	9	(87)
Foreign	86	(234)
Total current	**117**	**(301)**
Deferred tax (benefit) expense:		
U.S. Federal	$ (2,054)	$ 869
U.S. State	(209)	(3)
Foreign	(147)	105
Total deferred	**(2,410)**	**971**
Total income tax (benefit) expense	**$ (2,293)**	**$ 670**

Effective tax rates were 38.1% and 52.7% for fiscal 2015 and fiscal 2014, respectively. Our effective fiscal 2015 tax rate was lower than fiscal 2014 and more in line with the expected normal effective tax rate primarily due to the lack of an increased federal deferred tax expense as a percentage of income before income taxes that occurred in fiscal 2014.

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, 2009; ETC-Europe is no longer subject to tax examinations in the United Kingdom for tax periods prior to fiscal 2013. We are, however, subject to examination in various other foreign and state jurisdictions for fiscal years 2005-2015. 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 27, 2015	**February 28, 2014**
Deferred tax assets:		
Net operating loss and credits	$ 9,079	$ 7,001
Foreign	334	279
Vacation accrual	215	178
Inventory reserve	75	75
Receivable reserve	138	141
Warranty reserve	33	32
Compensation and other reserves	51	12
Other, net	114	191
	10,039	7,909
Valuation allowance	(617)	(558)
Total deferred tax assets	**9,422**	**7,351**
Deferred tax liabilities:		
Depreciation	3,025	3,106
Amortization of capitalized software	79	132
Foreign	48	102
APB 23 liability	19	170
Total deferred tax liabilities	**3,171**	**3,510**
Total net deferred tax assets	**$ 6,251**	**$ 3,841**

As of February 27, 2015 and February 28, 2014, we have provided for U.S. deferred income taxes and foreign withholding tax in the amount of $19 and $170, respectively, for all undistributed earnings not considered permanently reinvested in our non-U.S. subsidiaries.

As of February 27, 2015, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $27 and penalties of $40. 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. The interest and penalties recorded during both fiscal 2015 and fiscal 2014 primarily related to domestic state tax and foreign tax issues.

As of February 27, 2015 and February 28, 2014, the total amount of unrecognized tax benefits was $499 and $395, respectively, of which $183 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.

8. 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 ("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 and to civil aviation organizations. 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 sales. 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 2015, one customer, a U.S. defense agency in the Aerospace segment, represented 10.0% or more of total net sales, and sales to this customer totaling $7,080 represented 19.0% of total net sales. 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.

Included in the segment information for fiscal 2015 and fiscal 2014 are export sales of $13,007 and $24,544, respectively. In fiscal 2015, International sales totaling at least $500 were made to customers in ten (10) different countries; in fiscal 2014, International sales totaling at least $500 were made to customers in nine (9) different countries. Sales to the U.S. Government and its agencies aggregated to $7,562 and $12,119 for fiscal 2015 and fiscal 2014, respectively.

The following segment information reflects the accrual basis of accounting:

	Aerospace	CIS	Corporate	Company Total
Fiscal 2015:				
Net sales	$ 22,101	$ 15,239	$ -	$ 37,340
Interest expense, net	441	304	-	745
Depreciation and amortization	1,263	482	64	1,809
Operating (loss) income	(4,114)	478	(1,201)	(4,837)
Income tax benefit	-	-	(2,293)	(2,293)
Identifiable assets	35,189	5,253	11,208	51,650
Expenditures for segment assets	992	498	15	1,505
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
Income tax provision	-	-	670	670
Identifiable assets	38,904	5,929	11,359	56,192
Expenditures for segment assets	748	470	214	1,432

Reconciliation to consolidated net income attributable to Environmental Tectonics Corporation:

	Fiscal 2015	Fiscal 2014
Operating (loss) income	$ (4,837)	$ 2,461
Interest expense, net	(745)	(808)
Other expense, net	(439)	(381)
Income tax benefit (provision)	2,293	(670)
Loss (income) attributable to non-controlling interest	13	(3)
Net (loss) income attributable to Environmental Tectonics Corporation	**$ (3,715)**	**$ 599**

9. Stock Option Plans

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

	Fiscal year ended			
	February 27, 2015		February 28, 2014	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	354,406	$ 3.34	219,917	$ 4.23
Granted	23,000	$ 2.00	151,500	$ 2.00
Exercised	-	$ -	-	$ -
Forfeited	(122,608)	$ 3.41	(17,011)	$ 2.94
Outstanding at end of year	254,798	$ 3.18	354,406	$ 3.34
Options exercisable at fiscal year end	159,465		199,573	
Weighted average fair value of options granted during the fiscal year		$ 0.79		$ 0.71

The following information applies to options outstanding as of February 27, 2015:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding as of February, 27 2015	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at February 27, 2015	Weighted average exercise price
Less than $2.64	174,500	6.51	$1.86	79,167	$2.27
$5.12	50,000	1.00	$5.12	50,000	$5.12
$6.07 to $7.24	30,298	1.56	$6.07	30,298	$6.07
Total	**254,798**			**159,465**	

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 2015 and fiscal 2014) is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility (30.0% and 27.4% for options granted in fiscal 2015 and fiscal 2014, respectively) is based on the Company's historical stock prices. The riskfree interest rate (0.9% and 0.6% for options granted in fiscal 2015 and fiscal 2014, respectively) 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 is required to estimate forfeitures at the time of grant, and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record sharebased 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 23,000 options granted in fiscal 2015; there were 151,500 options granted in fiscal 2014

The cost for stock option compensation was $36 and $20 in fiscal 2015 and fiscal 2014, respectively. As of February 27, 2015, there were 30,298 options outstanding under the 1998 Incentive Stock Option Plan, which expired in August 2008.

As of February 27, 2015, 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 27, 2015, there were 825,500 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 27, 2015, there were 550,000 shares available to be granted under this Plan.

10. Commitments and Contingencies

Operating Lease Obligations

The Company leases certain premises and office equipment under operating leases. Future minimum rental payments over the next five (5) years required under non-cancelable operating leases having a remaining term expiring after one fiscal year as of February 27, 2015 are $564 in fiscal 2016; $373 in fiscal 2017; $345 in fiscal 2018; $343 in fiscal 2019; and $324 in fiscal 2020. Total rental expense for all operating leases for fiscal 2015 and fiscal 2014 was $617 and $674, respectively.

Retirement and Consulting Agreement Obligations

Although William F. Mitchell, Sr., who founded the Company in 1969, has retired and resigned from the Board of Directors effective September 19, 2014, he is currently engaged as a senior technical consultant to the Company. Mr. Mitchell`s consulting engagement is for a period of up to thirty-six (36) months, and during this time, he will be eligible to receive consulting fees comparable to, but less than, his cash compensation as Chief Executive Officer, along with continuing to receive certain benefits.

Legal Proceedings

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.

11. 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 $486 and $463 in fiscal 2015 and fiscal 2014, 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.

12. 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 27, 2015 and February 28, 2014, 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 $10 and $15 in fiscal 2015 and fiscal 2014, 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.

13. Subsequent Events

The Company has evaluated subsequent events through May 28, 2015, 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 27, 2015.

On March 3, 2015, ETC-PZL entered into a loan agreement with a bank in Warsaw, Poland, whereby ETC-PZL obtained a $1,200 line of credit to fund current activity. Beginning on April 30, 2015, availability will decrease by approximately $120 each month and amounts may be borrowed, repaid, and re-borrowed, subject to availability, from time to time until December 10, 2015. Any amounts outstanding as of this date must be paid back by February 15, 2016.

On April 14, 2015, the Company's ATS business unit announced the award of multiple contracts totaling $45,400 for customers in the Middle East, Southeast Asia, and Europe, $38,000 of which would have increased the Company's sales backlog as of February 27, 2015. As of May 28, 2015, the date of issuance of our consolidated financial statements, the Company's sales backlog was approximately $65,300.

OWNERSHIP TABLE

DIRECTORS AND EXECUTIVE OFFICERS

NAME / ADDRESS**	TITLE	OWNERSHIP PERCENTAGE
H.F. Lenfest c/o The Lenfest Group Five Tower Bridge, Suite 460 300 Barr Harbor Drive West Conshohocken, PA 19428	Chairman of the Board of Directors	56.0%
George K. Anderson, M.D.	Vice Chairman of the Board of Directors	*
Linda J. Brent, Ed.D.	Director	*
Roger Colley	Director	*
Michael D. Malone	Director	*
Winston E. Scott	Director	*
Robert L. Laurent, Jr.	Chief Executive Officer, President, and Director	*
Mark Prudenti	Chief Financial Officer	*
Thomas G. Loughlin	Chief Operating Officer	*
William F. Mitchell, Jr.	Vice President, Contracts/Purchasing	*

CONTROL PERSONS

NAME / ADDRESS**	OWNERSHIP PERCENTAGE
William F. Mitchell, Sr. 2355 Fairway Road Huntingdon Valley, PA 19006	14.5%
T. Todd Martin, III 50 Midtown Park East Mobile, AL 36606	11.3%
3K Limited Partnership	7.1%
Pete L. Stephens	6.8%

*less than 1%
**address listed for all persons beneficially owning more than ten percent (10%)

Information is accurate as of February 27, 2015. None of the foregoing persons in the last five years has had a legal/disciplinary issue. Mr. James R. Wells, former Vice President, General Counsel, Chief Compliance Officer, and Corporate Secretary, resigned effective January 9, 2015 to pursue a General Counsel ... position with a new company.

FIVE YEAR SUMMARY

(in thousands, except per share information)	Fiscal 2011	Fiscal 2012	Fiscal 2013	Fiscal 2014	Fiscal 2015
Net sales	$ 55,451	$ 66,294	$ 62,773	$ 48,274	$ 37,340
Gross profit	21,790	23,531	24,869	14,559	7,850
Gross profit margin %	*39.3%*	*35.5%*	*39.6%*	*30.2%*	*21.0%*
Operating income (loss)	8,290	8,137	9,944	2,461	(4,837)
Operating margin %	*15.0%*	*12.3%*	*15.8%*	*5.1%*	*-13.0%*
Income (loss) before income taxes	6,877	7,488	8,821	1,272	(6,021)
Pre-tax margin %	*12.4%*	*11.3%*	*14.1%*	*2.6%*	*-16.1%*
Income tax (benefit) provision	(7,665)	2,620	3,859	670	(2,293)
Net income (loss)	14,542	4,868	4,962	602	(3,728)
(Income) loss attributable to non-controlling interest	(8)	5	(14)	(3)	13
Net income (loss) attributable to ETC	14,534	4,873	4,948	599	(3,715)
Preferred Stock dividends	(2,278)	(2,208)	(1,511)	(493)	(484)
Income (loss) attributable to common and participating shareholders	$ 12,256	$ 2,665	$ 3,437	$ 106	$ (4,199)
Diluted earnings (loss) per share	$ 0.59	$ 0.13	$ 0.19	$ 0.01	$ (0.27)
Working capital	$ 20,242	$ 27,786	$ 25,135	$ 26,536	$ 8,029
Total long-term debt obligations	3,303	16,724	22,185	21,483	20,621
Total assets	54,051	67,786	60,568	56,192	51,650
Total shareholders' equity	28,129	30,825	24,219	24,326	20,253
Capital expenditures	865	2,144	1,304	1,432	1,505
Depreciation and amortization	1,354	1,760	1,843	1,803	1,809
Interest expense, net	824	734	1,005	808	745
EBITDA	**$ 9,055**	**$ 9,982**	**$ 11,669**	**$ 3,913**	**$ (3,431)**

NAMRU-D'S GL-6000 IS FULLY INSTALLED AND CURRENTLY IN TESTING AT WPAFB

WE LOOK FORWARD DURING THE NEXT SEVERAL MONTHS FOR THIS DEVICE TO BECOME FULLY OPERATIONAL.

ETC'S BOARD OF DIRECTORS AND CORPORATE OFFICERS VISIT WPAFB

Corporate Governance

The Board of Directors is comprised of seven (7) 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	-	-
Winston E. Scott	-	Chairperson	Member

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 other than disclosed in Note 10 – Commitments and Contingencies 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 27, 2015, we had 295 full-time employees, compared to 316 full-time employees as of February 28, 2014, of which 4 were employed in executive positions, 126 were engineers, engineering designers, or draftspersons, 52 were administrative (sales, sales support, accounting, or general administrative) or clerical personnel, and 113 were engaged principally in production, operations, or field support. A total of 129 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
83,800 (approx.) sq. ft | Manufacturing (36,000 sq. ft), NASTAR Center (22,100 sq. ft.), and Corporate Headquarters (25,700 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 interim consolidated financial statements, and an annual report with audited consolidated financial statements.

Interim Consolidated Financial Statements

Interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for fiscal 2015. 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 Wednesday, July 15, 2015, to be held at the Crowne Plaza Philadelphia - Bucks County in Trevose (Feasterville) located at 4700 E. Street Rd, Trevose, PA. 19053, USA.

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.

AEROSPACE SOLUTIONS

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

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

ETC Integrated Logistics Support
Equipment maintenance, training and upgrades for domestic and foreign commercial accounts, civilian agencies and militaries.
SimulatorSupport.com

ETC'S NASTAR CENTER OFFERS TRAINING FOR CIVILIAN, MILITARY, AND COMMERCIAL SPACE PILOTS AND PASSENGERS

HYPOXIA TRAINING AT THE NASTAR CENTER

COMMERCIAL / INDUSTRIAL SYSTEMS

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

ETC Service and Support
Provides service and support for all sterilizers, environmental systems and chambers.
SterilizerSupport.com

BARA-MED SELECT HYPERBARIC CHAMBERS

QUALITY THROUGH
INTEGRITY AND TECHNOLOGY

ETC GLOBAL HEADQUARTERS
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