Environmental Tectonics Corporation

ANNUAL REPORT

2017

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letter to the SHAREHOLDERS

With continued strong international orders from customers in Asia and the Middle East for our Aircrew Training Systems (“ATS”) products, as well as significant increases in orders for our Environmental Testing and Simulation Systems (“ETSS”) and simulator upgrade services and training devices provided by ETC-PZL Aerospace Industries Sp. z o.o. (“ETC-PZL”), our 95%-owned subsidiary in Warsaw, Poland, fiscal 2017 showed another increase in orders booked, up 13% to $59.2 million from $52.2 million in fiscal 2016. This reflects the third consecutive year of increased orders, which have grown at a 13% rate since fiscal 2013. Due to timing of the receipt of the orders booked, our net sales for fiscal 2017 increased only 0.5% to $39.8 million over fiscal 2016. This resulted in a 43% increase in backlog, which stands at $64.4 million at fiscal 2017 year end compared to $45.1 million at fiscal 2016 year end and $32.5 million at fiscal 2015 year end, positioning the Company well entering fiscal 2018.

These positive order trends are also reflected in profitability. Gross profit margins increased again in fiscal 2017 to 33% of net sales from 29% in fiscal 2016, which had increased from 21% in fiscal 2015. Increased gross profit margins reflect a more favorable customer mix and greater operational efficiencies, which have allowed us to reduce our expense structure. Gross margins are also benefitting from progress made on three large U.S. Government contracts at Wright-Patterson Air Force Base; one for the U.S. Navy and two for the U.S. Air Force. The U.S. Navy Spatial Disorientation device was accepted by the Navy in October 2016, while the two contracts to supply a Centrifuge and a suite of Research Altitude Chambers to the U.S. Air Force are progressing toward completion.

The combination of increased sales, higher gross profit margins, and reduced general and administrative expenses, which declined by 19% in fiscal 2017, allowed the Company to return to positive operating income of $0.5 million in fiscal 2017, and position itself favorably entering fiscal 2018.

BOARD OF DIRECTORS

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

Michael D. Malone (2012)
Vice Chairman

Linda J. Brent, Ed.D. (2010)

Roger Colley (2011)

Robert L. Laurent, Jr. (2014)

H.F. Lenfest (2003)

Winston E. Scott (2010)

CORPORATE OFFICERS

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

Mark Prudenti
Chief Financial Officer and Treasurer

James D. Cashel
Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer

Thomas G. Loughlin
Chief Operating Officer

TRANSFER AGENT

American Stock Transfer
New York, New York

ETC GLOBAL LOCATIONS

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AEROSPACE solutions

Fiscal 2017 Aerospace Solutions net sales increased slightly over the prior year to $30.1 million; however, due primarily to large international orders for ATS products in fiscal 2017 totaling $30.7 million, Aerospace Solutions backlog at year end increased to $54.8 million, compared to $39.5 million in fiscal 2016. Included in this backlog are contracts for products such as an ATFS-400-25 High Performance Human Centrifuge, a GYROLAB GL-4000 with the capability of up to 6 Gs of motion stimuli generated in the planetary axis, FALCON Altitude (Hypobaric) Chambers, and ETC's first rectangular Multiplace Hyperbaric Chamber. ETC will be filing with the U.S. Food and Drug Administration a medical device Pre-Market Notification, or 510-K, for the rectangular Multiplace Hyperbaric Chamber as a first step toward marketing the product in the United States.

Domestically, ATS developed a suite of interactive motion-based simulation and virtual reality equipment to support an education/entertainment attraction currently under construction. The ETC-supplied equipment, which we expect to be operational later this year, will allow the attendees to engage in a number of hands-on education and simulation experiences.

We continue to see significant opportunities for our ATS products within the international community, who continue to invest in aircraft that in turn require an investment in aeromedical and other forms of training for pilots to fly safely.

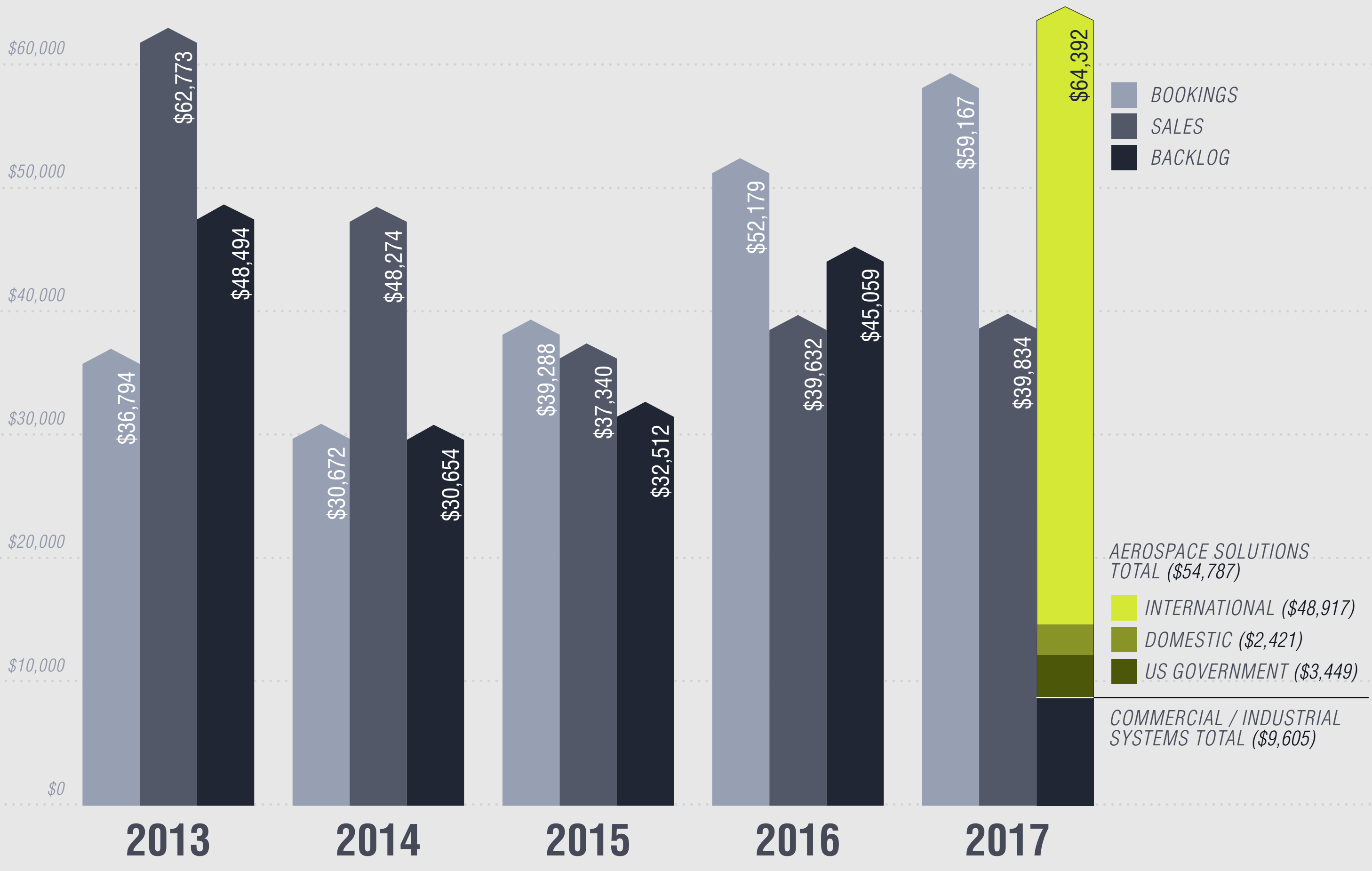
ETC-PZL experienced a 4% increase in net sales during fiscal 2017, but also saw record orders booked of $7.2 million, a four-fold increase over prior year, primarily related to a large flight simulator upgrade order.

Our Integrated Logistics Support ("ILS") group also experienced a four-fold increase over the prior year in orders booked, which totaled $4.9 million in fiscal 2017. ILS contracts provide ongoing equipment maintenance and upgrades for many of our military customers.

ETC Simulation sales were down 60% in fiscal 2017 as a result of a low backlog entering the year. However, orders booked during fiscal 2017 increased 68% over the prior year, resulting in backlog up 175% over prior year end. In addition to these orders, ETC Simulation expanded its airport market with the delivery of Aircraft Rescue and Firefighting ("ARFF") Vehicle Simulators and a major upgrade of an Airport Driver Simulator. ETC Simulation also delivered Advanced Disaster Management Simulators ("ADMS") to domestic and international defense customers for Military Fire and Emergency Response Training. Multiple system upgrades and expansions have been done for existing customers from educational institutions, government, police, fire, civil defense, and airports. The first system with the next generation ADMS software was produced. We are optimistic that these achievements will allow ETC Simulation to grow its position as a world-leader in advanced simulation of emergency response training systems and ARFF Vehicle Simulators.

In fiscal 2017, our NASTAR Center continued its commercial aviation Upset Recovery Training program, which includes Crew Resource Management utilizing a full motion, G-producing flight simulator that requires a flight crew to work together as a team to recover an upset aircraft. NASTAR was also selected as a team member in the Federal Aviation Administration ("FAA") Center of Excellence for Training Technology and Human Performance in addition to its prior selection as a member in the FAA Center of Excellence for Commercial Space Transportation.

AEROSPACE SOLUTIONS BACKLOG AT YEAR END INCREASED TO $54.8M, COMPARED TO $39.5M IN FISCAL 2016



Commercial/Industrial Systems sales of $9.8 million remained nearly constant from year to year, while orders booked and end of year backlog increased by 47% and 72%, respectively. A strong year for the ETSS business unit led the segment with increased sales of 25% over the prior year, up to $2.8 million in fiscal 2017, but more importantly, orders booked increased by 169% over the prior year to $6.5 million in fiscal 2017. ETSS is currently working on an Altitude Simulation System for both research and development and emission testing on heavy duty diesel truck engines. The system is capable of simulating altitudes and corresponding temperatures up to 14,000 feet, and also includes a turbo-charger intercooler (CAC) conditioning system. The ETSS business unit has also developed new designs for both light and heavy duty full vehicle test chambers and is in the process of installing such a system in Beijing, China.

Our Hyperbaric Chambers and Service and Spares business units experienced increased sales of 17% and 25%, respectively, which was offset by a decrease in Sterilizer sales, which remained weak for the second consecutive year. We believe, however, that the 27% increase in Sterilizer orders during fiscal 2017 indicates the beginning of a more positive trend.

With an increased backlog of orders for ATS products, ILS contracts, ETC Simulation products, ETC-PZL services and training devices, environmental test equipment, and sterilizers, and with continued improvement in gross profit and operating margins, we look forward to a solid fiscal 2018. ETC's growth in orders and margins, along with its expansion into new markets, is a testament to its team of hard working and dedicated employees. I'd like to express my gratitude to our shareholders for your continued support and my thanks to our loyal suppliers and customers.

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

FINANCIAL REVIEW

(in thousands, except per share information)	Fiscal year ended February 24, 2017	Fiscal year ended February 26, 2016
Net sales	$ 39,834	$ 39,632
Gross profit	13,279	11,592
Operating income (loss)	555	(2,375)
Net loss attributable to Environmental Tectonics Corporation	(923)	(10,783)
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed loss per share:		
Common	$ (0.09)	$ (0.74)
Preferred	$ (0.09)	$ (0.74)
Diluted loss per share	$ (0.09)	$ (0.74)
Working capital	$ 13,242	$ 1,720
Total long-term debt obligations	17,940	19,439
Total assets	44,538	44,249
Total shareholders' equity	7,976	9,111
Weighted average common and participating shares:		
Basic	15,248	15,248
Diluted	15,250	15,250

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 24, 2017, which totaled $1,944 thousand, remained unpaid as of May 31, 2017, 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 with PNC Bank, National Association ("PNC Bank").

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 words 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 2017 are references to the fifty-two week period ended February 24, 2017. References to fiscal 2016 are references to the fifty-two week period ended February 26, 2016. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2017.

Overview

ETC was incorporated in 1969 in Pennsylvania. For over four decades, we have provided our customers with products, services, 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 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) ATS products; (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:

- Advanced Tactical Flight Simulator ("ATFS") Motion Platforms;
  - ATFS-400-31 High Performance Human Centrifuge
  - ATFS-400-25 High Performance Human Centrifuge
- Cockpit Modules;
- Turnkey Aeromedical Centers;
- GYROLAB GL-6000 KRAKEN Advanced Spatial 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 IPT-III 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");
- Parachute Descent and Landing Simulator;
- Pilot Selection System ("PSS");
- Water Survival Training equipment;
- Night Vision Training System ("NVTS");
- Night Vision Goggle Training System ("NVGTS");
- Interactive motion based simulation and virtual reality equipment designed for the education/entertainment industry; and our
- ADMS line of products (primarily AIRBASE, COMMAND, CONTROL, DRIVE, FIRE, and the Aircraft Rescue and Firefighting ("ARFF") Vehicle Simulator).

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");
- Crew resource management ("CRM") training;
- 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.

Net sales, operating income (loss), 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, which we are winding down, functioned as a sales office in the United Kingdom.

We utilize both employees and independent representatives to market our products and services. As of February 24, 2017, approximately twenty-four (24) employees were committed to sales and marketing functions. In addition to our two operating subsidiaries, we have employees stationed in the Netherlands, Egypt, Turkey, Saudi Arabia, the United Arab Emirates, India, and Malaysia. In certain countries outside the United States, we have relationships with independent sales representatives and distributors.

We sell integrated products and training services. 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 ATS products 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 governmental organizations both in the United States and internationally, original equipment manufacturers in the global special fire truck market (including ARFF vehicles), fire and emergency training schools, universities, and airports. We also provide ILS for customers who purchase these products or similar products manufactured by other parties.

In the CIS segment, we sell our sterilizers to medical device and pharmaceutical manufacturers. We sell our environmental testing and simulation devices primarily to commercial automotive 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 2017

The following items had a material impact on our financial performance, cash flow, and financial position during fiscal 2017:

Additional work required on three contracts

Although gross profit for fiscal 2017 increased by $1.7 million, or 14.6%, compared to fiscal 2016, additional work required on three contracts still hindered our financial performance. The additional work, for some of which we are pursuing recoveries, lowered gross profits by $4.0 million in fiscal 2017, a decrease of $1.1 million compared to the $5.1 million in fiscal 2016. On April 24, 2014, we reached a settlement agreement on the first of these recoveries that partially offset the effects of the additional work during fiscal 2014. With respect to additional recoveries, 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 has received acceptance on one of these contracts and the other two contracts are progressing toward completion, so we expect that any future impacts on our financial performance should decline in comparison to fiscal 2017.

Market for our ADMS line of products

Our ADMS line of products are sold primarily to governmental organizations both in the United States and internationally, original equipment manufacturers in the global special fire truck market (including ARFF vehicles), fire and emergency training schools, universities, and airports, many of which have delayed purchases over the past two fiscal years. Sales of our ADMS line of products decreased by $2.2 million, or 59.6%, during fiscal 2017 compared to fiscal 2016. ADMS sales backlog as of February 24, 2017 was $1.1 million compared to $0.4 million as of February 26, 2016, and fiscal 2018 bookings are forecasted to increase in comparison to fiscal 2017.

Market for our ethylene oxide sterilizers

Our ethylene oxide sterilizers are sold primarily to medical device and pharmaceutical manufacturers, both of which we believe have continued to delay purchases during fiscal 2017 as a result of consolidations within the industry. Sales of sterilizers decreased by $1.5 million, or 40.4%, during fiscal 2017 compared to fiscal 2016. Sales of our steam sterilizers and ethylene oxide computer controls continue to meet budgeted targets and comprise 80.4% of the $3.7 million Sterilizers sales backlog as of February 24, 2017.

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

During the past two fiscal years, we have spent $1.9 million (including $0.7 million in fiscal 2017) for capital improvements. Most of this investment has been related to the enhancement and promotion of our ATS products and related training, and includes engineering costs to improve the technical abilities of our ATFS line of products and enhance our UPRT capabilities. This investment is in addition to several full-time employees and consultants whose main responsibilities are to support ATFS and UPRT business development

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 (in no 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 Annual Report to Shareholders.

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 disclosures 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, dispute resolution, 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, but are not limited to, general supervision, utilities, supplies, 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 operating 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 realizability of the related deferred tax asset. Deferred tax liabilities and assets are offset and presented as a single non-current liability.

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 2017 versus Fiscal 2016

Summary Table of Results

(in thousands, except per share information)	**Fiscal 2017**	**Fiscal 2016**	**Variance ($)**	**Variance (%)**
Net sales:				
Domestic sales	$ 9,980	$ 10,128	$ (148)	(1.5)
U.S. Government sales	276	6,449	(6,173)	(95.7)
International sales	29,578	23,055	6,523	28.3
Net sales total	39,834	39,632	202	0.5
Gross profit	13,279	11,592	1,687	14.6
Gross profit margin %	*33.3%*	*29.2%*	*4.1%*	*14.0%*
Operating expenses:				
Selling and marketing	5,559	5,258	301	5.7
General and administrative	5,554	6,906	(1,352)	(19.6)
Research and development	1,611	1,803	(192)	(10.6)
Operating expenses total	12,724	13,967	(1,243)	(8.9)
Operating income (loss)	555	(2,375)	2,930	123.4
Operating margin %	*1.4%*	*-6.0%*	*7.4%*	*123.3%*
Interest expense, net	559	920	(361)	(39.2)
Other expense, net	727	845	(118)	(14.0)
Loss before income taxes	(731)	(4,140)	3,409	(82.3)
Pre-tax margin %	*-1.8%*	*-10.4%*	*8.6%*	*(82.7)*
Income tax provision	161	6,620	(6,459)	(97.6)
Net loss	(892)	(10,760)	9,868	(91.7)
Income attributable to non-controlling interest	(31)	(23)	(8)	34.8
Net loss attributable to ETC	**$ (923)**	**$ (10,783)**	**$ (9.860)**	**(91.4)**
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 per share:				
Common	$ (0.09)	$ (0.74)	$ (0.65)	(87.8)
Preferred	$ (0.09)	$ (0.74)	$ (0.65)	(87.8)
Diluted loss per share	**$ (0.09)**	**$ (0.74)**	**$ (0.65)**	**(87.8)**

Net loss attributable to ETC

Net loss attributable to ETC was $0.9 million, or $0.09 diluted loss per share, in fiscal 2017, compared to a net loss attributable to ETC of $10.8 million during fiscal 2016, equating to $0.74 diluted loss per share. The $9.9 million variance is due to the combined effect of a $6.5 million decrease in the provision for income taxes, a $1.7 million increase in gross profit, a $1.2 million decrease in operating expenses, a $0.4 million decrease in interest expense, and a $0.1 million decrease in other expense.

Net sales

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

	Fiscal 2017				Fiscal 2016			
	Domestic	**U.S. Gov't**	**International**	**Total**	**Domestic**	**U.S. Gov't**	**International**	**Total**
Aerospace Solutions								
ATS (including Chambers)	$ 832	$ 255	$ 24,803	$ 25,890	$ 376	$ 4,850	$ 17,994	$ 23,220
Simulation (ADMS)	551	20	946	1,517	828	1,574	1,351	3,753
ETC-PZL and other	17	-	2,648	2,665	214	-	2,550	2,764
Subtotal	1,400	275	28,397	30,072	1,418	6,424	21,895	29,737
Commercial/Industrial Systems								
Sterilizers	2,135	-	62	2,197	3,645	-	44	3,689
Environmental (ETSS)	2,541	1	280	2,822	2,231	25	-	2,256
Hyperbaric Chambers	1,998	-	788	2,786	1,341	-	1,038	2,379
Service and Spares	1,906	-	51	1,957	1,493	-	78	1,571
Subtotal	8,580	1	1,181	9,762	8,710	25	1,160	9,895
Net sales total	**$ 9,980**	**$ 276**	**$ 29,578**	**$ 39,834**	**$ 10,128**	**$ 6,449**	**$ 23,055**	**$ 39,632**

Net sales for fiscal 2017 were $39.8 million, an increase of $0.2 million, or 0.5%, from fiscal 2016. The increase reflects an increase in sales related to ATS products including Chambers within our Aerospace segment to both International and Domestic customers, and an increase in Domestic sales within the Hyperbaric Chambers business unit of our CIS segment due to consideration (approximately $0.6 million) realized from the termination of a software license, offset, in part, by decreased sales related to ATS products including Chambers and our ADMS line of products within our Aerospace segment to the U.S. Government, and decreased sales of ethylene oxide sterilizers within the Sterilizers business unit of our CIS segment to Domestic customers.

In fiscal 2017, one International customer within the Aerospace segment represented 10.0% or more of total net sales, and sales to this customer totaling $17.3 million represented 43.4% of total net sales. In fiscal 2016, two customers, both International and each within the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling $13.3 million represented 33.5% of total net sales. Within the Company's February 24, 2017 sales backlog of $64.4 million for work to be performed and revenue to be recognized under written agreements after such date, two contracts, both with International customers within the Aerospace segment, represented at least 10% of the total sales backlog and constituted $31.2 million, or 48.5%, of the total sales backlog. As of February 24, 207, ATS backlog was $42.1 million, or 65.4%, of the total sales backlog and ETC-PZL backlog was $6.6 million, or 10.3%, 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 2017 were $9.9 million, a decrease of $0.1 million, or 1.5%, compared to fiscal 2016, and represented 25.1% of total net sales compared to 25.6% in fiscal 2016. The decrease in Domestic sales is primarily a result of a $1.5 million, or 41.4%, decrease in sales of sterilizers, offset, in part, by an increase in sales within the Hyperbaric Chambers business unit of our CIS segment due to consideration (approximately $0.6 million) realized from the termination of a software license, a $0.5 million increase in sales related to ATS products, specifically a suite of interactive motion based simulation and virtual reality equipment, and a $0.3 million increase in sales of Environmental Testing and Simulation Systems ("ETSS").

U.S. Government sales

U.S. Government sales in fiscal 2017 were $0.3 million, a decrease of $6.2 million, or 95.7%, from fiscal 2016 primarily as a result of our U.S. Government contracts moving closer to completion. The $6.2 million decrease was comprised of a $4.6 million decrease in sales related to ATS products including Chambers and a $1.6 million decrease in sales of our ADMS line of products. U.S. Government sales represented 0.7% of total net sales in fiscal 2017 compared to 16.3% in fiscal 2016.

International sales

International sales in fiscal 2017, including those of the Company's foreign subsidiaries, were $29.6 million, an increase of $6.5 million, or 28.3%, from fiscal 2016. The increase in International sales is primarily a result of a $6.8 million, or 37.8%, increase in sales related to ATS products including Chambers, offset, in part, by a $0.4 million decrease in sales of our ADMS line of products. In aggregate, International sales represented 74.2% of the Company's total net sales in fiscal 2017 compared to 58.1% in fiscal 2016. In fiscal 2017, International sales totaling at least $500 thousand were made to customers in eleven (11) different countries; in fiscal 2016, International sales totaling at least $500 thousand were made to customers in seven (7) different countries.

Segment sales

Aerospace sales were $30.0 million in fiscal 2017, an increase of $0.3 million, or 1.1%, from sales of $29.7 million in fiscal 2016. This increase was primarily due to increased ATS sales within our Aerospace segment to International customers, offset, in part, by overall decreased U.S. Government sales and overall decreased sales of our ADMS line of products. Sales of Aerospace products accounted for 75.5% of our total net sales in fiscal 2017 versus 75.0% in fiscal 2016. Sales in our CIS segment decreased $0.1 million, or 1.3%, and constituted 24.5% of our total net sales in fiscal 2017 compared to 25.0% in fiscal 2016. The decrease was primarily due to decreased sales of sterilizers to Domestic customers, offset, in part, by an increase in sales within the Hyperbaric Chambers business unit due to consideration (approximately $0.6 million) realized from the termination of a software license, as well as increased sales of ETSS and increased Service and Spares related sales to Domestic customers.

Given the Company's sales backlog as of February 24, 2017, it is anticipated that our Aerospace segment will generate the majority of its sales from International contracts, while the majority of sales within our CIS segment will be generated domestically.

Gross profit

Gross profit for fiscal 2017 was $13.3 million compared to $11.6 million in fiscal 2016, an increase of $1.7 million, or 14.6%. The increase in gross profit was a combination of a reduction in the amount of additional work required on three contracts and a higher concentration of net sales from more off-the-shelf type products requiring less initial design and engineering work. Gross profit margin as a percentage of net sales increased to 33.3% in fiscal 2017 compared to 29.2% in fiscal 2016.

Selling and marketing expenses

Selling and marketing expenses for fiscal 2017 of $5.6 million increased by $0.3 million, or 5.7%, compared to fiscal 2016. The 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 including a reduction in headcount, travel and entertainment, and tradeshow and advertising related expenses. As a percentage of net sales, selling and marketing expenses increased to 14.0% in fiscal 2017 from 13.3% in fiscal 2016 due primarily to a higher concentration of International sales in fiscal 2017.

General and administrative expenses

General and administrative expenses for fiscal 2017 of $5.6 million decreased by $1.3 million, or 19.6%, from fiscal 2016. The decrease is the combined result of the absence of a one-time severance charge that occurred in fiscal 2016, a decrease in the allowance for doubtful accounts related to the recovery of a long overdue International receivable as compared to the write-off of a receivable deemed to be uncollectable in fiscal 2016, and an on-going effort to reduce non-revenue generating expenses such as an approximately 6% reduction in headcount over the past two fiscal years and a reduction in travel and entertainment related expenses. As a percentage of net sales, general and administrative expenses decreased to 13.9% in fiscal 2017 compared to 17.4% in fiscal 2016.

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 $1.6 million for fiscal 2017 compared to $1.8 million in fiscal 2016, a decrease of $0.2 million, or 10.6%. The decrease is primarily the result of more research and development employees being assigned to specific contracts; thus, expenses related to these employees were included in cost of sales in fiscal 2017. 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 decreased to 4.0% in fiscal 2017 compared to 4.5% in fiscal 2016.

Operating income (loss)

Operating income in fiscal 2017 was $0.5 million compared to operating loss in fiscal 2016 of $2.4 million. The $2.9 million variance is due primarily to a $1.7 million increase in gross profit, resulting from a combination of a reduction in the amount of additional work required on three contracts and a higher concentration of net sales from more off-the-shelf type products requiring less initial design and engineering work, and a $1.2 million decrease in operating expenses.

On a segment basis, Aerospace posted operating income of $1.2 million for fiscal 2017, a $1.9 million, or 282.1%, improvement compared to an operating loss of $0.7 million in fiscal 2016. CIS posted operating income of $0.3 million for fiscal 2017, a $0.8 million, or 161.6%, improvement compared to an operating loss of $0.5 million in fiscal 2016. These segment operating results were offset, in part, by unallocated corporate expenses.

Interest expense, net

Interest expense, net, for fiscal 2017 was $0.5 million compared to $0.9 million in fiscal 2016, a decrease of $0.4 million, or 39.2%, due to the combination of an increase in interest income associated with a two decade old receivable, and a decrease in interest expense due to the combination of a lower level of bank borrowing throughout fiscal 2017 as a whole compared to fiscal 2016 and a decreased interest rate.

Other expense, net

Other expense, net, for fiscal 2017 was $0.7 million compared to $0.8 million in fiscal 2016, a decrease of $0.1 million, or 14.0%, due primarily to a decrease in letter of credit fees.

Income taxes

As of February 24, 2017, the Company reviewed the components of its deferred tax assets and determined, based upon all available information, that it is more likely than not that deferred tax assets relating to its federal and state net operating loss carryforwards will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established a $9.5 million valuation allowance for such deferred tax assets that we do not expect to realize. If there is a change in our ability to realize our deferred tax assets for which a valuation allowance has been established, then our tax valuation allowance may decrease in the period in which we determine that realization is more likely than not.

An income tax provision of $0.2 million was recorded in fiscal 2017 compared to an income tax provision of $6.6 million recorded in fiscal 2016. Effective tax rates were 22.0% and 159.9% for fiscal 2017 and fiscal 2016, respectively. Our effective fiscal 2016 tax rate was significantly higher than fiscal 2017 primarily due to the $7.6 million prior year increase in the aforementioned valuation allowance.

Liquidity and Capital Resources

On July 9, 2015, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, the following:

(i) The Company's existing Line of Credit with PNC Bank ("PNC Line of Credit") was extended from October 31, 2015 to June 10, 2016.

(ii) The Company must have maintained a minimum Consolidated Tangible Net Worth of $19.0 million for the fiscal quarter ended May 29, 2015. Going forward, ETC was to maintain at all times a minimum Consolidated Tangible Net Worth of $18.5 million; further, commencing with the fiscal quarter ending May 27, 2016, ETC was to 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 was to increase to 1.10 to 1 on August 26, 2016, and was to remain at that level at all times thereafter.

(iii) No monthly principal payments were to be due and payable on the existing Term Loan from September 29, 2014 through May 27, 2016. Monthly principal payments commenced on May 28, 2016, and were to continue for each succeeding month thereafter. Interest was to be payable on a monthly basis, regardless of whether or not any principal payment was due. Any outstanding principal and accrued interest was to be due and payable in full on September 28, 2017, which was the original maturity date.

On November 25, 2015, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, a modification that temporarily reduced the required value of the collateral under the accompanying Pledge Agreement until such time funds related to a significant open receivable as of November 27, 2015 were collected or February 29, 2016, whichever occurred first, and allowed PNC Bank to transfer $2.0 million of restricted cash to the Company's operating account on December 1, 2015. The significant open receivable as of November 27, 2015 was collected on February 18, 2016 and the $2.0 million of restricted cash was transferred back on February 19, 2016.

On June 10, 2016, the Company received a waiver as of the fiscal quarter ended February 26, 2016 for failing to exceed the permitted minimum Consolidated Tangible Net Worth. The waiver also provides that ETC must maintain at all times a minimum Consolidated Tangible Net Worth of $7.5 million; further, commencing with the fiscal quarter ending May 26, 2017, ETC is to maintain as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio will increase to 1.10 to 1 on August 25, 2017, and will remain at that level at all times thereafter. The waiver extended the maturity date of the PNC Line of Credit to August 10, 2016, during which time the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, the following:

(i) The PNC Line of Credit and the Term Loan were consolidated into a $21.0 million Revolving Line of Credit (the "Revolving Line of Credit"). Amounts may be borrowed, repaid, and re-borrowed under the Revolving Line of Credit from time to time until December 31, 2017.
(ii) The existing Committed Line of Credit (the "Committed Line of Credit") is capped at $8.6 million, an amount equivalent to the total outstanding standby letters of credit under which the Committed Line of Credit covered as of May 27, 2016. Total outstanding standby letters of credit covered by the Committed Line of Credit decreased to approximately $6.3 million as of May 31, 2017, the date of issuance of our consolidated financial statements.
(iii) A new $1.0 million FX Equivalent Line of Credit (the "FX Equivalent Line of Credit") for potential future foreign exchange obligations.
(iv) The Revolving Line of Credit, the Committed Line of Credit, and the FX Equivalent Line of Credit (collectively, the "2016 PNC Credit Facilities") had an original maturity date of December 31,, 2017, which on May 26, 2017 was subsequently extended to June 30, 2018.
(v) The interest rate on the 2016 PNC Credit Facilities will be based on the PNC Daily LIBOR Rate (0.992% as of May 3, 2017, the date of our most current Revolving Line of Credit statement) plus a margin of 3.00%.
(vi) The 2016 PNC Credit Facilities are collateralized by a combination of the Company's pledged restricted cash ($6.0 million as of February 24, 2017), substantially all of the Company's additional assets, and the pledged cash collateral of H.F. Lenfest ("Mr. Lenfest"), a major shareholder and member of the Board of Directors.

As of February 24, 2017, the Company's availability under the Revolving Line of Credit was $2.5 million. This reflected cash borrowings of $17.6 million and net outstanding standby letters of credit not covered by the Committed Line of Credit of approximately $0.9 million. As of May 3, 2017, the date of our most current Revolving Line of Credit statement, the Company's availability under the Revolving Line of Credit was approximately $2.1 million. The Company had working capital of $13.3 million as of February 24, 2017 compared to working capital of $1.7 million as of February 26, 2016. The increase in working capital was primarily the result of the Revolving Line of Credit being presented as long-term as of February 24, 2017 because of the approximate sixteen (16) month period between February 24, 2017, the current balance sheet date, and June 30, 2018, the current maturity date of the 2016 PNC Credit Facilities, offset, in part, by the net effect of the decrease in costs and estimated earnings in excess of billings on uncompleted long-term contracts and the increase in billings in excess of costs and estimated earning on uncompleted long-term contracts, offset, in part, by the increase in accounts receivable. Under POC revenue recognition, these accounts represent the timing differences of spending on production activities versus the billing and collecting of customer payments.

With unused availability under the Company's various current lines of credit, the conversion of costs and estimated earnings in excess of billings on uncompleted long-term contracts into cash, the collection of milestone payments associated with several International contracts, and expected deposits on fiscal 2018 bookings, the Company anticipates its sources of liquidity will be sufficient to fund its operating activities, anticipated capital expenditures, and debt repayment obligations throughout fiscal 2018.

Cash flows from operating activities

Cash flows from operations are driven by income from the sale of our products and services and changes in operating assets and liabilities, which primarily depend on the timing of receipts, offset by payments, in the ordinary course of business.

During fiscal 2017, due primarily from the increase in billings in excess of costs and estimated earnings on uncompleted long-term contracts and a decrease in costs and estimated earnings in excess of billings on uncompleted long-term contracts, offset, in part, by the increase in accounts receivable, the Company generated $1.4 million of cash from operating activities compared to generating $6.5 million of cash from operating activities in fiscal 2016.

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 2017 investing activities used $0.7 million, which consisted primarily of equipment and software enhancements for our ATFS and ADMS technologies and UPRT capabilities, and costs to upgrade existing information technology systems and streamline our engineering and manufacturing processes. This is a decrease of $0.5 million from cash used in investing activities in fiscal 2016.

Cash flows from financing activities

During fiscal 2017, the Company's financing activities used $1.3 million of cash on payments on the Term Loan, offset in part, by borrowings under the Company's various lines of credit and a decrease in restricted cash. During fiscal 2016, the Company's financing activities used $4.8 million of cash to increase restricted cash and on repayments under the Company's various lines of credit.

Outlook

We expect to use our cash, cash equivalents, and credit facilities for working capital and general corporate purposes, products, technologies, property, plant, and equipment, the payment of contractual and other legal obligations, including scheduled interest payments on credit facilities and dividends on Preferred Stock 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 with PNC Bank. We expect that net sales of our currently marketed products and services, combined with the current and anticipated future availability under our various lines of credit, the conversion of costs and estimated earnings in excess of billings on uncompleted long-term contracts into cash, the collection of milestone payments associated with several International contracts, and expected deposits on fiscal 2018 bookings, should continue to provide us sufficient funds for fiscal 2018. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated results in fiscal 2019 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 2017 or fiscal 2016 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.

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.

RSM US 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

RSM

Independent Auditor's Report

RSM US LLP

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 24, 2017 and February 26, 2016 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 (collectively, the financial statements).

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these 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 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 financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Environmental Tectonics Corporation and Subsidiaries as of February 24, 2017 and February 26, 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Blue Bell, Pennsylvania
May 31, 2017

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CONSOLIDATED BALANCE SHEETS

(in thousands, except share information)	February 24, 2017	February 26, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 445	$ 976
Restricted cash	5,956	6,162
Accounts receivable, net	7,053	4,222
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	12,931	14,973
Inventories, net	2,842	2,600
Prepaid expenses and other current assets	2,071	1,414
Total current assets	31,298	30,347
Property, plant and equipment, at cost, net	13,094	13,726
Capitalized software development costs, net	146	172
Other assets	-	4
Total assets	**$ 44,538**	**$ 44,249**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt obligations, net of debt issuance costs	$ 362	$ 13,827
Accounts payable, trade	2,709	3,224
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	9,663	6,148
Customer deposits	1,101	1,061
Accrued taxes	154	410
Accrued interest and dividends	1,995	1,533
Other accrued liabilities, current	2,072	2,424
Total current liabilities	18,056	28,627
Long-term debt obligations, net of debt issuance costs, less current portion:		
Credit facility payable to bank, net of debt issuance costs	17,554	-
Term Loan	-	5,569
Total long-term debt obligations, net of debt issuance costs, less current portion	17,554	5,569
Deferred tax liabilities, non-current, net	297	200
Other accrued liabilities, non-current	655	742
Total liabilities	36,562	35,138
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 24, 2017 and February 26, 2016	12,127	12,127
Common Stock, $0.05 par value, 50,000,000 shares authorized; 9,185,161 shares issued and outstanding as of February 24, 2017 and February 26, 2016	459	459
Additional paid-in capital	8,798	9,169
Accumulated deficit	(13,064)	(12,141)
Accumulated other comprehensive loss	(443)	(571)
Total shareholders' equity before non-controlling interest	7,877	9,043
Non-controlling interest	99	68
Total shareholders' equity	7,976	9,111
Total liabilities and shareholders' equity	**$ 44,538**	**$ 44,249**

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands, except per share information)	Fiscal year ended February 24, 2017	Fiscal year ended February 26, 2016
Net sales	$ 39,834	$ 39,632
Cost of goods sold	26,555	28,040
Gross profit	13,279	11,592
Operating expenses:		
Selling and marketing	5,559	5,258
General and administrative	5,554	6,906
Research and development	1,611	1,803
Operating expenses total	12,724	13,967
Operating income (loss)	555	(2,375)
Other expenses:		
Interest expense, net	559	920
Other expense, net	727	845
Other expenses total	1,286	1,765
Loss before income taxes	(731)	(4,140)
Income tax provision	161	6,620
Net loss	(892)	(10,760)
Income attributable to non-controlling interest	(31)	(23)
Net loss attributable to Environmental Tectonics Corporation	**(923)**	**(10,783)**
Foreign currency translation adjustment	128	(45)
Comprehensive loss	$ (795)	$ (10,828)
Preferred Stock dividends	(484)	(484)
Loss attributable to common and participating shareholders	$ (1,407)	$ (11,267)
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed loss per share:		
Common	$ (0.09)	$ (0.74)
Preferred	$ (0.09)	$ (0.74)
Diluted loss per share	**$ (0.09)**	**$ (0.74)**
Basic weighted average common and participating shares:		
Common weighted average number of shares	9,185	9,185
Participating preferred shares	6,063	6,063
Total basic weighted average common and participating shares	15,248	15,248
Diluted weighted average shares:		
Basic weighted average common and participating shares	15,248	15,248
Dilutive effect of stock warrants and options	2	2
Total diluted weighted average shares	15,250	15,250

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

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands, except share information)	Preferred Stock	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, February 27, 2015	$ 12,127	9,185,161	$ 459	$ 9,506	$ (1,358)	$ (526)	$ 20,253
Less: Prior year non-controlling interest	-	-	-	-	-	-	(45)
Net loss attributable to Environmental Tectonics Corporation	-	-	-	-	(10,783)	-	(10,783)
Foreign currency translation adjustment	-	-	-	-	-	(45)	(45)
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	147	-	-	147
Balance before non-controlling interest, February 26, 2016	12,127	9,185,161	459	9,169	(12,141)	(571)	9,043
Non-controlling interest	-	-	-	-	-	-	68
Balance, February 26, 2016	**12,127**	**9,185,161**	**459**	**9,169**	**(12,141)**	**(571)**	**9,111**
Less: Prior year non-controlling interest	-	-	-	-	-	-	(68)
Net loss attributable to Environmental Tectonics Corporation	-	-	-	-	(923)	-	(923)
Foreign currency translation adjustment	-	-	-	-	-	128	128
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	113	-	-	113
Balance before non-controlling interest, February 24, 2017	12,127	9,185,161	459	8,798	(13,064)	(443)	7,877
Non-controlling interest	-	-	-	-	-	-	99
Balance, February 24, 2017	**$ 12,127**	**9,185,161**	**$ 459**	**$ 8,798**	**$ (13,064)**	**$ (443)**	**$ 7,976**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Fiscal year ended February 24, 2017	Fiscal year ended February 26, 2016
Cash flows from operating activities:		
Net loss	$ (892)	$ (10,760)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	1,360	1,645
Deferred income taxes	(1,213)	(1,135)
Increase in valuation allowance for deferred tax assets	1,310	7,586
(Decrease) increase in allowance for doubtful accounts and inventory obsolescence	(436)	305
Accretion of loan origination deferred charge and deferred financing costs	36	50
Stock compensation expense	113	147
Changes in operating assets and liabilities:		
Accounts receivable	(2,518)	1,382
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	2,042	2,725
Inventories	(119)	913
Prepaid expenses and other assets	(653)	(641)
Accounts payable, trade	(515)	619
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	3,515	3,134
Customer deposits	40	(12)
Accrued taxes	(256)	235
Accrued interest and dividends	(22)	5
Other accrued liabilities	(439)	301
Net cash provided by operating activities	**1,353**	**6,499**
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(622)	(1,079)
Capitalized software development costs	(80)	(165)
Net cash used in investing activities	**(702)**	**(1,244)**
Cash flows from financing activities:		
Borrowings (repayments) under lines of credit	6,320	(1,182)
Decrease (increase) in restricted cash	206	(3,646)
Payments on the Term Loan and of other debt obligations	(7,819)	-
Payments of deferred financing costs	(17)	(17)
Net cash used in financing activities	**(1,310)**	**(4,845)**
Effect of exchange rate changes on cash	128	(45)
Net (decrease) increase in cash and cash equivalents	(531)	365
Cash and cash equivalents at beginning of period	976	611
Cash and cash equivalents at end of period	**$ 445**	**$ 976**
Supplemental schedule of cash flow information:		
Interest paid	$ 797	$ 874
Income taxes paid	$ 59	$ 4
Supplemental information on non-cash operating and investing activities:		
Preferred Stock dividends accrued during each respective fiscal year	$ 484	$ 484

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, services, 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 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 (loss), 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) ATS products; (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 ATS products 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 governmental organizations both in the United States and internationally, original equipment manufacturers in the global special fire truck market (including Aircraft Rescue and Firefighting vehicles), fire and emergency training schools, universities, and airports. We also provide ILS 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 medical device and pharmaceutical manufacturers. We sell our environmental testing and simulation devices primarily to commercial automotive and heating, ventilation, and air conditioning ("HVAC") manufacturers. We sell our 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 2017 are references to the fifty-two week period ended February 24, 2017. References to fiscal 2016 are references to the fifty-two week period ended February 26, 2016. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2017.

Sales Backlog

Below is a breakdown of the Company's February 24, 2017 sales backlog (amounts in thousands, except percentages):

	Business segment			
Geographic area	**Aerospace**	**CIS**	**Total**	**%**
Domestic	$ 2,421	$ 8,231	$ 10,652	16.5%
U.S. Government	3,449	51	3,500	5.4
International	48,917	1,323	50,240	78.1
Total	**$ 54,787**	**$ 9,605**	**$ 64,392**	**100.0%**
% of Total	85.1%	12.4%	100.0%	

Our sales backlog as of February 24, 2017, for work to be performed and revenue to be recognized under written agreements after such dates, was $64,392. Of the February 24, 2017 sales backlog, two business units, ATS and ETC-PZL (as defined below), represented at least 10% of the total backlog. ATS sales backlog as of February 24, 2017 was $42,144, or 65.4%, of the total sales backlog. ETC-PZL sales backlog as of February 24, 2017 was $6,627, or 10.3%, of the total sales backlog. Of the February 24, 2017 sales backlog, $31,204, or 48.5%, represents two International contracts.

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of ETC, ETC-PZL Aerospace Industries Sp. z o.o. ("ETC-PZL"), our 95%-owned subsidiary in Warsaw, Poland, and our 99%-owned subsidiary Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"), which we are winding down. "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 the 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, dispute resolution, 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 several locations internationally. Accounts in each domestic institution are insured by the Federal Deposit Insurance Corporation up to $250. During each fiscal year, the Company may periodically have cash and cash equivalents in excess of insured amounts.

Restricted Cash

Restricted cash was $5,956 as of February 24, 2017 compared to $6,162 as of February 26, 2016. Restricted cash is comprised primarily of collateral for any obligations under our loan agreements with PNC Bank, National Association ("PNC Bank") as defined in Note 6 – Long-Term Obligations and Related Equity Arrangements.

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 $503 or 7.1%, of total net accounts receivable as of February 24, 2017. Subsequent to fiscal year end and prior to May 31, 2017, the date of issuance of our consolidated financial statements, 53.6% 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 uses 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 $16,880 and $15,807 as of February 24, 2017 and February 26, 2016, respectively. The net book value of demonstration equipment was $9,328 and $9,059 as of February 24, 2017 and February 26, 2016, 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 2017 and fiscal 2016, $52 and $79, respectively, of machinery and equipment, all of which was fully depreciated, was retired.

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 $106 and $118 in fiscal 2017 and fiscal 2016, respectively. Estimated software amortization, which is based on existing capitalized software, for each of the next five (5) fiscal years is as follows: $93 in fiscal 2018; $37 in fiscal 2019; $16 in fiscal 2020; and $0 in fiscal 2021, fiscal 2022, 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 2017 and fiscal 2016, the Company was involved with three (3) and two (2) such grants, respectively. Payments received under these grants are recorded as a reduction of research and development costs. Such payments totaled \$497 in fiscal 2017 and \$478 in fiscal 2016. Research and development expenses, which totaled \$2,108 in fiscal 2017 and \$2,281 in fiscal 2016, 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 \$1,611 for fiscal 2017 compared to \$1,803 for fiscal 2016.

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 operating 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. Deferred tax liabilities and assets are offset and presented as a single non-current liability.

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 2017 or fiscal 2016.

Share-Based Compensation

Share-based compensation expense is measured at the stock option grant date, based on the fair value of the award, and is recorded primarily to general and administrative expense. The Company uses the Black-Scholes option-pricing model and the straight-line attribution approach to determine the fair value of share-based awards in accordance with Accounting Standards Codification ("ASC") 718, Compensation. This option-pricing model requires the input of highly subjective assumptions, including the option's expected term, the price volatility of the underlying stock, risk-free rates of return, dividend yield, and expected forfeitures. The expected term of an award is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility is based on the Company's historical stock prices. The risk-free interest rate is approximated using rates available on U.S. Treasury securities in effect at the time of grant with a remaining term similar to the award's expected life. The Company uses a dividend yield of zero in the Black-Scholes option-pricing model as it does not anticipate paying cash dividends in the near future. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense for only those awards that are expected to vest as the requisite service is rendered. The guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from these estimates. The Company typically issues new shares of Common Stock upon the exercise of stock options, as opposed to using treasury shares. There were 10,000 options granted in fiscal 2017; there were 402,000 options granted in fiscal 2016.

Advertising Costs

The Company expenses advertising costs, which include trade shows, as incurred. Advertising costs were \$206 and \$288 in fiscal 2017 and fiscal 2016, 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 currently outstanding, 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.

As of both February 24, 2017 and February 26, 2016, 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 28, 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. As of February 28, 2016, these warrants have expired. 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. As of July 2, 2016, these warrants have expired.

As of February 24, 2017 and February 26, 2016, there were outstanding options to purchase the Company's Common Stock totaling 511,500 and 637,917 shares at an average price of $1.24 and $1.25 per share, respectively. Due to the conversion price of the Common Stock options, 501,500 and 637,917 shares were excluded from the calculation of diluted earnings per share as of February 24, 2017 and February 26, 2016, respectively, because the effect of their conversion would be anti-dilutive; further, all 143,885 shares of the Company's Common Stock pertaining to the 200,000 warrants issued on February 20, 2009 were excluded from the calculation of diluted earnings per share as of February 26, 2016 because the effect of their conversion would also be anti-dilutive. Due to the expiration of all warrants during fiscal 2017, all shares pertaining to warrants were excluded from the calculation of diluted earnings per share as of February 24, 2017.

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 ("IFRS"), the FASB issued Accounting Standards Update ("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. As amended by ASU 2015-14 in August 2015, ASU 2014-09 will be effective for our fiscal 2019, which will begin on February 24, 2018. Further amendments and technical corrections were made to the ASU during calendar 2016. The standard permits the use of either the retrospective or cumulative effect transition method. As the ASU will supersede substantially all existing revenue guidance, we anticipate this standard will have a material impact on revenue and cost recognition. As a result, our evaluation of the impact the ASU will have on our consolidated financial statements, as well as our related business processes and potentially our information technology systems, will extend through fiscal 2018.

In February 2016, as part of its initiative to increase transparency and comparability among organizations, the FASB issued ASU 2016-02, Leases (Topic 842), which introduces a lessee model that brings most leases on the balance sheet. ASU 2016-02 will be effective for our fiscal 2021, which will begin on February 29, 2020. Based on our current operating lease commitments as disclosed in Note 10 – Commitments and Contingencies, we do not expect this standard to have a material impact on our consolidated financial statements; however, we do anticipate significant changes in internal controls and related business processes during the implementation phase.

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which introduces targeted amendments intended to simplify the accounting for stock compensation; specifically, the ASU requires all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized as income tax expense or benefit in the Consolidated Statements of Operations and Comprehensive Loss. The new guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. ASU 2016-09 will be effective for our fiscal 2018, which began on February 25, 2017, and early adoption is permitted. We do not expect it to have a significant impact on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. This guidance is effective for fiscal years beginning after December 15, 2017. ASU 2016-15 will be effective for our fiscal 2019, which will begin on February 24, 2018, and early adoption is permitted. We are currently evaluating the impact of this accounting standard update on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires a company to include in its cash and cash equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash, a reconciliation between the statement of financial position and the statement of cash flows when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents, and proper disclosure about the nature of the restrictions when company has a material balance of amounts generally described as restricted cash and restricted cash equivalents. This guidance is effective for fiscal years beginning after December 15, 2017. ASU 2016-18 will be effective for our fiscal 2019, which will begin on February 24, 2018, and early adoption is permitted. We are currently evaluating the impact of this accounting standard update on our consolidated financial statements.

2. Accounts Receivable

The components of accounts receivable are as follows:

	February 24, 2017	February 26, 2016
U.S. Commercial ("Domestic")	$ 2,745	$ 1,553
U.S. Government	77	637
International	4,521	2,635
	7,343	4,825
Less: allowance for doubtful accounts	(290)	(603)
Accounts receivable, net	**$ 7,053**	**$ 4,222**

3. Costs and Estimated Earnings on Uncompleted Contracts

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

	February 24, 2017	February 26, 2016
Cost incurred on uncompleted long-term contracts	$ 138,131	$ 123,952
Estimated earnings	36,371	32,253
	174,502	156,205
Less: billings to date	(171,234)	(147,380)
	$ 3,268	**$ 8,825**

Included in accompanying balance sheets under the following captions:

	February 24, 2017	February 26, 2016
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	$ 12,931	$ 14,973
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(9,663)	(6,148)
	$ 3,268	**$ 8,825**

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 2017 and fiscal 2016.

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 24, 2017	February 26, 2016
Raw materials	$ 108	$ 132
Work in process	2,292	2,372
Finished goods	442	96
Inventories, net	**$ 2,842**	**$ 2,600**

Inventory is presented net of an allowance for obsolescence of $188 (raw material $55 and work in process $133), and $311 (raw material $54 and work in process $257) as of February 24, 2017 and February 26, 2016, 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 24, 2017	February 26, 2016
Land	$ 100	$ 100
Buildings and building additions	3,851	3,851
Machinery and equipment	10,945	10,835
Demonstration equipment	16,880	15,807
Office furniture and equipment	1,324	1,324
Building improvements	3,145	3,144
Construction in process	406	1,020
	36,651	36,081
Less: accumulated depreciation	(23,557)	(22,355)
Property, plant, and equipment, at cost, net	**$ 13,094**	**$ 13,726**

Depreciation expense for fiscal 2017 and fiscal 2016 was $1,254 and $1,527, respectively.

As of both February 24, 2017 and February 26, 2016, substantially all of the Company's long-lived assets were located in the United States of America.

6. Long-Term Obligations and Related Equity Arrangements

2009 Lenfest Financing Transaction

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

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

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

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

2012 Financial Restructuring

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

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

(ii) PNC Bank provided to the Company a new five (5) year $15,000 Term Loan. The Company used $10,000 of the proceeds from the Term Loan to repurchase and retire 10,000 shares of its Series D and Series E Preferred Stock owned by Mr. Lenfest at the stated price of $1,000 per share. The remaining $5,000 was used to partially decrease the amount outstanding on the PNC Line of Credit and to pay Mr. Lenfest $417 of interest due under the Lenfest Pledge, in cash, in lieu of Series D Preferred Stock. The $10,000 in marketable securities associated with the Lenfest Pledge was returned to Mr. Lenfest and the Lenfest Pledge was terminated; therefore, as of both February 24, 2017 and February 26, 2016, no interest has been accrued for under the Lenfest Pledge.

(iii) The PNC Line of Credit was no longer guaranteed by Mr. Lenfest. Instead, the PNC Line of Credit was 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 holders 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 with PNC Bank

Effective September 28, 2012, ETC and PNC Bank entered into a loan agreement (the "September 28, 2012 Loan Agreement"), which included ETC executing a Line of Credit Note and a Term Loan Note (as defined below). As set forth in the September 28, 2012 Loan Agreement, borrowings under the PNC Line of Credit were available for working capital and other general business purposes, and for issuances of letters of credit. Amounts were borrowed, repaid, and re-borrowed under the PNC Line of Credit from time to time until August 5, 2016, the date on which the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the consolidation of the PNC Line of Credit and the Term Loan into a $21,000 Revolving Line of Credit (the "Revolving Line of Credit"); see "Fiscal 2017 Amendment to the September 28, 2012 Loan Agreement" below for details. The Company's obligation to repay the advances under the Revolving 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 Revolving Line of Credit. As of February 24, 2017, the Company's availability under the Revolving Line of Credit was $2,478. This reflected cash borrowings of $17,578 and net outstanding standby letters of credit not covered by the Committed Line of Credit of $944. As of May 3, 2017, the date of our most current Revolving Line of Credit statement, the Company's availability under the Revolving Line of Credit was approximately $2,126.

As security for repayment of the Line of Credit Note, as noted above, and the Term Loan Note, which set forth the Company's obligation to repay the principal on the Term Loan, including interest, on a monthly basis, 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 and ("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, which was subsequently amended and restated in conjunction with the Fiscal 2017 Amendment to the September 28, 2012 Loan Agreement (as defined below), the Company pledged to PNC Bank as collateral the Company's ownership interest in certain subsidiaries of the Company.

The September 28, 2012 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 September 28, 2012 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 September 28, 2012 Loan Agreement, including the non-payment of principal or interest, the obligations of the Company under the September 28, 2012 Loan Agreement may be accelerated and the assets securing the obligations secured. See "Fiscal 2017 Amendment 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 not recorded an unrealized gain or loss related to the fair value of our interest rate swap in either fiscal 2017 or fiscal 2016. We have designated our current interest rate swap as a cash flow hedge instrument. As of February 24, 2017, 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 September 28, 2012 Loan Agreement, 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 24, 2017 and February 26, 2016. Following the execution of the Preferred Stock Repurchase and Financial Restructuring Agreement, and as approved by the Company's Common Stock holders 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%).

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 2016 Amendments to the September 28, 2012 Loan Agreement

On July 9, 2015, 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 extended from October 31, 2015 to June 10, 2016.

(ii) The Company must have maintained a minimum Consolidated Tangible Net Worth of $19,000 for the fiscal quarter ended May 29, 2015. Going forward, ETC was to maintain at all times a minimum Consolidated Tangible Net Worth of $18,500; further, commencing with the fiscal quarter ending May 27, 2016, ETC was to 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 was to increase to 1.10 to 1 on August 26, 2016 and was to remain at that level at all times thereafter.

(iii) No monthly principal payments were to be due and payable on the existing Term Loan from September 29, 2014 through May 27, 2016. Monthly principal payments commenced on May 28, 2016, and were to continue for each succeeding month thereafter. Interest was to be payable on a monthly basis, regardless of whether or not any principal payment was due. Any outstanding principal and accrued interest was to be due and payable in full on September 28, 2017, which was the original maturity date.

On November 25, 2015, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, a modification that temporarily reduced the required value of the collateral under the accompanying Pledge Agreement until such time funds related to a significant open receivable as of November 27, 2015 were collected or February 29, 2016, whichever occurred first, and allowed PNC Bank to transfer $2,000 of restricted cash to the Company's operating account on December 1, 2015. The significant open receivable as of November 27, 2015 was collected on February 18, 2016 and the $2,000 of restricted cash was transferred back on February 19, 2016.

Fiscal 2017 Amendment to the September 28, 2012 Loan Agreement

On June 10, 2016, the Company received a waiver as of the fiscal quarter ended February 26, 2016 for failing to exceed the permitted minimum Consolidated Tangible Net Worth. The waiver also provides that ETC must maintain at all times a minimum Consolidated Tangible Net Worth of $7,500; further, commencing with the fiscal quarter ending May 26, 2017, ETC is to maintain as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio will increase to 1.10 to 1 on August 25, 2017, and will remain at that level at all times thereafter. The waiver extended the maturity date of the PNC Line of Credit to August 10, 2016, during which time the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, the following:

(i) The PNC Line of Credit and the Term Loan were consolidated into a $21,000 Revolving Line of Credit. Amounts may be borrowed, repaid, and re-borrowed under the Revolving Line of Credit from time to time until December 31, 2017.

(ii) The existing Committed Line of Credit (the "Committed Line of Credit") is capped at $8,600, an amount equivalent to the total outstanding standby letters of credit under which the Committed Line of Credit covered as of May 27, 2016. Total outstanding standby letters of credit covered by the Committed Line of Credit decreased to approximately $6,329 as of May 31, 2017, the date of issuance of our consolidated financial statements.

(iii) A new $1,000 FX Equivalent Line of Credit (the "FX Equivalent Line of Credit") for potential future foreign exchange obligations.

(iv) The Revolving Line of Credit, the Committed Line of Credit, and the FX Equivalent Line of Credit (collectively, the "2016 PNC Credit Facilities") had an original maturity date of December 31, 2017, which on May 26, 2017 was subsequently extended to June 30, 2018.

(v) The interest rate on the 2016 PNC Credit Facilities will be based on the PNC Daily LIBOR Rate (0.992% as of May 3, 2017, the date of our most current Revolving Line of Credit statement) plus a margin of 3.00%.

(vi) The 2016 PNC Credit Facilities are collateralized by a combination of the Company's pledged restricted cash ($5,956 as of February 24, 2017), substantially all of the Company's additional assets, and the pledged cash collateral Mr. Lenfest.

Preferred Stock

Presently, the Company has one class of cumulative convertible participating Preferred Stock currently outstanding, 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, 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 Accounting Standards Codification ("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 net losses incurred in fiscal 2015 and beyond, all $484 of dividends recorded during each of those fiscal years were recorded as a reduction of additional paid-in capital.

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, 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 24, 2017.

As of both February 24, 2017 and February 26, 2016, 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 24, 2017, which totaled $1,944, remained unpaid as of May 31, 2017, 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 were equal in value to ten percent (10%) of the $2,000 note. The warrants were exercisable for seven (7) years following issuance at an exercise price of $1.39, which equaled the average closing price of ETC Common Stock during the 120 days prior to the issuance of the warrant. As of February 28, 2016, these warrants have expired.

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 were equal in value to ten percent (10%) of the amount of the $5,000 increase. The warrants were exercisable for seven (7) 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. As of July 2, 2016, these warrants have expired.

ETC-PZL Line of Credit Agreement

On December 9, 2015, ETC-PZL entered into a loan agreement with a bank in Warsaw, Poland, whereby ETC-PZL has line of credit ("ETC-PZL Line of Credit") to fund current activity. As of February 24, 2017, there was no availability under the ETC-PZL Line of Credit as any amounts borrowed as of December 9, 2016 were to be repaid as of February 28, 2017 ; after which, up to approximately $160 may be borrowed, repaid, and re-borrowed from time to time until November 12, 2017. As of February 24, 2017, outstanding borrowings under the ETC-PZL Line of Credit were approximately $362. As of February 26, 2016, 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:

	February 24, 2017	February 26, 2016
Credit facility payable to bank	$ 17,578	$ 11,620
Term Loan	-	7,819
Borrowed under ETC-PZL Line of Credit	362	-
Total long-term debt obligations	17,940	19,439
Less: debt issuance costs	(24)	(43)
Total long-term debt obligations, net of debt issuance costs	17,916	19,396
Less: current portion	(362)	(13,827)
Total long-term debt obligations, net of debt issuance costs, less current portion	**$ 17,554**	**$ 5,569**

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 2018	$ 362
Fiscal 2019	17,578
Fiscal 2020	-
Fiscal 2021	-
Fiscal 2022	-
Total future long-term debt obligations	**$ 17,940**

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 operating 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. Deferred tax liabilities and assets are offset and presented as a single non-current liability.

As of February 24, 2017, the Company reviewed the components of its deferred tax assets and determined, based upon all available information, that it is more likely than not that deferred tax assets relating to its federal and state net operating loss carryforwards will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established a $9,513 valuation allowance for such deferred tax assets that we do not expect to realize. If there is a change in our ability to realize our deferred tax assets for which a valuation allowance has been established, then our tax valuation allowance may decrease in the period in which we determine that realization is more likely than not.

An income tax provision of $161 was recorded in fiscal 2017 compared to an income tax provision of $6,620 recorded in fiscal 2016. Our income tax provision consists of the following:

	Fiscal year ended	
	February 24, 2017	**February 26, 2016**
Current tax expense (benefit):		
U.S. Federal	$ 20	$ 28
U.S. State	(24)	46
Foreign	68	95
Total current tax expense, net	**64**	**169**
Deferred tax expense:		
U.S. Federal	$ 26	$ 5,952
U.S. State	10	434
Foreign	61	65
Total deferred tax expense	**97**	**6,451**
Income tax provision	**$ 161**	**$ 6,620**

Effective tax rates were 22.0% and 159.9% for fiscal 2017 and fiscal 2016, respectively. Our effective fiscal 2016 tax rate was significantly higher than fiscal 2017 primarily due to the $7,586 prior year increase in the aforementioned valuation allowance.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As of February 24, 2017, the Company had approximately $25,995 of federal net operating loss carryforwards available to offset future income tax liabilities, which will begin to expire in 2025. The Company is no longer subject to U.S. federal tax examinations by tax authorities for the fiscal years before and including 2015. ETC-PZL is no longer subject to tax examinations in Poland for tax periods prior to December 31, 2011; ETC-Europe is no longer subject to tax examinations in the United Kingdom for tax periods prior to fiscal 2015. We are, however, subject to examination in various other foreign and state jurisdictions for fiscal years 2007-2017. We believe appropriate provisions for all outstanding tax issues have been made for all jurisdictions and all open years.

As of February 24, 2017, the Company has a net deferred tax liability of $297 compared to a net deferred tax liability of $200 as of February 26, 2016. Significant components of our net deferred tax liability are as follows:

	February 24, 2017	**February 26, 2016**
Deferred tax assets:		
Net operating loss carryforwards	$ 9,719	$ 8,203
U.S. R&D tax credits	1,406	1,322
U.S. AMT credits	584	584
Foreign	296	292
Vacation accrual	263	264
Inventory reserve	66	111
Receivable reserve	101	214
Other, net	316	246
	12,751	11,236
Valuation allowance	(9,513)	(8,203)
Total deferred tax assets	**3,238**	**3,033**
Deferred tax liabilities:		
Depreciation	(2,972)	(2,854)
Amortization of capitalized software	(86)	(97)
Foreign	(168)	(94)
APB 23 liability	(309)	(188)
Total deferred tax liabilities	**(3,535)**	**(3,233)**
Total net deferred tax liability	**$ (297)**	**$ (200)**

As of February 24, 2017 and February 26, 2016, we have provided for U.S. deferred income taxes and foreign withholding tax in the amount of $309 and $188, respectively, for all undistributed earnings not considered permanently reinvested in our non-U.S. subsidiaries.

As of February 24, 2017, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $48 and penalties of $73. As of February 26, 2016, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $43 and penalties of $64. The interest and penalties recorded during both fiscal 2017 and fiscal 2016 primarily related to domestic state tax and foreign tax issues.

As of February 24, 2017 and February 26, 2016, the total amount of unrecognized tax benefits was $646 and $587, respectively, of which $231 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) ATS products; (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); and (iv) ADMS, as well as 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 (loss) 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 our National Aerospace Training and Research Center (the "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 2017, one International customer within the Aerospace segment represented 10.0% or more of total net sales, and sales to this customer totaling $17,290 represented 43.4% of total net sales. In fiscal 2016, two customers, both International and each within the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling $13,264 represented 33.5% of total net sales.

Included in the segment information for fiscal 2017 and fiscal 2016 are export sales of $29,578 and $23,055, respectively. In fiscal 2017, International sales totaling at least $500 were made to customers in eleven (11) different countries; in fiscal 2016, International sales totaling at least $500 were made to customers in seven (7) different countries. Sales to the U.S. Government and its agencies aggregated to $276 and $6,449 for fiscal 2017 and fiscal 2016, respectively.

The following segment information reflects the accrual basis of accounting:

	Aerospace	CIS	Corporate	Company Total
Fiscal 2017:				
Net sales	$ 30,072	$ 9,762	$ -	$ 39,834
Interest expense, net	422	137	-	559
Depreciation and amortization	941	359	60	1,360
Operating income (loss)	1,233	282	(960)	555
Income tax provision	-	-	161	161
Identifiable assets	29,908	5,221	9,409	44,538
Expenditures for segment assets	612	61	29	702
Fiscal 2016:				
Net sales	$ 29,737	$ 9,895	$ -	$ 39,632
Interest expense, net	690	230	-	920
Depreciation and amortization	1,144	437	64	1,645
Operating loss	(677)	(458)	(1,240)	(2,375)
Income tax provision	-	-	6,620	6,620
Identifiable assets	30,874	3,866	9,509	44,249
Expenditures for segment assets	1,192	38	14	1,244

Reconciliation to consolidated net loss attributable to Environmental Tectonics Corporation:

	Fiscal 2017	Fiscal 2016
Operating income (loss)	$ 555	$ (2,375)
Interest expense, net	(559)	(920)
Other expense, net	(727)	(845)
Income tax provision	(161)	(6,620)
Income attributable to non-controlling interest	(31)	(23)
Net loss attributable to Environmental Tectonics Corporation	**$ (923)**	**$ (10,783)**

9. Stock Option Plans

The following is a summary of the status of the Company's stock option plans:

	Fiscal year ended			
	February 24, 2017		February 26, 2016	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	637,917	$ 1.25	254,798	$ 3.18
Granted	10,000	$ 0.57	402,000	$ 1.25
Exercised	-	$ -	-	$ -
Forfeited	(136,417)	$ 1.25	(18,881)	$ 1.76
Outstanding at end of year	**511,500**	**$ 1.24**	**637,917**	**$ 1.25**
Options exercisable at fiscal year end	130,167		195,417	
Weighted average fair value of options granted during the fiscal year		$ 0.39		$ 0.78

The following information applies to options outstanding as of February 24, 2017:

	Options outstanding			Options exercisable	
Exercise price	Number outstanding as of February, 24 2017	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at February 24, 2017	Weighted average exercise price
$0.57	10,000	9.39	$0.57	-	
$1.25	501,500	7.52	$1.25	130,167	$1.25
Total	**511,500**			**130,167**	

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 2017 and fiscal 2016) is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility (60.8% and 54.1% for options granted in fiscal 2017 and fiscal 2016, respectively) is based on the Company's historical stock prices. The risk-free interest rate (0.8% for options granted in fiscal 2017 and 0.9% for options granted in fiscal 2016) 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 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 10,000 options granted in fiscal 2017; there were 402,000 options granted in fiscal 2016. Stock option compensation expense was $113 and $147 in fiscal 2017 and fiscal 2016, respectively.

As of February 24, 2017, 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 24, 2017, there were 648,500 shares available to be granted under this Plan.

Non-employee Director Stock Plan

In September 2005, the Company adopted a stock option plan that 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 24, 2017, there were 440,000 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 24, 2017 are $517 in fiscal 2018; $507 in fiscal 2019; $487 in fiscal 2020; $465 in fiscal 2021; and $463 in fiscal 2022. Total rental expense for all operating leases for fiscal 2017 and fiscal 2016 was $579 and $592, respectively.

Retirement and Consulting Agreement Obligations

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 expires September 18, 2017, and prior to expiration, he is eligible to receive consulting fees upon request from the Company, which are comparable to, but less than, his cash compensation as Chief Executive Officer. He is also entitled to receive certain other benefits prior to expiration of the consulting engagement.

Separation Agreements

In February 2016, the Company entered into separation agreements with a small number of employees that resulted in a one-time severance charge of $415 being reflected in fiscal 2016 general and administrative expenses. This amount is payable on a weekly basis for a period of up to twenty-four (24) months.

Legal Proceedings

Orbit Movers & Erectors, Inc. ("Orbit") filed suit in the Court of Common Pleas in Montgomery County, Ohio, seeking damages for alleged additional costs that Orbit claims to have incurred under a contract (the "Orbit Contract") pursuant to which Orbit was to fabricate and install certain piping systems for an ETC Aerospace product (the "Orbit Litigation"). The amount of the alleged additional costs claimed by Orbit was approximately $500. The litigation was removed to federal district court in Ohio, after which the Company filed its answer and counterclaim for breach of contract. Following a pre-trial conference, the Court scheduled a jury trial in 2017. Last year, the Company filed a Motion for Leave to Amend Answer With Affirmative Defenses and Amended Counterclaims ("Amended Answer"), which was granted. The Amended Answer was subsequently filed and Orbit has replied to ETC's Amended Answer. On July 26, 2016, the Company settled the Orbit Litigation in its entirety. The Company and Orbit have carried out their respective obligations under the Court-approved settlement agreement during fiscal 2017, and the Orbit Litigation was dismissed on February 28, 2017. The settlement did not have a material adverse effect on the Company's financial position or results of operations.

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 $455 and $503 in fiscal 2017 and fiscal 2016, respectively.

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 24, 2017 and February 26, 2016, 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 not recorded an unrealized gain or loss related to the fair value of our interest rate swap in either fiscal 2017 or fiscal 2016.

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. 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 31, 2017, 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 24, 2017.

On May 26, 2017, the maturity date of the 2016 PNC Credit Facilities was extended from December 31, 2017 to June 30, 2018. See Note 6 – Long-Term Obligations and Related Equity Arrangements for further details regarding the Company's loan agreements with PNC Bank.

OWNERSHIP TABLE

DIRECTORS AND EXECUTIVE OFFICERS

NAME / ADDRESS**	TITLE	OWNERSHIP PERCENTAGE
George K. Anderson, M.D.	Chairman of the Board of Directors	*
Michael D. Malone	Vice Chairman of the Board of Directors	*
Linda J. Brent, Ed.D.	Director	*
Roger Colley	Director	*
Robert L. Laurent, Jr.	Chief Executive Officer, President, and Director	* 1.0%
H.F. Lenfest *c/o The Lenfest Group* *Five Tower Bridge, Suite 460* *300 Barr Harbor Drive* *West Conshohocken, PA 19428*	Director	*** 53.5%
Winston E. Scott	Director	*
Mark Prudenti	Chief Financial Officer and Treasurer	*
James D. Cashel	Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer	*
Thomas G. Loughlin	Chief Operating Officer	*

CONTROL PERSONS

NAME / ADDRESS**	OWNERSHIP PERCENTAGE
William F. Mitchell, Sr. *2355 Fairway Road* *Huntingdon Valley, PA 19006*	14.2%
T. Todd Martin, III *50 Midtown Park East* *Mobile, AL 36606*	11.0%
3K Limited Partnership	6.9%
Estate of Pete L. Stephens	6.3%

* less than 1%

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

*** the denominator for this ownership percentage calculation includes all participating preferred shares

Information is accurate as of May 31, 2017, the date of issuance of our consolidated financial statements, based on information available to the Company. None of the foregoing Directors and Executive Officers in the last five years has had a legal/disciplinary issue.

five year
SUMMARY

(in thousands, except per share information)	Fiscal 2013	Fiscal 2014	Fiscal 2015	Fiscal 2016	Fiscal 2017
Net sales	$ 62,773	$ 48,274	$ 37,340	$ 39,632	$ 39,834
Gross profit	24,869	14,559	7,850	11,592	13,279
Gross profit margin %	*39.6%*	*30.2%*	*21.0%*	*29.2%*	*33.3%*
Operating income (loss)	9,944	2,461	(4,837)	(2,375)	555
Operating margin %	*15.8%*	*5.1%*	*-13.0%*	*-6.0%*	*1.4%*
Income (loss) before income taxes	8,821	1,272	(6,021)	(4,140)	(731)
Pre-tax margin %	*14.1%*	*2.6%*	*-16.1%*	*-10.4%*	*-1.8%*
Income tax provision (benefit)	3,859	670	(2,293)	6,620	161
Net income (loss)	4,962	602	(3,728)	(10,760)	(892)
(Income) loss attributable to non-controlling interest	(14)	(3)	13	(23)	(31)
Net income (loss) attributable to ETC	4,948	599	(3,715)	(10,783)	(923)
Preferred Stock dividends	(1,511)	(493)	(484)	(484)	(484)
Income (loss) attributable to common and participating shareholders	$ 3,437	$ 106	$ (4,199)	$ (11,267)	$ (1,407)
Diluted earnings (loss) per share	$ 0.19	$ 0.01	$ (0.27)	$ (0.74)	$ (0.09)
Working capital	$ 25,135	$ 26,536	$ 6,731	$ 1,720	$ 13,242
Total long-term debt obligations	22,185	21,483	20,621	19,439	17,940
Total assets	60,568	56,192	51,650	44,249	44,538
Total shareholders' equity	24,219	24,326	20,253	9,111	7,976
Capital expenditures	1,304	1,432	1,505	1,244	702
Depreciation and amortization	1,843	1,803	1,809	1,645	1,360
Interest expense, net	1,005	808	745	920	559
EBITDA *	**$ 11,669**	**$ 3,913**	**$ (3,431)**	**$ (1,428)**	**$ 1,301**

* In addition to disclosing financial results that are determined in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), we also disclose Earnings Before Income Taxes, Depreciation, and Amortization ("EBITDA"). The presentation of a non-U.S. GAAP financial measure such as EBITDA is intended to enhance the usefulness of financial information by providing a measure that management uses internally to evaluate our expenses and operating performance and factors into several of our financial covenant calculations.

A reader may find this item important in evaluating our performance. Management compensates for the limitations of using non-U.S. GAAP financial measures by using them only to supplement our U.S. GAAP results to provide a more complete understanding of the factors and trends affecting our business.

IT WAS A STRONG YEAR FOR ENVIRONMENTAL TESTING AND SIMULATION SYSTEMS

The ETSS business unit led the segment with increased sales of 25% over the prior year, up to $2.8 million in fiscal 2017, but more importantly, orders booked increased by 169% over the prior year, up to $6.5 million in fiscal 2017.

Corporate Governance

The Board of Directors is comprised of seven (7) members, five (5) 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.	-	-	-
Michael D. Malone	Member	Member	-
Linda J. Brent, Ed.D	Member	-	Chairperson
Roger Colley	Chairperson	Member	-
H.F. Lenfest	-	-	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, which we are winding down. 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 24, 2017, we had 277 full-time employees, compared to 279 full-time employees as of February 26, 2016 and 295 full-time employees as of February 27, 2015, of which 4 were employed in executive positions, 119 were engineers, engineering designers, or draftspersons, 49 were administrative (sales, sales support, accounting, or general administrative) or clerical personnel, and 105 were engaged principally in production, operations, or field support. A total of 122 employees were stationed at ETC-SH 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. A summary of square footage and current use as of February 24, 2017 is presented below:

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 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 U.S. Securities and Exchange Commission ("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 2017. 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.astfinancial.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 12, 2017, to be held at The Fuge located at 780 Falcon Circle, Warminster, PA, 18974, USA.

Corporate Data

Environmental Tectonics Corporation, 125 James Way, Southampton, PA 18966

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.

For further information, contact Mark Prudenti, Chief Financial Officer. Telephone: (215) 355-9100 x1531

AEROSPACE SOLUTIONS

ETC Aircrew Training Systems
For over four decades, ATS has provided clients in over eighty countries with simulation systems designed for high-G, SD, SA, aircraft egress, night vision, hypoxic environments, tactical aviation, avionics maintenance, helicopter flight, water survival training, and research applications.
etcAircrewTraining.com

The National AeroSpace Training And Research (NASTAR) Center
The NASTAR Center is the premier commercial air and space training, research, and development facility. It combines state-of-the-art flight simulators with physiology-based coursework to optimize human performance in extreme environments.
NASTARcenter.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, Florida, ETC Simulation offers the most thorough training for incident command and disaster management teams.
etcSimulation.com

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

COMMERCIAL / INDUSTRIAL SYSTEMS

ETC Environmental Testing & Simulation Systems
ETSS 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, ETSS offers the most customized equipment available for optimizing R&D, testing, and validation programs.
TestingandSimulation.com

ETC Hyperbaric Chambers
Founded in 1971, ETC Hyperbaric Chambers 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 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 markets with unique design solutions for any challenge.
etcSterilization.com

ETC Service and Support
ETC's Service and Support unit operates out of offices worldwide and provides service and support for all sterilizers, environmental systems, and chambers.
SterilizerSupport.com

WITH NEARLY FIFTY YEARS OF EXPERIENCE, ETC IS A LEADER IN ENGINEERING SOLUTIONS THAT SIMULATE ENVIRONMENTS FOR TRAINING, TESTING, AND R&D.

ETC GLOBAL
HEADQUARTERS

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INVESTOR CONTACT

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