ETC 2019 Annual Report

50 YEARS

Y E A R S

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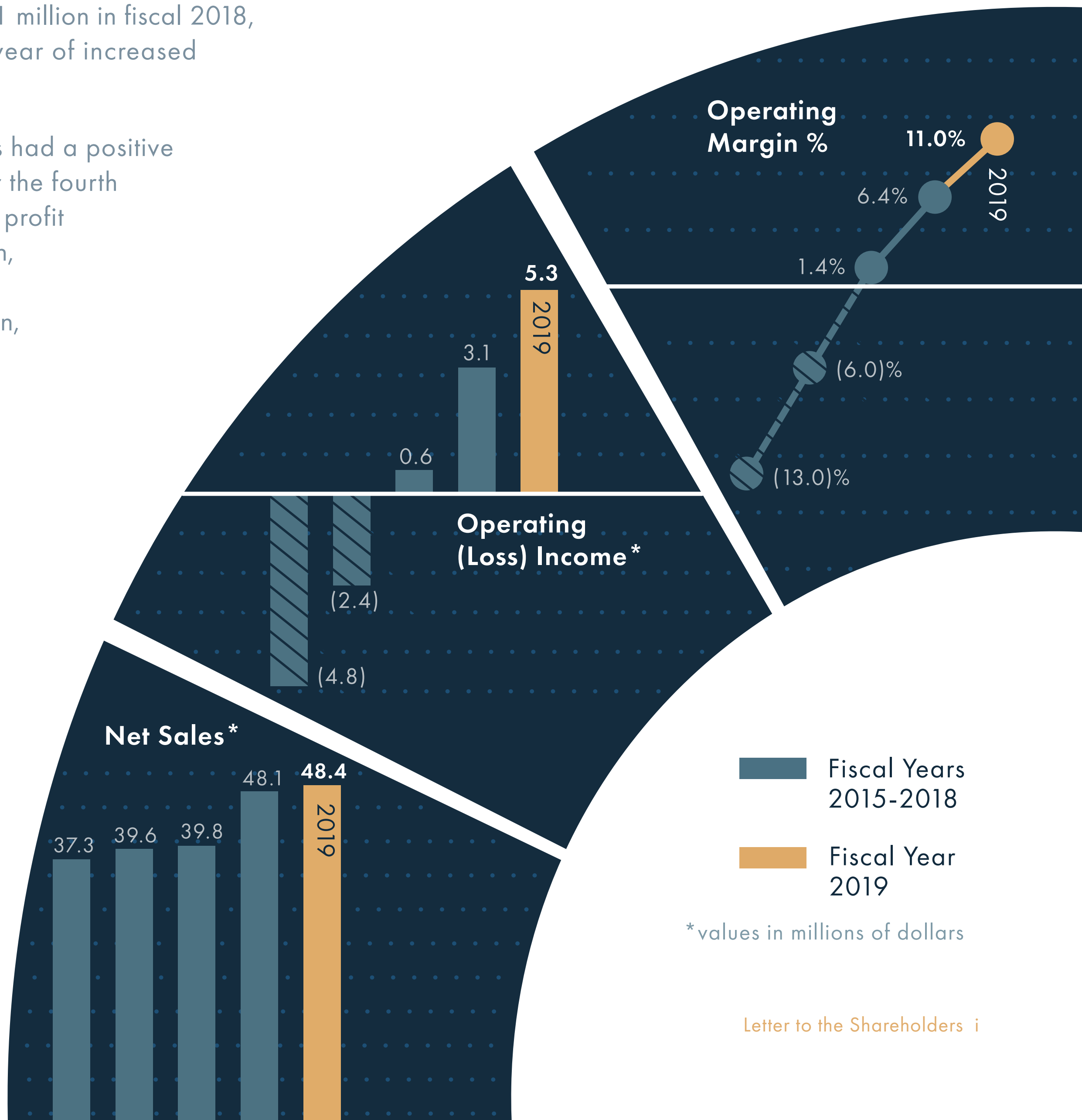
LETTER TO THE SHAREHOLDERS

We entered fiscal 2019

with a strong backlog of $67.5 million built upon strong international orders from the Middle East and Asia, added new orders from Europe and Australia for our Aircrew Training Systems products, and surpassed our prior year total orders for Sterilizer products. This resulted in net sales increasing by 0.7% to $48.4 million from $48.1 million in fiscal 2018, our fourth consecutive year of increased net sales.

This increase in net sales had a positive effect on profitability for the fourth consecutive year. Gross profit increased to $17.4 million, or 35.9% of net sales, compared to $16.1 million, or 33.5% of net sales in fiscal 2018. Increased gross profit margins reflect a more favorable product and customer mix, greater operational efficiencies, and fewer expenses related to a long-term contract for research altitude chambers at Wright-Patterson Air Force Base.

Increased sales and gross profit resulted in operating income increasing to $5.3 million, or 11.0% of net sales, from $3.1 million, or 6.4% of net sales,
in fiscal 2018.



TWO ATFS-400-25
HUMAN CENTRIFUGES
IN SOUTHAMPTON

ADMS - NEW TAIPEI CITY
EMERGENCY RESPONSE ACADEMY

AEROSPACE SOLUTIONS

In May 2018, the U.S. Air Force accepted its ATFS-400-31, the most sophisticated human centrifuge in the world today. We are pleased with its operational availability rate of about 98%.

Fiscal 2019 Aerospace Solutions net sales increased 2.2%, to $35.4 million, compared to $34.6 million in fiscal 2018. Backlog at year end in Aerospace Solutions of $27.2 million was down from the prior year end of $53.5 million, as a large percentage of those contracts were completed. Included in this backlog are contracts for products such as ATFS-400-25, GL-1500, Ejection Seat Simulator, Night Vision Trainer, Full-Flight Simulators (one fixed-wing and one rotary), and ADMS products.

During fiscal 2019, we completed the delivery of aeromedical equipment for an Aeromedical Center constructed for a new Middle Eastern customer and, after undergoing successful factory acceptance testing, shipped an ATFS-400-25 to an existing Asian customer.

Also during the year, we developed and delivered a GH-100 for the U.S. Army and a GH-200 for a European customer. Both are products specifically designed for spatial disorientation training in rotary wing (helicopter) aircraft that includes night vision capability.

GH-100
US ARMY

ETC Simulation sales decreased 26.1% in fiscal 2019 as a result of orders received during the second half of the fiscal year that will not be delivered until fiscal 2020. ETC Simulation expanded their sales and product range of vehicle operation simulators for the airport and fire department markets. Several large and customized incident command training systems were delivered to emergency response organizations. Multiple system upgrades and expansions have been done for existing customers. The realism and functionality of the next generation ADMS software is highly appreciated by the users and will contribute to the future growth of the business.

We continue

to see significant international opportunities for our Aircrew Training Systems, where the international community is investing in high performance aircraft that requires an investment in aeromedical and other forms of training for pilots to fly safely.

ETC-PZL Aerospace Industries Sp. Z o.o., our 95%-owned subsidiary in Warsaw, Poland, experienced a 13.1% increase in sales during fiscal 2019. This increase was due primarily to a strong backlog entering fiscal 2019 of $6.1 million. These contracts were primarily for full-flight simulator training devices and upgrade services.

EUROPEAN CUSTOMER GH-200
SPATIAL DISORIENTATION TRAINER

COMMERCIAL/INDUSTRIAL SYSTEMS

Commercial/ Industrial Systems sales of $13.0 million, decreased by 3.1%, from fiscal 2018, while the backlog at year end increased by 7.2%. A strong year for Sterilizers, with a sales increase of 13.9%, was due to a higher level of both ethylene oxide sterilizers and control system upgrades. This increase in ethylene oxide sterilizers reflects a trend after several years of weak sales.

The ETSS business unit sales declined by 53.5% in fiscal 2019, following a 98.2% increase in the prior year, primarily a result of a customer's requested delay in delivery, which represents a significant portion of the ETSS backlog.

Our Hyperbaric Chambers business unit sales increased to $2.8 million, or 213.2% over fiscal 2018, which was a weak year for hyperbaric sales. Much of this is a result of increased orders from Japan, which presently has improved the regulatory environment for this product.

All of us at ETC - Board members, Management, and Employees offer our thanks to H.F. "Gerry" Lenfest, our long time director and shareholder, who passed this year. We at ETC are grateful for Gerry's many years of unwavering support, and his guidance and counsel. We also offer our thanks to USN Vice Admiral (retired) Michael D. Malone, our Vice Chairman of the Board and a director since 2012, who recently passed away. Mike's guidance and counsel will also be missed.

ETC is poised for the future. We enter our 50th year with a backlog of $42.2 million, and a strong international pipeline. ETC's continued technological development of products that broaden its customer base continue its tradition of "Quality through Integrity and Technology". I'd like to thank our team of dedicated employees for their passion and pursuit of excellence, and our customers for their continued loyalty.

Robert L. Laurent, Jr.

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

STERILIZER CREW
IN FRONT OF TWO OF THE FIVE EO STERILIZERS IN PRODUCTION IN SOUTHAMPTON

FINANCIAL REVIEW

(in thousands, except per share information)

	Fiscal year ended	
	February 22, 2019	February 23, 2018
Net sales	$ 48,424	$ 48,086
Gross profit	17,397	16,127
Operating income	5,333	3,087
Net income attributable to ETC	3,147	2,377
Per share information:		
Basic earnings per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed earnings per share:		
Common	$ 0.17	$ 0.12
Preferred	$ 0.17	$ 0.12
Diluted earnings per share	$ 0.17	$ 0.12
Working capital	$ 13,673	$ 18,306
Total long-term debt obligations	12,359	20,893
Total assets	45,412	46,423
Total shareholders' equity	12,537	9,629
Weighted average common and participating shares:		
Basic	15,559	15,533
Diluted	15,561	15,536

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 22, 2019, which totaled $2,912 thousand, remained unpaid as of July 23, 2019, 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 2019 are references to the fifty-two week period ended February 22, 2019. References to fiscal 2018 are references to the fifty-two week period ended February 23, 2018. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2019.

Overview

ETC was incorporated in 1969 in Pennsylvania. For five 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, fixed and rotary wing 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 systems ("ETSS"); 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:

- Turnkey Aeromedical Centers;
- Authentic Tactical Fighting System ("ATFS") Motion Platforms;
  - ATFS-400-31 High Performance Human Centrifuge
  - ATFS-400-25 High Performance Human Centrifuge
- Interchangeable Cockpit Modules;
- G-LAB Human Centrifuge and G Trainer;
- GYROLAB GL-6000 KRAKEN Advanced Spatial Disorientation Training and Research Device;
- GYROLAB GL-4000;
- GYROLAB GL-1500;
- GYRO IPT-III eFOV;
- GYRO IPT-II Fixed Wing Spatial Disorientation Trainer;
- GH-200 Rotary Wing Spatial Disorientation Trainer;
- GAT-II Fixed Wing Aviation Trainer;
- GH-100 Rotary Wing Aviation Trainer;
- Night Vision Training System ("NVTS");
- Night Vision Goggle Training System ("NVGTS");
- FALCON Altitude (Hypobaric) Chambers;
- Multiplace Hyperbaric Chambers;
- Ejection Seat Simulator ("ESS");
- Pilot Selection System ("PSS");

Specific products within Aerospace include (continued):

- Water Survival Training equipment;
- Vestibular Illusion Demonstrator ("VID");
- 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;
- Aeromedical training;
- Suborbital and orbital commercial human spaceflight training;
- Upset prevention and recovery training ("UPRT");
- Crew resource management ("CRM") training;
- Advanced pilot training;
- Basic pilot training;
- Pilot selection;
- Emergency response training; and
- Integrated logistics support.

CIS encompasses the design, manufacture, and sale of:

- Environmental testing and simulation systems ("ETSS");
- Hyperbaric (100% oxygen) chambers for one person (monoplace chambers); and
- Steam and gas (ethylene oxide) sterilizers;
- 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.

ETC-PZL Aerospace Industries Sp. z o.o. ("ETC-PZL"), our 95%-owned subsidiary in Warsaw, Poland, is currently our only operating subsidiary. ETC-PZL manufactures certain simulators and provides software to support products manufactured domestically within our Aerospace segment. Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"), our formerly 99%-owned subsidiary, which was officially dissolved on August 15, 2017, 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 22, 2019, approximately twenty-four (24) employees were committed to sales and marketing functions. In addition to our one operating subsidiary, we have employees stationed in the United Kingdom, 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 integrated 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 ETSS 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.

Critical Accounting Policies

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

- estimating budget costs for large, multi-year contracts that involve significant engineering and software development;
- 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

The majority of our net sales are generated from long-term contracts with U.S. and foreign government agencies (including foreign military sales ("FMS") contracted through the U.S. Government) for the research, design, development, manufacture, integration, and sustainment of ATS products, including Chambers and the simulators manufactured and sold through ETC-PZL, collectively, Aeromedical Training Solutions. The Company also enters into long-term contracts with domestic customers for the sale of sterilizers and ETSS. Net sales of ADMS and monoplace chambers are generally much shorter term in nature and vary between domestic and international customers. We generally provide our products and services under fixed-price contracts.

Under fixed-price contracts, we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less profit or could incur a loss. Some fixed-price contracts have a performance-based component under which we may incur financial penalties based on our performance, such as liquidated damages for delayed delivery.

We account for a contract after it has been approved by all parties to the arrangement, the rights of the parties are identified, payment terms are identified, the contract has commercial substance, and collectability of consideration is probable.

We assess each contract at its inception to determine whether it should be combined with other contracts. When making this determination, we consider factors such as whether two or more contracts were negotiated and executed at or near the same time or were negotiated with an overall profit objective. If combined, we treat the combined contracts as a single contract for revenue recognition purposes.

We evaluate the products or services promised in each contract at inception to determine whether the contract should be accounted for as having one or more performance obligations. The majority of the Company's contracts with customers are accounted for as one performance obligation, as the majority of products and services is part of a single project or capability. In limited cases, our contracts have more than one distinct performance obligation, which occurs when we perform activities that are not interrelated or involve different product lifecycles. Significant judgment is required in determining performance obligations, and these decisions could change the amount of revenue and profit recorded in a given period.

We determine the transaction price for each contract based on the consideration we expect to receive for the products or services being provided under the contract, net of all sales and similar taxes collected from customers. For contracts where a portion of the price may vary, we estimate variable consideration at the most likely amount, which is included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur. We analyze the risk of a significant revenue reversal, and if necessary, constrain the amount of variable consideration recognized in order to mitigate this risk.

At the inception of a contract, we estimate the transaction price based on our current rights and do not contemplate future modifications (including unexercised options) or follow-on contracts until they become legally enforceable. Contracts are often subsequently modified to include changes in specifications, requirements, or price, which may create new or change existing enforceable rights and obligations. Depending on the nature of the modification, we consider whether to account for the modification as an adjustment to the existing contract or as a separate contract. Generally, modifications to our contracts are not distinct from the existing contract due to the significant integration and interrelated tasks provided in the context of the contract; therefore, such modifications are accounted for as if they were part of the existing contract and recognized as a cumulative adjustment to revenue. 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 may increase the transaction price if it is probable that the claim will result in an increase in the contract value and if the increase can be reliably estimated; however, the resulting 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.

For contracts with multiple performance obligations, we allocate the transaction price to each performance obligation based on the estimated standalone selling price of the product or service underlying each performance obligation. The standalone selling price represents the amount we would sell the product or service to a customer on a standalone basis (i.e., not bundled with any other products or services). Our contracts with the U.S. Government, including FMS contracts, are subject to the Federal Acquisition Regulations ("FAR") and the price is typically based on estimated or actual costs plus a reasonable profit margin. As a result of these regulations, the standalone selling price of products or services in our contracts with the U.S. Government and FMS contracts are typically equal to the selling price stated in the contract; therefore, we typically do not need to allocate (or reallocate) the transaction price to multiple performance obligations.

For non-U.S. Government contracts with multiple performance obligations, we evaluate whether the stated selling prices for the products or services represent their standalone selling prices. We primarily sell customized solutions unique to a customer's specifications. When it is necessary to allocate the transaction price to multiple performance obligations, we typically use the expected cost plus a reasonable profit margin to estimate the standalone selling price of each product or service. We occasionally sell standard products or services with observable standalone sales transactions. In these situations, the observable standalone sales transactions are used to determine the standalone selling price.

We recognize revenue as performance obligations are satisfied and the customer obtains control of the products and services. In determining when performance obligations are satisfied, we consider factors such as contract terms, payment terms, and whether there is an alternative future use of the product or service. Substantially all of our revenue is recognized over a period of time as we perform under the contract because control of the work in process transfers continuously to the customer. For contracts with the U.S. Government and FMS contracts, this continuous transfer of control of the work in process to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit, and take control of any work in process. Our non-U.S. Government contracts, primarily domestic and international direct commercial contracts, typically do not include termination for convenience provisions; however, continuous transfer of control to our customer is supported as, if our customer were to terminate the contract for reasons other than our non-performance, we would have the right to recover damages that would include, among other potential damages, the right to payment for our work performed to date plus a reasonable profit to deliver products or services that do not have an alternative use to us.

For performance obligations to deliver products with continuous transfer of control to the customer, revenue is recognized by means of an input measure based on the extent of progress towards completion of the performance obligation, generally using the percentage-of-completion cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer as we incur costs on our contracts. Under the percentage-of-completion cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs to complete the performance obligation(s).

For performance obligations in which control does not continuously transfer to the customer, we recognize revenue at the point in time in which each performance obligation is fully satisfied. This coincides with the point in time the customer obtains control of the product or service, which typically occurs upon customer acceptance or receipt of the product or service, given that we maintain control of the product or service until that point.

The Company also offers one to three year (and in limited cases fifteen year) maintenance and support agreements for many of its products, especially within the Aerospace segment. The specific terms and conditions of these agreements vary depending upon the product sold and country in which the product was sold. Revenue is recognized on such agreements over a period of time on a straight-line basis over the term of the maintenance and support services or the right to invoice method (in situations where the value transferred matches our billing rights) as our customer receives and consumes the benefits. The standalone selling price is determined based on the price charged when sold separately or upon renewal.

Sales backlog (i.e., unfulfilled or remaining performance obligations) represents the sales we expect to recognize for our products and services for which control has not yet transferred to the customer. The estimated consideration is determined at the outset of the contract and considers the risks related to the technical, schedule, and cost impacts to complete the contract and an estimate of any variable consideration. We review these risks on a quarterly basis and may increase or decrease backlog accordingly. As the risks on such contracts are successfully retired, the estimated consideration from customers may be reduced, resulting in a reduction of backlog without a corresponding recognition of sales.

For arrangements with the U.S. Government and FMS contracts, we generally do not begin work on contracts until funding is appropriated by the customer. Billing timetables and payment terms on our contracts vary based on a number of factors, including the contract type. Typical payment terms under fixed-price contracts with the U.S. Government provide that the customer pays either performance-based payments based on the achievement of contract milestones or progress payments based on a percentage of costs we incur. For the majority of our domestic and international direct commercial contracts, we typically receive advance payments prior to commencement of work, as well as milestone payments that are paid in accordance with the terms of our contract as we perform. We recognize a liability for payments in excess of revenue recognized, which is presented as a contract liability on the balance sheet. The portion of payments that may be retained by the customer until final contract settlement is not considered a significant financing component because the intent is to protect the customer from our failure to adequately complete some or all of the obligations under the contract. Payments received from customers in advance of revenue recognition are not considered to be significant financing components because they are used to meet working capital demands that can be higher in the early stages of a contract. We present revenues recognized in excess of billings as contract assets on the balance sheet. Amounts billed and due from our customers are classified as receivables on the balance sheet.

Significant estimates and assumptions are made in estimating contract sales and costs, including the profit booking rate. At the outset of a long-term contract, we identify and monitor risks to the achievement of the technical, schedule, and cost aspects of the contract, as well as variable consideration, and assess the effects of those risks on our estimates of sales and total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events), and costs (e.g., material, labor, subcontractor, overhead, and the estimated costs to fulfill our industrial cooperation agreements, sometimes referred to as offset agreements, required under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule, and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule, and cost aspects of the contract, which decreases the estimated total costs to complete the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the contract increase or our estimates of variable consideration we expect to receive decrease. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate. When estimates of total costs to be incurred on a contract exceed total estimates of the transaction price, a provision for the entire loss is determined at the contract level and is recorded in the period in which the loss is determined.

Comparability of our segment sales, operating income, and operating margin may be impacted favorably or unfavorably by changes in profit booking rates on our contracts for which we recognize revenue over a period of time using the percentage-of-completion cost-to-cost method to measure progress towards completion. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs to fulfill the performance obligations that reflect improved conditions on a particular contract. Conversely, conditions on a particular contract may deteriorate, resulting in an increase in the estimated total costs to fulfill the performance obligations and a reduction in the profit booking rate. Increases or decreases in profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes.

The aggregate impact of adjustments in contract estimates to net income attributable to ETC are presented below (in thousands):

Net income (loss) attributable to ETC		
	Fiscal 2019	**Fiscal 2018**
Aerospace	$ 223	$ (2,781)
CIS	(282)	(386)
Total	**$ (59)**	**$ (3,167)**

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 ("NOL") carryforwards and research and development tax credits. 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 assets and liabilities are offset and presented as a single non-current asset.

Results of Operations

Because of the nature of our business, we have historically experienced significant variability in our quarterly revenue, earnings, and other operating results, and our performance may fluctuate significantly in the future.

FISCAL 2019 VERSUS FISCAL 2018

(in thousands, except per share information)

	Summary Table of Results			
	Fiscal 2019	**Fiscal 2018**	**Variance ($)**	**Variance (%)**
Net sales:				
Domestic sales	$ 10,981	$ 14,987	$ (4,006)	(26.7)
U.S. Government sales	1,916	1,296	620	47.8
International sales	35,527	31,803	3,724	11.7
Net sales total	48,424	48,086	338	0.7
Gross profit	17,397	16,127	1,270	7.9
Gross profit margin %	35.9%	33.5%	2.4%	7.2%
Operating expenses:				
Selling and marketing	5,121	5,102	19	0.4
General and administrative	5,625	6,430	(805)	(12.5)
Research and development	1,318	1,508	(190)	(12.6)
Operating expenses total	12,064	13,040	(976)	(7.5)
Operating income	5,333	3,087	2,246	72.8
Operating margin %	11.0%	6.4%	4.6%	71.9%
Interest expense, net	1,003	857	146	17.0
Other expense, net	434	464	(30)	(6.5)
Income before income taxes	3,896	1,766	2,130	120.6
Pre-tax margin %	8.0%	3.7%	4.3%	116.2%
Income tax provision (benefit)	698	(662)	1,360	
Net income	3,198	2,428	770	31.7
Income attributable to non-controlling interest	(51)	(51)	-	0.0
Net income attributable to ETC	**$ 3,147**	**$ 2,377**	**$ 770**	**32.4**
Per share information:				
Basic earnings per common and participating share:				
Distributed earnings per share:				
Common	$ -	$ -	$ -	
Preferred	$ 0.08	$ 0.08	$ -	0.0
Undistributed earnings per share:				
Common	$ 0.17	$ 0.12	$ 0.05	41.7
Preferred	$ 0.17	$ 0.12	$ 0.05	41.7
Diluted earnings per share	**$ 0.17**	**$ 0.12**	**$ 0.05**	**41.7**

Net income attributable to ETC

Net income attributable to ETC was $3.1 million, or $0.17 diluted earnings per share, in fiscal 2019, compared to $2.4 million during fiscal 2018, equating to $0.12 diluted earnings per share. The $0.8 million increase is due to the combined effect of a $1.3 million increase in gross profit and a $1.0 million decrease in operating expenses, offset, in part, by a $1.4 million variance between the $0.7 million income tax provision recorded in fiscal 2019 compared to the $0.7 million income tax benefit recorded in fiscal 2018 and a $0.1 million increase in interest expense.

Net sales

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

	Fiscal 2019				Fiscal 2018			
	Domestic	U.S. Gov't	International	Total	Domestic	U.S. Gov't	International	Total
Aerospace Solutions								
Aeromedical Training Solutions	$ 407	$ 1,751	$ 30,176	$ 32,334	$ 1,832	$ 1,247	$ 27,416	$ 30,495
Simulation (ADMS)	516	165	2,379	3,060	1,039	-	3,100	4,139
Subtotal	923	1,916	32,555	35,394	2,871	1,247	30,516	34,634
Commercial/Industrial Systems								
Sterilizers	5,389	-	510	5,899	5,161	-	18	5,179
Environmental (ETSS)	2,100	-	502	2,602	4,580	49	965	5,594
Hyperbaric Chambers	790	-	1,960	2,750	574	-	304	878
Service and Spares	1,779	-	-	1,779	1,801	-	-	1,801
Subtotal	10,058	-	2,972	13,030	12,116	49	1,287	13,452
Net sales total	**$ 10,981**	**$ 1,916**	**$ 35,527**	**$ 48,424**	**$ 14,987**	**$ 1,296**	**$ 31,803**	**$ 48,086**

Type of Revenue	Fiscal 2019	Fiscal 2018
Products	86.4%	88.5%
Maintenance and support agreements	6.7%	5.7%
Services	5.2%	4.1%
Spare parts	1.7%	1.7%
Total	**100.0%**	**100.0%**

Net sales for fiscal 2019 were $48.4 million, an increase of $0.3 million, or 0.7%, compared to fiscal 2018 net sales of $48.1 million. The increase reflects higher International sales within Aeromedical Training Solutions and of monoplace chambers within the Hyperbaric Chambers business unit, offset, in part, by a decrease in Domestic sales, especially within our Aerospace segment and our Environmental business unit of our CIS segment.

In fiscal 2019, 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 $16.1 million represented 33.2% of total net sales. In fiscal 2018, the same 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 $17.2 million represented 35.8% of total net sales.

Within the Company's February 22, 2019 sales backlog of $42.2 million, two contracts, each with International customers (one within the Aerospace segment and one within the CIS segment), represented at least 10% of the total sales backlog and constituted $17.2 million, or 40.9%, of the total sales backlog. As of February 22, 2019, three (3) business units, Aeromedical Training Solutions, ETSS, and Sterilizers, each represented 10.0% or more of total sales backlog. Aeromedical Training Solutions sales backlog was $25.3 million, or 59.9%, of the total sales backlog, ETSS sales backlog was $7.7 million, or 18.3%, of the total sales backlog, and Sterilizers sales backlog was $6.0 million, or 14.3% of total sales backlog. We expect to recognize approximately 80% of the total sales backlog as of February 22, 2019 over the next twelve (12) months and approximately 91% over the next twenty-four (24) months as revenue, with the remainder recognized thereafter. Given the Company's sales backlog as of February 22, 2019, it is anticipated that ETC will generate the majority of its sales from International contracts.

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 2019 were $11.0 million, a decrease of $4.0 million, or 26.7%, compared to fiscal 2018, and represented 22.7% of total net sales compared to 31.2% in fiscal 2018. The decrease in Domestic sales is comprised of a $2.5 million decrease in sales within ETSS, a $1.4 million decrease in sales within Aeromedical Training Solutions, and a $0.5 decrease in sales of our ADMS line of products, offset, in part, by a $0.2 million increase in sales within both the Sterilizers and Hyperbaric Chambers business units of our CIS segment.

U.S. Government sales

U.S. Government sales in fiscal 2019 were $1.9 million, an increase of $0.6 million, or 47.8%, from fiscal 2018 primarily as a result of receiving several new U.S. Government contracts. The $0.6 million increase was comprised almost entirely of sales within our Aerospace segment. U.S. Government sales represented 4.0% of total net sales in fiscal 2019 compared to 2.7% in fiscal 2018.

International sales

International sales in fiscal 2019, including those of ETC-PZL, were $35.5 million, an increase of $3.7 million, or 11.7%, compared to fiscal 2018. The increase in International sales is a result of a $2.7 million increase in sales within Aeromedical Training Solutions, a $1.7 million increase in sales of monoplace chambers within the Hyperbaric Chambers business unit, and a $0.5 million increase in sales within our Sterilizers business unit due primarily to higher sales of ethylene oxide sterilizers, offset, in part, by a $0.7 million decrease in sales of our ADMS line of products and a $0.5 million decrease in sales within ETSS. In aggregate, International sales represented 73.3% of the Company's total net sales in fiscal 2019 compared to 66.1% in fiscal 2018. In fiscal 2019, International sales totaling at least $500 thousand were made to customers in eleven (11) different countries; in fiscal 2018, International sales totaling at least $500 thousand were made to customers in nine (9) different countries.

Segment sales

Aerospace sales were $35.4 million in fiscal 2019, an increase of $0.8 million, or 2.2%, from sales of $34.6 million in fiscal 2018. This increase was primarily due to higher International sales within Aeromedical Training Solutions. Sales of Aerospace products accounted for 73.1% of our total net sales in fiscal 2019 versus 72.0% in fiscal 2018. Sales in our CIS segment decreased $0.5 million, or 3.1%, and constituted 26.9% of our total net sales in fiscal 2019 compared to 28.0% in fiscal 2018. The decrease was primarily due to lower sales within ETSS; offset, in part, by an increase in International sales of monoplace chambers within the Hyperbaric Chambers business unit.

Gross profit

Gross profit for fiscal 2019 was $17.4 million compared to $16.1 million in fiscal 2018, an increase of $1.3 million, or 7.9%. The increase in gross profit was due to a higher blended gross profit margin as a percentage of net sales, which increased to 35.9% in fiscal 2019 compared to 33.5% in fiscal 2018. The increase in gross profit margin as a percentage of net sales was due primarily to a higher concentration of net sales from more mature products requiring less initial design and engineering work. The shift in concentration of net sales from Domestic sales within the CIS segment in fiscal 2018 to International sales within the Aerospace segment in fiscal 2019 also contributed to the increase in gross profit margin as a percentage of net sales.

Selling and marketing expenses

Selling and marketing expenses for both fiscal 2019 and fiscal 2018 were $5.1 million. As a percentage of net sales, selling and marketing expenses also remained steady at 10.6% for both fiscal 2019 and fiscal 2018.

General and administrative expenses

General and administrative expenses for fiscal 2019 of $5.6 million decreased by $0.8 million, or 12.5%, from $6.4 million in fiscal 2018. The decrease in general and administrative expenses was due primarily to a reduction in expenses related to the Company's process to explore strategic alternatives and the conclusion of a consulting agreement with the Company's former Chief Executive Officer. As a percentage of net sales, general and administrative expenses decreased to 11.6% in fiscal 2019 compared to 13.4% in fiscal 2018.

Research and development expenses

Research and development expenses include spending for potential new products and technologies, and work performed internationally under government grant programs. This spending, net of grant payments from the Polish and Turkish governments, totaled $1.3 million for fiscal 2019 compared to $1.5 million in fiscal 2018, a decrease of $0.2 million, or 12.6%. 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 2019. 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 2.7% in fiscal 2019 compared to 3.1% in fiscal 2018.

Operating income

Operating income in fiscal 2019 was $5.3 million compared to $3.1 million in fiscal 2018. The $2.2 million, or 72.8%, increase was due to a higher blended gross profit margin as a percentage of net sales combined with a decrease in operating expenses.

On a segment basis, Aerospace posted operating income of $6.9 million for fiscal 2019, a $1.6 million, or 29.0%, improvement compared to $5.3 million in fiscal 2018. The increase in Aerospace operating income is due primarily to a higher concentration of International net sales of more mature products requiring less initial design and engineering work. CIS posted an operating loss of $0.5 million for fiscal 2019, a $0.4 million improvement compared to an operating loss of $0.9 million in fiscal 2018. The increase in International sales of monoplace chambers was the primary contributing factor in improving the profitability of the CIS segment. These segment operating results were offset, in part, by unallocated corporate expenses.

Interest expense, net

Interest expense, net, for fiscal 2019 was $1.0 million compared to $0.9 million in fiscal 2018, an increase of $0.1 million, or 17.0%, due to the combination of a higher level of bank borrowing and an increase in interest rates.

Other expense, net

Other expense, net, for both fiscal 2019 and fiscal 2018 was $0.4 million. Other expense, net consists primarily of bank and letter of credit fees, as well as realized foreign currency exchange gains and losses.

Income taxes

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act, among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. Consequently, we wrote down approximately $2.2 million of our net deferred tax assets as of February 23, 2018 to reflect the re-measurement of certain net deferred tax assets using the lower U.S. corporate income tax rate; however, due to the previously established valuation allowance for such deferred tax assets, the impact was minimal. As of February 22, 2019, 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 NOL carryforwards and research and development tax credits will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established a $6.0 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 $0.7 million was recorded in fiscal 2019 compared to an income tax benefit of $0.7 million recorded in fiscal 2018. Effective tax rates were 17.9% and 37.5% for fiscal 2019 and fiscal 2018, respectively. The decrease in the effective tax rate for fiscal 2019 as compared to fiscal 2018 was driven primarily by the Tax Act, which among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. The income tax benefit recorded in fiscal 2018 was driven primarily by a net one-time benefit of $0.4 million to reflect the estimated impact of the Tax Act. This net one-time benefit of $0.4 million was comprised of a reduction in the valuation allowance related to our alternative minimum tax credit (approximately $0.6 million), offset, in part, by a deemed repatriation tax (approximately $0.2 million, for which we were allowed to net against our federal NOL carryforwards). As of December 22, 2018, we completed our accounting for all of the enactment-date income tax effects of the Tax Act and did not identify any material changes to the provisional, net, one-time benefit recorded in fiscal 2018 related to the Tax Act.

Liquidity and Capital Resources

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 ended 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 increased 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"), under which amounts may be borrowed, repaid, and re-borrowed until the maturity date.

(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 $3.8 million as of July 23, 2019, 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 (2.3980% as of July 1, 2019, 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 22, 2019), substantially all of the Company's additional assets, and the pledged cash collateral of the estate of H.F. Lenfest ("Mr. Lenfest"), a major shareholder and director of ETC since 2003, who passed away on August 5, 2018.

On April 9, 2018, subsequent to the end of fiscal 2018, 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 Revolving Line of Credit was increased from $21.0 million to $25.0 million.

(ii) The maturity date of the 2016 PNC Credit Facilities was extended from June 30, 2018 to June 30, 2019.

(iii) The interest rate margin on the 2016 PNC Credit Facilities was lowered from 3.00% to 2.75%.

On June 28, 2019, subsequent to the end of fiscal 2019, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that extended the maturity date of the 2016 PNC Credit Facilities from June 30, 2019 to June 30, 2020.

As of February 22, 2019, the Company's availability under the Revolving Line of Credit was $9.5 million. This reflected cash borrowings of $12.4 million and net outstanding standby letters of credit not covered by the Committed Line of Credit of approximately $3.1 million. As of July 1, 2019, the date of our most current Revolving Line of Credit statement, the Company's availability under the Revolving Line of Credit was approximately $7.3 million. The Company had working capital of $13.7 million as of February 22, 2019 compared to working capital of $18.3 million as of February 23, 2018. The decrease in working capital was primarily the result of an increase in accrued expenses. With unused availability under the Company's various current lines of credit, the conversion of contract assets into cash, the collection of milestone payments associated with several International contracts, and expected deposits on fiscal 2020 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 2020.

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 2019, due primarily from the increase in net income, the decrease in accounts receivable and contract assets, and the increase in other accrued liabilities, the Company generated $13.3 million of cash from operating activities compared to using $2.1 million in fiscal 2018.

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 2019 investing activities used $0.3 million, which consisted primarily of equipment and software enhancements for our ATFS and ADMS technologies, and costs to upgrade existing information technology systems and enhance our manufacturing and ETSS testing capabilities. This is a decrease of $0.2 million from cash used in investing activities in fiscal 2018.

Cash flows from financing activities

During fiscal 2019, the Company's financing activities used $8.5 million of cash for repayments under the Company's various lines of credit. During fiscal 2018, the Company's financing activities provided $3.0 million of cash from borrowings 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 contract assets into cash, the collection of milestone payments associated with several International contracts, and expected deposits on fiscal 2020 bookings, should continue to provide us sufficient funds for fiscal 2020. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated results in fiscal 2021 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 2019 or fiscal 2018 other than disclosed in Note 10 – Commitments and Contingencies that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to our shareholders.

Board of Directors Actions

Effective June 18, 2019, Ms. Joy Tartar, a director since 2018, has exited the Board of Directors. Ms. Tartar's exit from the Board was not based on any disagreement with the Company on any matter relating to the Company's operations, policies, or practices.

On June 20, 2019, Michael D. Malone, Vice Admiral, USN (Ret.), a director of ETC since 2012 and Vice Chairman of the Board of Directors since 2015, passed away. Mr. Malone's contribution to the strategic direction of ETC's ATS business will be missed.

At the present time, replacements for Ms. Tartar and Mr. Malone have not been named. Ms. Tartar's seat on the ETC Board is reserved for nomination by the holder of ETC's Series E Preferred Stock.

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

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 22, 2019 and February 23, 2018 the related consolidated statements of earnings and comprehensive 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 the 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 the 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 22, 2019 and February 23, 2018, 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
July 23, 2019

CONSOLIDATED BALANCE SHEETS

(in thousands, except share information)

	February 22, 2019	February 23, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,061	$ 329
Restricted cash	5,956	5,954
Accounts receivable, net	2,913	5,912
Contract assets	15,264	16,548
Inventories, net	2,819	2,377
Prepaid expenses and other current assets	1,378	2,374
Total current assets	33,391	33,494
Property, plant, and equipment, at cost, net	11,490	12,353
Capitalized software development costs, net	90	87
Deferred tax assets, non-current, net	441	489
Total assets	**$ 45,412**	**$ 46,423**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	$ 3,607	$ 3,886
Contract liabilities	6,609	5,930
Accrued taxes	1,703	162
Accrued interest and dividends	2,985	2,495
Other accrued liabilities, current	4,814	2,715
Total current liabilities	19,718	15,188
Long-term debt obligations, net of debt issuance costs, less current portion:		
Credit facility payable to bank, net of debt issuance costs	12,359	20,893
Total long-term debt obligations, net of debt issuance costs, less current portion	12,359	20,893
Other accrued liabilities, non-current	798	713
Total liabilities	32,875	36,794
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Cumulative convertible participating Preferred Stock, Series E, $0.05 par value, 25,000 authorized; 12,127 shares outstanding as of Feb. 22, 2019 and Feb. 23, 2018	12,127	12,127
Common Stock, $0.05 par value, 50,000,000 shares authorized; 9,443,785 and 9,428,071 shares issued and outstanding as of Feb. 22, 2019 and Feb. 23, 2018, respectively	472	471
Additional paid-in capital	8,105	8,563
Accumulated deficit	(7,540)	(10,687)
Accumulated other comprehensive loss	(828)	(995)
Total shareholders' equity before non-controlling interest	12,336	9,479
Non-controlling interest	201	150
Total shareholders' equity	12,537	9,629
Total liabilities and shareholders' equity	**$ 45,412**	**$ 46,423**

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

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(in thousands, except per share information)

	Fiscal Year Ended	
	Feb. 22, 2019	Feb. 23, 2018
Net sales	$ 48,424	$ 48,086
Cost of goods sold	31,027	31,959
Gross profit	17,397	16,127
Operating expenses:		
Selling and marketing	5,121	5,102
General and administrative	5,625	6,430
Research and development	1,318	1,508
Operating expenses total	12,064	13,040
Operating income	5,333	3,087
Other expenses:		
Interest expense, net	1,003	857
Other expense, net	434	464
Other expenses total	1,437	1,321
Income before income taxes	3,896	1,766
Income tax provision (benefit)	698	(662)
Net income	3,198	2,428
Income attributable to non-controlling interest	(51)	(51)
Net income attributable to ETC	**3,147**	**2,377**
Foreign currency translation adjustment	167	(552)
Comprehensive income	$ 3,314	$ 1,825
Preferred Stock dividends	(484)	(484)
Income attributable to common and participating shareholders	$ 2,663	$ 1,893
Per share information:		
Basic earnings per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed earnings per share:		
Common	$ 0.17	$ 0.12
Preferred	$ 0.17	$ 0.12
Diluted earnings per share	**$ 0.17**	**$ 0.12**
Basic weighted average common and participating shares:		
Common weighted average number of shares	9,434	9,412
Participating preferred shares	6,125	6,121
Total basic weighted average common and participating shares	15,559	15,533
Diluted weighted average shares:		
Basic weighted average common and participating shares	15,559	15,533
Dilutive effect of stock options	2	3
Total diluted weighted average shares	15,561	15,536

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

CONSOLIDATED STATEMENTS 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 24, 2017	$ 12,127	9,185,161	$ 459	$ 8,798	$ (13,064)	$ (443)	$ 7,976
Less: Prior year non-controlling interest	-	-	-	-	-	-	(99)
Net income attributable to ETC	-	-	-	-	2,377	-	2,377
Foreign currency translation adjustment	-	-	-	-	-	(552)	(552)
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	98	-	-	98
Issuance of stock for officer compensation	-	242,910	12	151	-	-	163
Balance before non-controlling interest, February 23, 2018	12,127	9,428,071	471	8,563	(10,687)	(995)	9,479
Non-controlling interest	-	-	-	-	-	-	150
Balance, February 23, 2018	**$ 12,127**	**9,428,071**	**$ 471**	**$ 8,563**	**$ (10,687)**	**$ (995)**	**$ 9,629**
Less: Prior year non-controlling interest	-	-	-	-	-	-	(150)
Net income attributable to ETC	-	-	-	-	3,147		3,147
Foreign currency translation adjustment	-	-	-	-	-	167	167
Preferred Stock dividends	-			(484)			(484)
Stock compensation expense	-	-	-	16	-	-	16
Issuance of stock for director compensation	-	15,714	1	10	-	-	11
Balance before non-controlling interest, February 22, 2019	12,127	9,443,785	472	8,105	(7,540)	(828)	12,336
Non-controlling interest	-	-	-	-	-	-	201
Balance, February 22, 2019	**$ 12,127**	**9,443,785**	**$ 472**	**$ 8,105**	**$ (7,540)**	**$ (828)**	**$ 12,537**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Fiscal year ended	
	Feb. 22, 2019	Feb. 23, 2018
Cash flows from operating activities:		
Net income	$ 3,198	$ 2,428
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,136	1,265
Deferred income taxes	24	2,790
Increase (decrease) in valuation allowance for deferred tax assets	24	(3,576)
Increase in allowance for doubtful accounts and inventory obsolescence	50	28
Accretion of loan origination deferred charge and deferred financing costs	-	24
Stock compensation expense	16	98
Issuance of Common Stock	11	163
Changes in operating assets and liabilities:		
Accounts receivable	3,144	1,121
Contract assets	1,284	(3,617)
Inventories	(637)	457
Prepaid expenses and other assets	996	(327)
Accounts payable, trade	(279)	1,177
Contract liabilities	679	(4,834)
Accrued taxes	1,541	8
Accrued interest and dividends	6	16
Other accrued liabilities	2,184	701
Net cash provided by (used in) operating activities	**13,377**	**(2,078)**
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(212)	(402)
Capitalized software development costs	(64)	(63)
Net cash used in investing activities	**(276)**	**(465)**
Cash flows from financing activities:		
(Repayments) borrowings under lines of credit	(8,534)	2,977
Net cash (used in) provided by financing activities	**(8,534)**	**2,977**
Effect of exchange rate changes on cash	167	(552)
Net increase (decrease) in cash, cash equivalents, and restricted cash	4,734	(118)
Cash, cash equivalents, and restricted cash at beginning of period	6,283	6,401
Cash, cash equivalents, and restricted cash at end of period	**$ 11,017**	**$ 6,283**
Less: Restricted cash	(5,956)	(5,954)
Cash and cash equivalents at end of period	**$ 5,061**	**$ 329**
Supplemental schedule of cash flow information:		
Interest paid	$ 1,102	$ 805
Income taxes paid	$ 15	$ -
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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share information)

Description of Business

ETC was incorporated in 1969 in Pennsylvania. For five 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, fixed and rotary wing, 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 systems ("ETSS"); 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) ETSS; 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 ETSS 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 2019 are references to the fifty-two week period ended February 22, 2019. References to fiscal 2018 are references to the fifty-two week period ended February 23, 2018. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2019.

Sales Backlog

Below is a breakdown of the Company's February 22, 2019 sales backlog (amounts in thousands, except percentages):

	Business segment			
Geographic Area	**Aerospace**	**CIS**	**Total**	**%**
Domestic	$ 1,277	$ 2,822	$ 4,099	9.7
U.S. Government	2,086	-	2,086	4.9
International	23,877	12,129	36,006	85.4
Total	**$ 27,240**	**$ 14,951**	**$ 42,191**	**100.0**
% of Total	64.6%	35.4%	100.0%	

Within the Company's February 22, 2019 sales backlog of $42,191, two contracts, each with International customers (one within the Aerospace segment and one within the CIS segment), represented at least 10% of the total sales backlog and constituted $17,249, or 40.9%, of the total sales backlog. As of February 22, 2019, three (3) business units, Aeromedical Training Solutions, ETSS, and Sterilizers, each represented 10.0% or more of total sales backlog. Aeromedical Training Solutions sales backlog was $25,252, or 59.9%, of the total sales backlog, ETSS sales backlog was $7,732, or 18.3%, of the total sales backlog, and Sterilizers sales backlog was $6,025, or 14.3% of total sales backlog. We expect to recognize approximately 80% of the total sales backlog as of February 22, 2019 over the next twelve (12) months and approximately 91% over the next twenty-four (24) months as revenue, with the remainder recognized thereafter. Given the Company's sales backlog as of February 22, 2019, it is anticipated that ETC will generate the majority of its sales from 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 formerly 99%-owned subsidiary Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"), which was officially dissolved on August 15, 2017. "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 when estimating budget costs for large, multi-year contracts that involve significant engineering and software development and for 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

The majority of our net sales are generated from long-term contracts with U.S. and foreign government agencies (including foreign military sales ("FMS") contracted through the U.S. Government) for the research, design, development, manufacture, integration, and sustainment of ATS products, including Chambers and the simulators manufactured and sold through ETC-PZL, collectively, Aeromedical Training Solutions. The Company also enters into long-term contracts with domestic customers for the sale of sterilizers and ETSS. Net sales of ADMS and monoplace chambers are generally much shorter term in nature and vary between domestic and international customers. We generally provide our products and services under fixed-price contracts.

Under fixed-price contracts, we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less profit or could incur a loss. Some fixed-price contracts have a performance-based component under which we may incur financial penalties based on our performance, such as liquidated damages for delayed delivery.

We account for a contract after it has been approved by all parties to the arrangement, the rights of the parties are identified, payment terms are identified, the contract has commercial substance, and collectability of consideration is probable.

We assess each contract at its inception to determine whether it should be combined with other contracts. When making this determination, we consider factors such as whether two or more contracts were negotiated and executed at or near the same time or were negotiated with an overall profit objective. If combined, we treat the combined contracts as a single contract for revenue recognition purposes.

We evaluate the products or services promised in each contract at inception to determine whether the contract should be accounted for as having one or more performance obligations. The majority of the Company's contracts with customers are accounted for as one performance obligation, as the majority of products and services is part of a single project or capability. In limited cases, our contracts have more than one distinct performance obligation, which occurs when we perform activities that are not interrelated or involve different product lifecycles. Significant judgment is required in determining performance obligations, and these decisions could change the amount of revenue and profit recorded in a given period.

We determine the transaction price for each contract based on the consideration we expect to receive for the products or services being provided under the contract, net of all sales and similar taxes collected from customers. For contracts where a portion of the price may vary, we estimate variable consideration at the most likely amount, which is included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur. We analyze the risk of a significant revenue reversal, and if necessary, constrain the amount of variable consideration recognized in order to mitigate this risk.

At the inception of a contract, we estimate the transaction price based on our current rights and do not contemplate future modifications (including unexercised options) or follow-on contracts until they become legally enforceable. Contracts are often subsequently modified to include changes in specifications, requirements, or price, which may create new or change existing enforceable rights and obligations. Depending on the nature of the modification, we consider whether to account for the modification as an adjustment to the existing contract or as a separate contract. Generally, modifications to our contracts are not distinct from the existing contract due to the significant integration and interrelated tasks provided in the context of the contract; therefore, such modifications are accounted for as if they were part of the existing contract and recognized as a cumulative adjustment to revenue. 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 may increase the transaction price if it is probable that the claim will result in an increase in the contract value and if the increase can be reliably estimated; however, the resulting 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.

For contracts with multiple performance obligations, we allocate the transaction price to each performance obligation based on the estimated standalone selling price of the product or service underlying each performance obligation. The standalone selling price represents the amount we would sell the product or service to a customer on a standalone basis (i.e., not bundled with any other products or services). Our contracts with the U.S. Government, including FMS contracts, are subject to the Federal Acquisition Regulations ("FAR") and the price is typically based on estimated or actual costs plus a reasonable profit margin. As a result of these regulations, the standalone selling price of products or services in our contracts with the U.S. Government and FMS contracts are typically equal to the selling price stated in the contract; therefore, we typically do not need to allocate (or reallocate) the transaction price to multiple performance obligations.

For non-U.S. Government contracts with multiple performance obligations, we evaluate whether the stated selling prices for the products or services represent their standalone selling prices. We primarily sell customized solutions unique to a customer's specifications. When it is necessary to allocate the transaction price to multiple performance obligations, we typically use the expected cost plus a reasonable profit margin to estimate the standalone selling price of each product or service. We occasionally sell standard products or services with observable standalone sales transactions. In these situations, the observable standalone sales transactions are used to determine the standalone selling price.

We recognize revenue as performance obligations are satisfied and the customer obtains control of the products and services. In determining when performance obligations are satisfied, we consider factors such as contract terms, payment terms, and whether there is an alternative future use of the product or service. Substantially all of our revenue is recognized over a period of time as we perform under the contract because control of the work in process transfers continuously to the customer. For contracts with the U.S. Government and FMS contracts, this continuous transfer of control of the work in process to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit, and take control of any work in process. Our non-U.S. Government contracts, primarily domestic and international direct commercial contracts, typically do not include termination for convenience provisions; however, continuous transfer of control to our customer is supported as, if our customer were to terminate the contract for reasons other than our non-performance, we would have the right to recover damages that would include, among other potential damages, the right to payment for our work performed to date plus a reasonable profit to deliver products or services that do not have an alternative use to us.

For performance obligations to deliver products with continuous transfer of control to the customer, revenue is recognized by means of an input measure based on the extent of progress towards completion of the performance obligation, generally using the percentage-of-completion cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer as we incur costs on our contracts. Under the percentage-of-completion cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs to complete the performance obligation(s).

For performance obligations in which control does not continuously transfer to the customer, we recognize revenue at the point in time in which each performance obligation is fully satisfied. This coincides with the point in time the customer obtains control of the product or service, which typically occurs upon customer acceptance or receipt of the product or service, given that we maintain control of the product or service until that point.

The Company also offers one to three year (and in limited cases fifteen year) maintenance and support agreements for many of its products, especially within the Aerospace segment. The specific terms and conditions of these agreements vary depending upon the product sold and country in which the product was sold. Revenue is recognized on such agreements over a period of time on a straight-line basis over the term of the maintenance and support services or the right to invoice method (in situations where the value transferred matches our billing rights) as our customer receives and consumes the benefits. The standalone selling price is determined based on the price charged when sold separately or upon renewal.

Sales backlog (i.e., unfulfilled or remaining performance obligations) represents the sales we expect to recognize for our products and services for which control has not yet transferred to the customer. The estimated consideration is determined at the outset of the contract and considers the risks related to the technical, schedule, and cost impacts to complete the contract and an estimate of any variable consideration. We review these risks on a quarterly basis and may increase or decrease backlog accordingly. As the risks on such contracts are successfully retired, the estimated consideration from customers may be reduced, resulting in a reduction of backlog without a corresponding recognition of sales.

For arrangements with the U.S. Government and FMS contracts, we generally do not begin work on contracts until funding is appropriated by the customer. Billing timetables and payment terms on our contracts vary based on a number of factors, including the contract type. Typical payment terms under fixed-price contracts with the U.S. Government provide that the customer pays either performance-based payments based on the achievement of contract milestones or progress payments based on a percentage of costs we incur. For the majority of our domestic and international direct commercial contracts, we typically receive advance payments prior to commencement of work, as well as milestone payments that are paid in accordance with the terms of our contract as we perform. We recognize a liability for payments in excess of revenue recognized, which is presented as a contract liability on the balance sheet. The portion of payments that may be retained by the customer until final contract settlement is not considered a significant financing component because the intent is to protect the customer from our failure to adequately complete some or all of the obligations under the contract. Payments received from customers in advance of revenue recognition are not considered to be significant financing components because they are used to meet working capital demands that can be higher in the early stages of a contract. We present revenues recognized in excess of billings as contract assets on the balance sheet. Amounts billed and due from our customers are classified as receivables on the balance sheet.

Significant estimates and assumptions are made in estimating contract sales and costs, including the profit booking rate. At the outset of a long-term contract, we identify and monitor risks to the achievement of the technical, schedule, and cost aspects of the contract, as well as variable consideration, and assess the effects of those risks on our estimates of sales and total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events), and costs (e.g., material, labor, subcontractor, overhead, and the estimated costs to fulfill our industrial cooperation agreements, sometimes referred to as offset agreements, required under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule, and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule, and cost aspects of the contract, which decreases the estimated total costs to complete the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the contract increase or our estimates of variable consideration we expect to receive decrease. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate. When estimates of total costs to be incurred on a contract exceed total estimates of the transaction price, a provision for the entire loss is determined at the contract level and is recorded in the period in which the loss is determined.

Comparability of our segment sales, operating income, and operating margin may be impacted favorably or unfavorably by changes in profit booking rates on our contracts for which we recognize revenue over a period of time using the percentage-of-completion cost-to-cost method to measure progress towards completion. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs to fulfill the performance obligations that reflect improved conditions on a particular contract. Conversely, conditions on a particular contract may deteriorate, resulting in an increase in the estimated total costs to fulfill the performance obligations and a reduction in the profit booking rate. Increases or decreases in profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes.

The aggregate impact of adjustments in contract estimates to net income attributable to ETC are presented below:

Net income (loss) attributable to ETC		
	Fiscal 2019	**Fiscal 2018**
Aerospace	$ 223	$ (2,781)
CIS	(282)	(386)
Total	**$ (59)**	**$ (3,167)**

Cash and Cash Equivalents

Cash includes short-term deposits at market interest rates with original maturities of three (3) 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 22, 2019 compared to $5,954 as of February 23, 2018. 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

Accounts receivable represents our unconditional right to consideration under the contract and include amounts billed and currently due from customers. The amounts are stated at their net estimated realizable value.

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 $291, or 10.0%, of total net accounts receivable as of February 22, 2019 as compared to $829, or 14.0%, of total net accounts receivable as of February 23, 2018. As of July 23, 2019, the date of issuance of our consolidated financial statements, 77.3% of these receivables outstanding as of February 22, 2019 and 90.1% of these receivables outstanding as of February 23, 2018 have been collected, respectively. See Note 2 – Accounts Receivable for additional disclosures related to our accounts receivable.

Contract Assets

Contract assets (formerly referred to as costs and estimated earnings of billings on uncompleted long-term contracts) include unbilled amounts typically resulting from sales under contracts when the percentage-of-completion cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer. The amounts may not exceed their estimated net realizable value. In accordance with industry practices, contract assets are classified as current even though a portion of these amounts may not be realized within one year.

Contract Liabilities

Contract liabilities include billings in excess of revenue recognized (formerly referred to as billings in excess of costs and estimated earnings on uncompleted long-term contracts) and advance payments (formerly referred to as customer deposits). In accordance with industry practices, contract liabilities are classified as current.

Inventories

Inventories are valued at the lower of cost or net realizable value. 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 addition, we capitalize costs to fulfill incurred in advance of contract award in inventories as work-in-process if we determine that contract award is probable.

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 it 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 $16,983 and $16,932 as of February 22, 2019 and February 23, 2018, respectively. The net book value of demonstration equipment was $7,835 and $8,577 as of February 22, 2019 and February 23, 2018, 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 2019 and fiscal 2018, $118 and $2, 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 $61 and $122 in fiscal 2019 and fiscal 2018, respectively. Estimated software amortization, which is based on existing capitalized software, for each of the next five (5) fiscal years is as follows: $46 in fiscal 2020, $28 in fiscal 2021, and $16 in fiscal 2022.

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 2019 and fiscal 2018, the Company was involved with zero (0) and two (2) such grants, respectively. Payments received under these grants are recorded as a reduction of research and development costs. Such payments totaled $0 in fiscal 2019 and $239 in fiscal 2018. Research and development expenses, which totaled $1,318 in fiscal 2019 and $1,747 in fiscal 2018, 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 $1,318 for fiscal 2019 compared to $1,508 for fiscal 2018.

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 ("NOL") carryforwards and research and development tax credits. 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 assets and liabilities are offset and presented as a single non-current asset.

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

Long-Lived Assets

The Company reviews its property, plant, and equipment for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the net undiscounted cash flows expected to be generated by the asset. An impairment loss would be recorded for the excess of net book value over the fair value of the asset impaired. The fair value is estimated based on expected undiscounted future cash flows. The results of impairment tests are subject to management's estimates and assumptions of projected cash flows and operating results; actual results may differ. There were no impairment losses recorded in either fiscal 2019 or fiscal 2018.

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 no stock options granted in either fiscal 2019 or fiscal 2018.

Advertising Costs

The Company expenses advertising costs, which include trade shows, as incurred. Advertising costs were $177 and $174 in fiscal 2019 and fiscal 2018, 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 22, 2019 and February 23, 2018, there was $12,127 of cumulative convertible participating Series E Preferred Stock convertible at an exercise price of $1.98 per share, equating to 6,124,567 shares of Common Stock, originally issued in July 2009.

As of February 22, 2019 and February 23, 2018, there were outstanding options to purchase the Company's Common Stock totaling 507,500 and 509,500 shares at an average price of $1.24. Due to the conversion price of the Common Stock options, 497,500 and 499,500 shares were excluded from the calculation of diluted earnings per share as of February 22, 2019 and February 23, 2018, respectively, because the effect of their conversion would be anti-dilutive.

Standards Issued and Implemented

Revenue from Contracts with Customers

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), commonly referred to as ASC 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. Further amendments and technical corrections were made to ASU 2014-09 during calendar 2016.

The Company accounts for revenue in accordance with ASC 606, which we adopted on February 24, 2018 using the modified retrospective method. The Company evaluated the distinct performance obligations and the pattern of revenue recognition of its significant contracts upon adoption of the standard; consequently, after our review of contracts in each revenue stream, the Company concluded that the impact of adopting the standard did not have an impact to its consolidated balance sheets or the related consolidated statements of earnings and comprehensive income, changes in shareholders' equity, or cash flows.

Statements of Cash Flows

In the 2019 first quarter, we adopted 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, and 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 the company has a material balance of amounts generally described as restricted cash and restricted cash equivalents. The impact of adoption was not material.

Recent Accounting Pronouncements

Leases

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 2020, which began on February 23, 2019. Among other requirements, the transition provisions require the lessee to recognize a right-of-use asset and liability for most existing lease arrangements on the date the transition provisions are applied. We have elected to apply the transition provisions of this new standard on February 23, 2019; therefore, periods prior to the effective date of adoption will continue to be reported using current GAAP (ASC 840).

The majority of our existing lease arrangements are classified as operating leases, which will continue to be classified as operating under the new standard. Upon adoption of the new standard, we will record a right-of-use asset and lease liability, both with an approximate balance of $595, on our balance sheet for all of our existing lease arrangements. We do not anticipate that adoption of the new standard will have a significant impact on our net earnings or cash flows.

2. Accounts Receivable

The components of accounts receivable are as follows:

	Feb. 22, 2019	Feb. 23, 2018
U.S. Commercial ("Domestic")	$ 1,722	$ 2,495
U.S. Government	371	61
International	985	3,666
	3,078	6,222
Less: allowance for doubtful accounts	(165)	(310)
Accounts receivable, net	**$ 2,913**	**$ 5,912**

3. Contract Assets and Contract Liabilities

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

	Feb. 22, 2019	Feb. 23, 2018
Cost incurred on uncompleted long-term contracts	$ 173,183	$150,364
Estimated earnings	51,932	39,609
	225,115	189,973
Less: billings to date	(216,460)	(179,355)
	$ 8,655	**$ 10,618**

Included in accompanying balance sheets under the following captions:

	Feb. 22, 2019	Feb. 23, 2018
Contract assets	$ 15,264	$ 16,548
Contract liabilities	(6,609)	(5,930)
	$ 8,655	**$ 10,618**

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 2019 and fiscal 2018.

In accordance with industry practices, contract assets 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:

	Feb. 22, 2019	Feb. 23, 2018
Raw materials	$ 236	$ 202
Work in process	2,132	1,311
Finished goods	451	864
Inventories, net	**$ 2,819**	**$ 2,377**

Inventory is presented net of an allowance for obsolescence of $391 (raw material $164 and work in process $227) and $196 (raw material $63 and work in process $133) as of February 22, 2019 and February 23, 2018, 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:

	Feb. 22, 2019	Feb. 23, 2018
Land	$ 100	$ 100
Buildings and building additions	3,851	3,851
Machinery and equipment	11,211	11,202
Demonstration equipment	16,983	16,932
Office furniture and equipment	1,324	1,324
Building improvements	3,164	3,145
Construction in process	513	498
	37,146	37,052
Less: accumulated depreciation	(25,656)	(24,699)
Property, plant, and equipment, at cost, net	**$ 11,490**	**$ 12,353**

Depreciation expense for fiscal 2019 and fiscal 2018 was $1,075 and $1,144, respectively.

As of both February 22, 2019 and February 23, 2018, 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

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"), which on April 9, 2018 was subsequently increased to $25,000; see "Recent Amendments 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 22, 2019, the Company's availability under the Revolving Line of Credit was $9,507. This reflected cash borrowings of $12,359 and net outstanding standby letters of credit not covered by the Committed Line of Credit of $3,134. As of July 1, 2019, the date of our most current Revolving Line of Credit statement, the Company's availability under the Revolving Line of Credit was approximately $7,286.

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 ("Pledge Agreement"), an Amended and Restated Guaranty and Suretyship Agreement executed on September 28, 2012 in favor of PNC Bank by H.F. Lenfest ("Mr. Lenfest"), a major shareholder and director of ETC since 2003, who passed away on August 5, 2018, 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 expired on September 28, 2017. The notional amount of $5,000 decreased ratably over the duration of the interest rate swap agreement. The interest rate swap effectively fixed 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 2019 or fiscal 2018. We have designated our current interest rate swap as a cash flow hedge instrument. We have determined the hedge to be effective through the date of expiration. See Note 12 – Fair Value Measurements and Interest Rate Swap for additional disclosures related to the interest rate swap.

Recent Amendments to the Sept. 28, 2012 Loan Agreement

Fiscal 2017 Amendment to the Sept. 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 was to have maintained as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio was to increase to 1.10 to 1 on August 25, 2017, and was to 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, under which amounts may be borrowed, repaid, and re-borrowed until the maturity date.

(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 $3,838 as of July 23, 2019, 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 (2.3980% as of July 1, 2019, 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 22, 2019), substantially all of the Company's additional assets, and the pledged cash collateral of the estate of Mr. Lenfest.

Fiscal 2019 Amendment to the Sept. 28, 2012 Loan Agreement

On April 9, 2018, 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 Revolving Line of Credit was increased from $21,000 to $25,000.

(ii) The maturity date of the 2016 PNC Credit Facilities was extended from June 30, 2018 to June 30, 2019.

(iii) The interest rate margin on the 2016 PNC Credit Facilities was lowered from 3.00% to 2.75%.

Fiscal 2020 Amendment to the Sept. 28, 2012 Loan Agreement

On June 28, 2019, subsequent to the end of fiscal 2019, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that extended the maturity date of the 2016 PNC Credit Facilities from June 30, 2019 to June 30, 2020.

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 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 during fiscal 2013 and fiscal 2014, respectively, were recorded as a reduction to retained earnings. Due to the accumulated deficit position entered into beginning in fiscal 2015, all $484 of dividends recorded during each of the fiscal years since 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 were 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. The estate of 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 22, 2019 and February 23, 2018.

As of both February 22, 2019 and February 23, 2018, Series E Preferred Stock was convertible at an exercise price of $1.98 per share, equating to 6,124,567 shares of 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 22, 2019, which totaled $2,912, remained unpaid as of July 23, 2019, 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.

ETC-PZL Line of Credit Agreement

On July 6, 2017, ETC-PZL entered into a new loan agreement with a bank in Warsaw, Poland, whereby ETC-PZL received two lines of credit (collectively, the "ETC-PZL Line of Credit") in the amount of $3,150 and $575 to fund two large multi-year long-term construction-type contracts and current activity, respectively. Amounts borrowed to fund long-term contracts were to be repaid by March 29, 2019. Amounts borrowed to fund current activity must be repaid by May 31, 2019. As of February 22, 2019 and February 23, 2018, outstanding borrowings under the ETC-PZL Line of Credit were $0 and approximately $2,084, respectively.

Summary of Long-Term Debt Obligations

Long-term debt obligations consist of the following:

	Feb. 22, 2019	Feb. 23, 2018
Credit facility payable to bank	$ 12,359	$ 18,809
Borrowed under ETC-PZL Line of Credit	-	2,084
Total long-term debt obligations	12,359	20,893
Less: debt issuance costs	-	-
Total long-term debt obligations, net of debt issuance costs	12,359	20,893
Less: current portion	-	-
Total long-term debt obligations, net of debt issuance costs, less current portion	**$ 12,359**	**$ 20,893**

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 2020	-
Fiscal 2021	$12,359
Fiscal 2022	-
Fiscal 2023	-
Fiscal 2024	-
Total future long-term debt obligations	**$ 12,359**

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 NOL carryforwards and research and development tax credits. 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 assets and liabilities are offset and presented as a single non-current asset.

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act, among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. Consequently, we wrote down approximately $2,175 of our net deferred tax assets as of February 23, 2018 to reflect the re-measurement of certain net deferred tax assets using the lower U.S. corporate income tax rate; however, due to the previously established valuation allowance for such deferred tax assets, the impact was minimal. As of February 22, 2019, 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 NOL carryforwards and research and development tax credits will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established a $5,961 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 $698 was recorded in fiscal 2019; whereas, an income tax benefit of $662 was recorded in fiscal 2018. Our income tax provision (benefit) consists of the following:

	Fiscal year ended	
	Feb. 22, 2019	**Feb. 23, 2018**
Current tax (benefit) expense:		
U.S. Federal	$ 92	$ 19
U.S. State	(25)	28
Foreign	583	77
Total current tax expense, net	**650**	**124**
Deferred tax expense (benefit):		
U.S. Federal	$ 276	$ (1,429)
U.S. State	108	412
Foreign	(336)	231
Total deferred tax expense (benefit)	**48**	**(786)**
Income tax provision (benefit)	**$ 698**	**$ (662)**

Effective tax rates were 17.9% and 37.5% for fiscal 2019 and fiscal 2018, respectively. The decrease in the effective tax rate for fiscal 2019 as compared to fiscal 2018 was driven primarily by the Tax Act, which among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. The income tax benefit recorded in fiscal 2018 was driven primarily by a net one-time benefit of $420 to reflect the estimated impact of the Tax Act. This net one-time benefit of $420 was comprised of a reduction in the valuation allowance related to our alternative minimum tax credit (approximately $586), offset, in part, by a deemed repatriation tax (approximately $166, for which we were allowed to net against our federal NOL carryforwards). As of December 22, 2018, we completed our accounting for all of the enactment-date income tax effects of the Tax Act and did not identify any material changes to the provisional, net, one-time benefit recorded in fiscal 2018, related to the Tax Act.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. The Company is no longer subject to U.S. federal tax examinations by tax authorities for the fiscal years before and including 2016. ETC-PZL is no longer subject to tax examinations in Poland for tax periods prior to December 31, 2013; ETC-Europe is no longer subject to tax examinations in the United Kingdom now that it is dissolved. We are, however, subject to examination in various other foreign and state jurisdictions for fiscal years 2009-2019. We believe appropriate provisions for all outstanding tax issues have been made for all jurisdictions and all open years.

As of February 22, 2019, the Company had approximately $20,533 of federal NOL carryforwards available to offset future income tax liabilities, which will begin to expire in 2025. Under Section 382 of the Internal Revenue Code of 1986, as amended ("IRC Section 382"), a corporation that undergoes an "ownership change", as defined therein, is subject to limitations on its use of pre-change NOL carryforwards to offset future taxable income. The Company at this time has not performed a full Section 382 analysis. If we were to undergo one or more "ownership changes" within the meaning of Section 382, our NOL carryforwards existing as of the date of each ownership change may be unavailable, in whole or in part, to offset U.S. federal income tax resulting from our operations, which could result in increased U.S. federal income tax liability. The Company has recorded a valuation allowance on the entire NOL carryforward as it believes that it is more likely than not that the deferred tax asset associated with the NOL carryforwards will not be realized regardless of whether an "ownership change" has occurred.

As of February 22, 2019, the Company has a net deferred tax asset of $441 compared to a net deferred tax asset of $489 as of February 23, 2018. Significant components of our net deferred tax asset are as follows:

	Feb. 22, 2019	**Feb. 23, 2018**
Deferred tax assets:		
NOL carryforwards	$ 5,063	$ 5,807
U.S. R&D tax credits	1,615	1,487
U.S. AMT credits	657	586
Foreign	195	265
Vacation accrual	173	170
Inventory reserve	87	44
Receivable reserve	37	69
Other, net	505	232
	8,332	8,660
Valuation allowance	(5,961)	(5,937)
Total deferred tax assets	**2,371**	**2,723**
Deferred tax liabilities:		
Depreciation	(1,691)	(1,733)
Amortization of capitalized software	(42)	(42)
Foreign	(43)	(363)
APB 23 liability	(154)	(96)
Total deferred tax liabilities	**(1,930)**	**(2,234)**
Total net deferred tax asset	**$ 441**	**$ 489**

U.S. income taxes have been provided on deemed repatriated earnings of $1,661 related to our non-U.S. subsidiaries as of February 23, 2018, as a result of the enactment of the Tax Act. The additional net transition tax of $166 on the deemed repatriated earnings was recorded for fiscal 2018. Before the Tax Act, we have provided for U.S. deferred income taxes and foreign withholding tax in the amount of $309 for all undistributed earnings not considered permanently reinvested in our non-U.S. subsidiaries.

As of February 22, 2019, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $59 and penalties of $89. As of February 23, 2018, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $53 and penalties of $81. The interest and penalties recorded during both fiscal 2019 and fiscal 2018 primarily related to domestic state tax and foreign tax issues.

As of February 22, 2019 and February 23, 2018, the total amount of unrecognized tax benefits was $782 and $702, respectively, of which $268 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) ETSS; 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 2019, 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 $16,092 represented 33.2% of total net sales. In fiscal 2018, the same 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 $17,210 represented 35.8% of total net sales.

Included in the segment information for fiscal 2019 and fiscal 2018 are export sales of $35,527 and $31,803, respectively. In fiscal 2019, International sales totaling at least $500 were made to customers in eleven (11) different countries; in fiscal 2018, International sales totaling at least $500 were made to customers in nine (9) different countries. Sales to the U.S. Government and its agencies aggregated to $1,916 and $1,296 for fiscal 2019 and fiscal 2018, respectively.

The following segment information reflects the accrual basis of accounting:

	Aerospace	CIS	Corporate	Company Total
Fiscal 2019:				
Net sales	$ 35,394	$ 13,030	$ -	$ 48,424
Interest expense, net	733	270	-	1,003
Depreciation and amortization	990	90	56	1,136
Operating income (loss)	6,912	(503)	(1,076)	5,333
Income tax provision	-	-	698	698
Identifiable assets	27,781	3,954	13,677	45,412
Expenditures for segment assets	224	67	(15)	276
Fiscal 2018:				
Net sales	$ 34,634	$ 13,452	$ -	$ 48,086
Interest expense, net	617	240	-	857
Depreciation and amortization	872	333	60	1,265
Operating income (loss)	5,359	(941)	(1,331)	3,087
Income tax benefit	-	-	(662)	(662)
Identifiable assets	31,235	5,130	10,058	46,423
Expenditures for segment assets	303	127	35	465

Reconciliation to consolidated net income attributable to ETC	**Fiscal 2019**	**Fiscal 2018**
Operating income	$ 5,333	$ 3,087
Interest expense, net	(1,003)	(857)
Other expense, net	(434)	(464)
Income tax (provision) benefit	(698)	662
Income attributable to non-controlling interest	(51)	(51)
Net income attributable to ETC	**$ 3,147**	**$ 2,377**

9. Stock Option Plans

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

	Fiscal year ended			
	Feb. 22, 2019		Feb. 23, 2018	
	Shares	**Weighted average exercise price**	**Shares**	**Weighted average exercise price**
Outstanding at beginning of year	509,500	$ 1.24	511,500	$ 1.24
Granted	-	$ -	-	$ -
Exercised	-	$ -	-	$ -
Forfeited	(2,000)	$ 1.25	(2,000)	$ 1.25
Outstanding at end of year	**507,500**	**$ 1.24**	**509,500**	**$ 1.24**
Options exercisable at fiscal year end	497,500		134,000	
Weighted average fair value of options granted during the fiscal year		$ -		$ -

The following information applies to options outstanding as of February 22, 2019:

	Options outstanding			Options exercisable	
Exercise price	**Number outstanding as of Feb. 22, 2019**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price**	**Number exercisable at Feb. 22, 2019**	**Weighted average exercise price**
$ 0.57	10,000	7.39	$ 0.57	-	
$ 1.25	497,500	5.52	$ 1.25	497,500	$ 1.25
Total	**507,500**			**497,500**	

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 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 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 no stock options granted in either fiscal 2019 or fiscal 2018. Stock option compensation expense was $16 and $98 in fiscal 2019 and fiscal 2018, respectively.

As of February 22, 2019, 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. No awards shall be granted under this Plan after July 2, 2019. As of February 22, 2019, there were 409,590 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 22, 2019, there were 370,498 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 22, 2019 are $235 in fiscal 2020; $186 in fiscal 2021; $188 in fiscal 2022; $35 in fiscal 2023; and $2 in fiscal 2024. Total rental expense for all operating leases for fiscal 2019 and fiscal 2018 was $573 and $580, 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 was engaged as a senior technical consultant to the Company. Mr. Mitchell`s consulting engagement expired September 18, 2017, and prior to expiration, he was eligible to receive consulting fees upon request from the Company, which were comparable to, but less than, his cash compensation as Chief Executive Officer. He was also entitled to receive certain other benefits prior to expiration of the consulting engagement. As of both February 22, 2019 and February 23, 2018, there were no remaining consulting fees or other benefits payments to be made under this consulting engagement.

Legal Proceedings

US Air Force Centrifuge Contract Settlement

The Company is a party to a firm fixed price contract with the US Air Force ("USAF") dated September 23, 2009 to build a centrifuge at the Wright-Patterson Air Force Base (the "Contract"). During the course of the Company's performance under the Contract, the Company believed that the USAF made changes to the scope and terms of the Contract which increased cost and resulted in delay to the program schedule. The Company previously made objections to these changes and reserved its rights. Subsequent to the end of fiscal 2018, the parties executed a modification to the Contract which, among other things, incorporated into the Contract the technical provisions of an engineering change proposal which made minor modifications to the device specification to conform it to the as-delivered Centrifuge, provided for the USAF's final acceptance of the Centrifuge, resulted in a reduction in the Contract base price of approximately two percent (2%), and resolved all potential claims regarding Contract changes and program delay. The execution of the Contract modification did not have a material effect on the Company's financial position or results of operations.

US Air Force Research Altitude Chamber Contract

The Company is a party to a contract with the USAF, namely a firm fixed-price contract dated June 14, 2010, to build a suite of research altitude chambers at the Wright-Patterson Air Force Base (the "RAC Contract"). Under the RAC Contract, the Company believes that the USAF has made changes to the scope and terms of said Contract that increased cost and resulted in delay to the program schedule. The Company has made objection and claims with respect to these changes. On April 23, 2019, the Company filed a Complaint before the Armed Services Board of Contract Appeals with respect to the Company's claims. The Company's Complaint seeks approximately $4,925 and compensable delay through the date of the Complaint so as to avoid the assessment of liquidated damages. On May 22, 2019, the USAF filed an Answer to the Company's Complaint. The claim litigation is ongoing and we are not able at this time to predict the outcome.

Other Matters

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against us. We believe, after consultation with legal counsel handling these specific matters, all such matters are reserved for or adequately covered by insurance or, if not so covered, are without merit or are of such kind, or involve such amounts, as would not be expected to have a significant effect on our financial position or results of operations if determined adversely against us.

11. Employee Benefit Plans

The Company maintains a 401(k) retirement savings plan for eligible employees. The Company 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 $458 and $480 in fiscal 2019 and fiscal 2018, 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.

We had one interest rate swap contract in place to reduce our exposure to fluctuations in interest rates on our Term Loan that expired on September 28, 2017. The swap converted 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. The notional amount of $5,000 decreased ratably over the duration of the interest rate swap agreement. The interest rate swap effectively fixed 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 2019 or fiscal 2018.

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 July 23, 2019, 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 22, 2019.

On July 28, 2019, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that extended the maturity date of the 2016 PNC Credit Facilities from June 30, 2019 to June 30, 2020. See Note 6 – Long-Term Obligations and Related Equity Arrangements for further details regarding the Company's loan agreements with PNC Bank.

Effective June 18, 2019, Ms. Tartar has exited the Board of Directors. On June 20, 2019, Michael D. Malone, Vice Admiral, USN (Ret.), a director of ETC since 2012 and Vice Chairman of the Board of Directors since 2015, passed away. At the present time, replacements for Ms. Tartar and Mr. Malone have not been named. Ms. Tartar's seat on the ETC Board is reserved for nomination by the holder of ETC's Series E Preferred Stock.

FIVE YEAR SUMMARY

(in thousands, except per share information)

	Fiscal 2015	Fiscal 2016	Fiscal 2017	Fiscal 2018	Fiscal 2019
Net sales	$ 37,340	$ 39,632	$ 39,834	$ 48,086	$ 48,424
Gross profit	7,850	11,592	13,279	16,127	17,397
Gross profit margin %	21.0%	29.2%	33.3%	33.5%	35.9%
Operating (loss) income	(4,837)	(2,375)	555	3,087	5,333
Operating margin %	-13.0%	-6.0%	1.4%	6.4%	11.0%
(Loss) income before income taxes	(6,021)	(4,140)	(731)	1,766	3,896
Pre-tax margin %	-16.1%	-10.4%	-1.8%	3.7%	8.0%
Income tax (benefit) provision	(2,293)	6,620	161	(662)	698
Net (loss) income	(3,728)	(10,760)	(892)	2,428	3,198
Loss (income) attributable to non-controlling interest	13	(23)	(31)	(51)	(51)
Net (loss) income attributable to ETC	$ (3,715)	$ (10,783)	$ (923)	$ 2,377	$ 3,147
Preferred Stock dividends	(484)	(484)	(484)	(484)	(484)
(Loss) income attributable to common and participating shareholders	$ (4,199)	$ (11,267)	$ (1,407)	$ 1,893	$ 2,663
Diluted (loss) earnings per share	$ (0.27)	$ (0.74)	$ (0.09)	$ 0.12	$ 0.17
Working capital	$ 6,731	$ 1,720	$ 13,242	$ 18,306	$ 13,673
Total long-term debt obligations	20,621	19,439	17,940	20,893	12,359
Total assets	51,650	44,249	44,538	46,423	45,412
Total shareholders' equity	20,253	9,111	7,976	9,629	12,537
Capital expenditures	1,505	1,244	702	465	276
Depreciation and amortization	1,809	1,645	1,360	1,265	1,136
Interest expense, net	745	920	559	857	1,003
EBITDA *	**$ (3,431)**	**$ (1,428)**	**$ 1,301**	**$ 4,149**	**$ 6,062**

* 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.

SUPPLEMENTAL INFORMATION

Company Affiliates and Locations

The consolidated financial statements include the accounts of ETC, our 95%-owned subsidiary ETC-PZL, and our formerly 99%-owned subsidiary ETC-Europe, which was officially dissolved on August 15, 2017. 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 22, 2019, we had 270 full-time employees, compared to 280 full-time employees as of February 23, 2018, of which 5 were employed in executive positions, 109 were engineers, engineering designers, or draftspersons, 53 were administrative (sales, sales support, accounting, or general administrative) or clerical personnel, and 103 were engaged principally in production, operations, or field support. A total of 120 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 22, 2019 is presented below.

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.

Location	**Approximate Square Footage**	**Function**	**Owned/ Leased**	**Segment**
ETC Global Headquarters 125 James Way Southampton, PA 18966 USA +1.215.355.9100	83,800	Manufacturing (36,000 sq. ft), NASTAR Center (22,100 sq. ft.), and Corporate Headquarters (25,700 sq. ft.)	Owned	Aerospace CIS
ETC Simulation Training Systems 2100 N. Alafaya Trail, Suite 900 Orlando, FL 32826 USA +1.407.282.3378	8,700	Product development and administration	Leased	Aerospace
ETC-PZL Aerospace Industries Sp. z o.o. Al. Krakowska 110/114, P.O. Box 22 02-256 Warszawa, Poland (+48.22) 846.54.17	28,000	Manufacturing, product development, and administration	Leased	Aerospace
ETC-Turkey ODTU Teknokent, Gumus Bloklar A Blok Zemin Kay Bati Cephe Suite 1 06531 ODTU Ankara, Turkey (+90) 312.210.17.80	5,700	Software development	Leased	Aerospace CIS
Total	**126,200**			

Corporate Governance

The Board of Directors is currently comprised of five (5) members, four (4) 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.

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 2019. 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 1:00 p.m. on Friday, September 6, 2019 and is to be held at the Company's headquarters in Southampton, PA.

Corporate Data

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

Board of Directors

George K. Anderson, M.D., Chairman (2003)
Linda J. Brent, Ed.D. (2010)
Roger Colley (2011)
Robert L. Laurent, Jr. (2014)
Winston E. Scott (2010)

COMMITTEE COMPOSITION

	Audit Committee	Compensation Committee	Nominating and Governance Committee
George K. Anderson, M.D.	-	-	-
Linda J. Brent Ed.D	Member	Member	Chairperson
Roger Colley	Chairperson	Member	Member
Winston E. Scott	Member	Chairperson	Member

OWNERSHIP TABLE

	Name/Address **	Title	Ownership Percentage
Directors and Executive Officers:	George K. Anderson, M.D.	Chairman of the Board of Directors	*
	Linda J. Brent, Ed.D.	Director	*
	Roger Colley	Director	*
	Winston E. Scott	Director	*
	Robert L. Laurent, Jr.	Chief Executive Officer, President, and Director	1.6%
	Mark Prudenti	Chief Financial Officer and Treasurer	*
	James D. Cashel	Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer	1.1%
	Thomas G. Loughlin	Chief Operating Officer	*
	Alper Kus	Senior Vice President, Aircrew Training Systems	*
Control Persons:	Estate of H.F. Lenfest *c/o The Lenfest Group* *Five Tower Bridge-Suite 460* *300 Barr Harbor Drive* *West Conshohocken, PA 19428*		*** 54.1%
	T. Todd Martin, III *50 Midtown Park East* *Mobile, AL 36606*		11.0%
	3K Limited Partnership *Peter H. Karmin* *Phillip B. Livingston*	 *Founder and Managing Partner* *Managing Director*	6.9%
	Estate of Pete L. Stephens		6.3%

* *less than 1%*

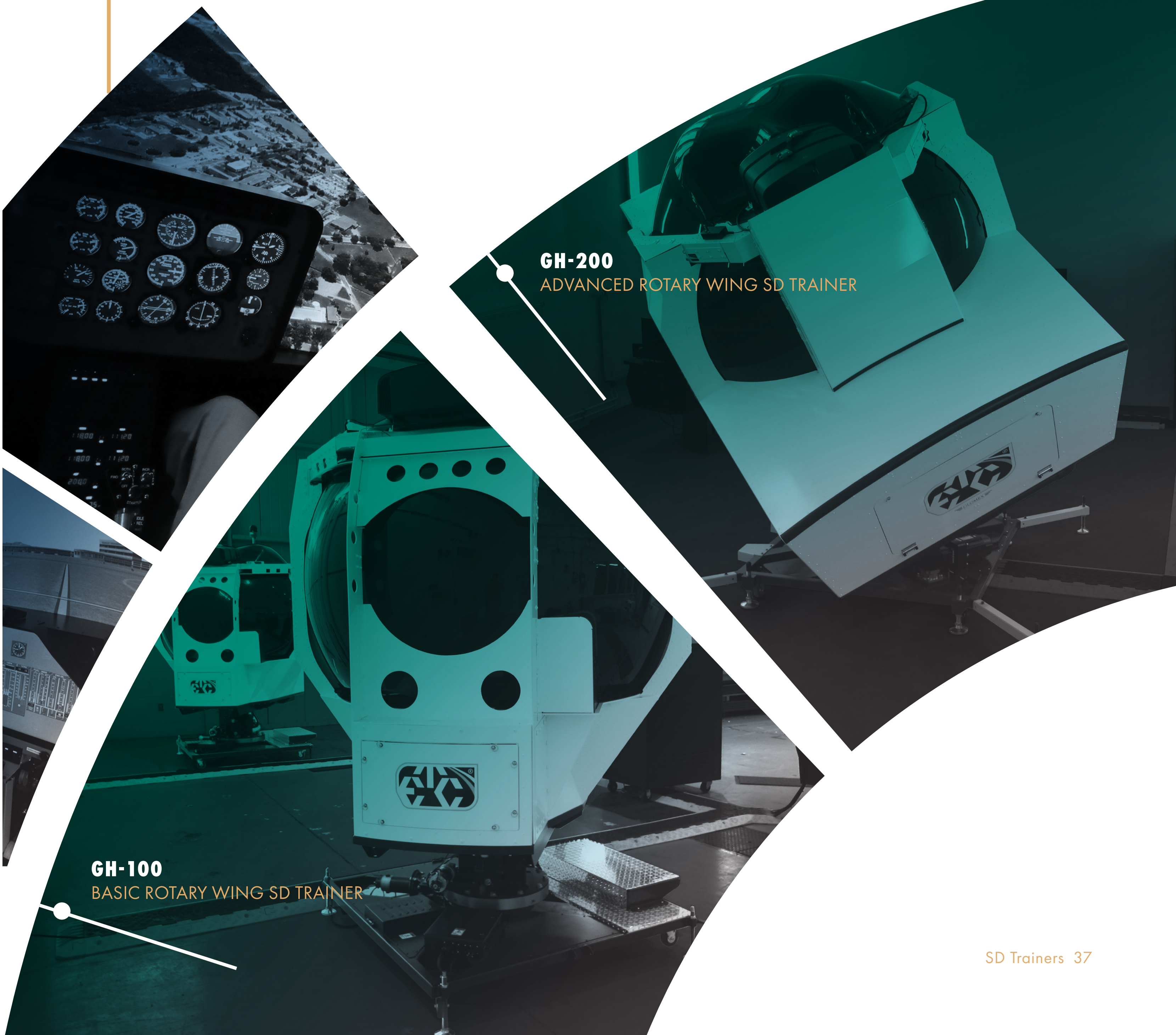
** *address listed for all persons beneficially owning more than ten percent (10%)*

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

Information is accurate as of July 23, 2019, 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 (5) years has had a legal/disciplinary issue.

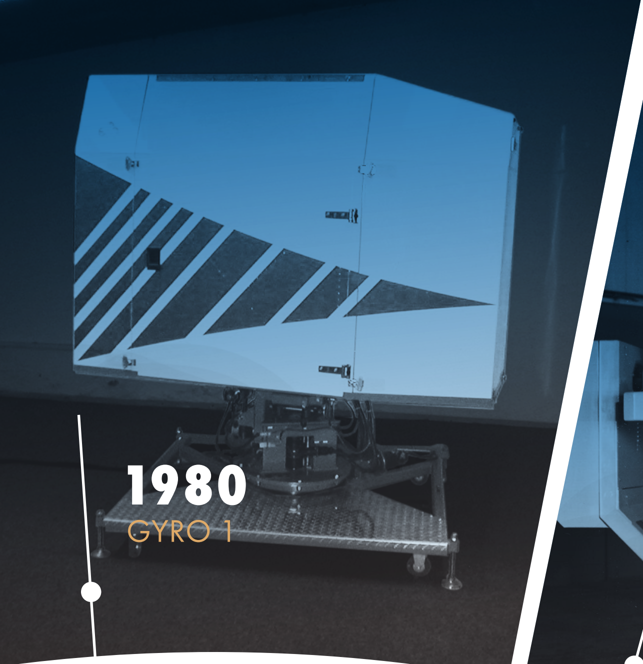
WITH NEWLY DESIGNED AND DELIVERED SPATIAL DISORIENTATION (SD) TRAINERS,

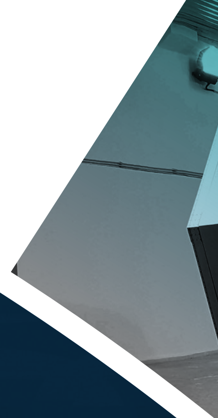
the GH-100 and GH-200, ETC brings its fifty years of experience in fixed wing SD to a critically overlooked area of the rotary wing (helicopter) research and training markets.

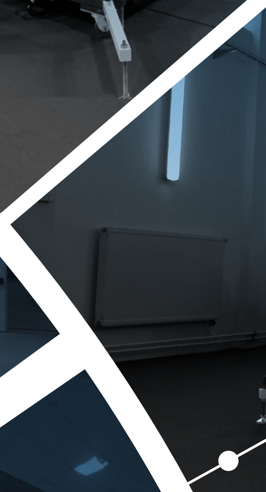


GH-200
ADVANCED ROTARY WING SD TRAINER

GH-100
BASIC ROTARY WING SD TRAINER







For fifty years,

ETC has driven technological research and training solutions for the aeromedical community while continuously developing its software driven products for its customers throughout aerospace and commercial/industrial systems.

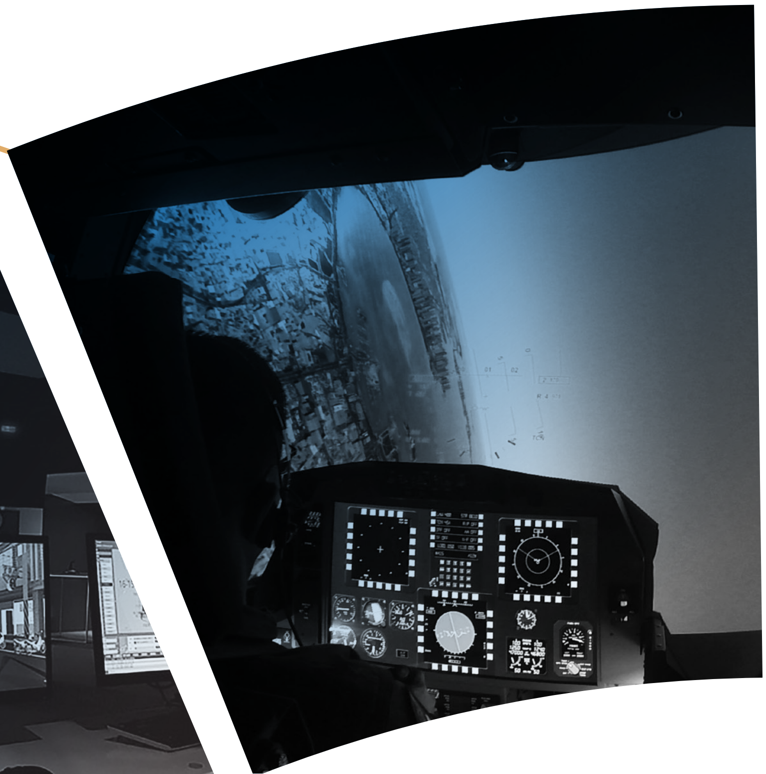

1985
G-LAB
1995
G-FET
2006
ATFS-400-25
2018
GH-200
2018
ATFS-400-31
2019
GL-4000

ETC Aircrew Training Systems

For nearly five decades, ATS has provided clients around the world 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.

ETC Integrated Logistics Support

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



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.

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.

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.

ETC Service and Support

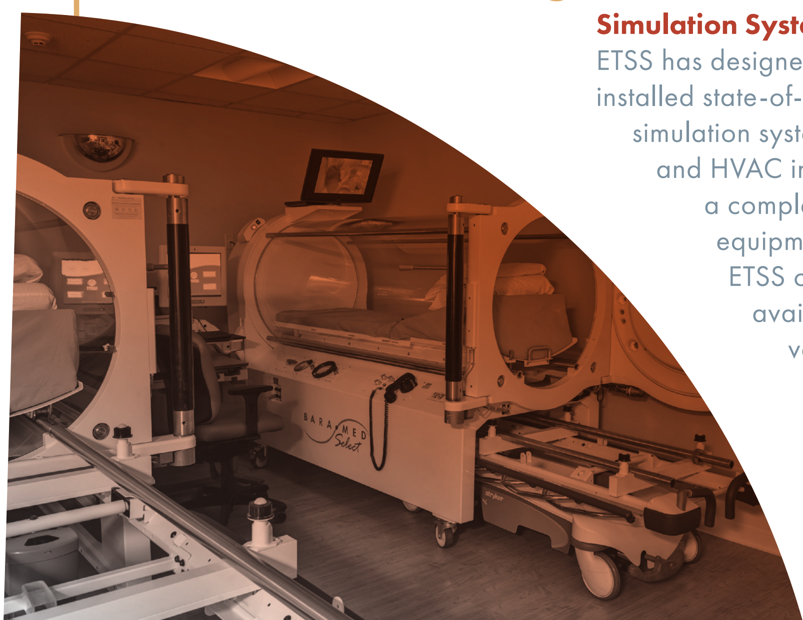
ETC's Service and Support unit operates out of offices worldwide and provides service and support for all sterilizers, environmental systems, and chambers.

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.

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.



ENVIRONMENTAL TECTONICS CORPORATION

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