

QUARTERLY REPORT 2



FOR THE THIRTEEN WEEKS
ENDED AUGUST 24, 2018

ENVIRONMENTAL TECTONICS CORPORATION

Quarterly Report
For the thirteen weeks ended August 24, 2018

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(Address of Issuer's Principal Executive Office)

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Table of Contents

Item 1.	Name of Issuer	Inside Cover
Item 2.	Address of Issuer’s Principal Executive Office	Inside Cover
Item 3.	Security Information	1
Item 4.	Issuance History	1
Item 5.	Financial Statements	2
Item 6.	Description of Business Operations	5
Item 7.	Description of Facilities	18
Item 8.	Officers, Directors, and Control Persons	19
Item 9.	Third Party Providers	19
Item 10.	Management’s Certification	20

Item numbers above refer to the OTC Pink Basic Disclosure Guidelines created by the OTC Markets Group. The OTC Pink Basic Disclosure Guidelines are available on the Internet at <http://www.otcmarkets.com/marketplaces/otc-pink>.

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

Item 3. Security Information

Trading symbol: ETCC
CUSIP: 294092

Title of class of securities outstanding:	Common Stock	Preferred Stock, Series E
Par value:	\$0.05	\$0.05
Total shares authorized:	50,000,000 as of August 24, 2018	25,000 as of August 24, 2018
Total shares outstanding:	9,428,071 as of August 24, 2018	12,127 as of August 24, 2018

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

* registered under the Exchange Act

List any restrictions on the transfer of security: N/A

Describe any trading suspension: N/A

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past twelve months:

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 August 24, 2018, which totaled \$2,670 thousand, remained unpaid as of October 24, 2018, the date of issuance of the accompanying interim 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").

Item 4. Issuance History

A. The nature of each offering of Common Stock in the last two fiscal years:

Date	Shareholder	Shares	Transaction	Value
March 20, 2017	Robert L. Laurent, Jr.	71,828	Common Stock award at \$0.67 per share	\$ 48,125
March 20, 2017	Mark Prudenti	41,791	Common Stock award at \$0.67 per share	\$ 28,000
March 20, 2017	James D. Cashel	57,463	Common Stock award at \$0.67 per share	\$ 38,500
March 20, 2017	Thomas G. Loughlin	36,567	Common Stock award at \$0.67 per share	\$ 24,500
March 20, 2017	Alper Kus	35,261	Common Stock award at \$0.67 per share	\$ 23,625

B. Any jurisdictions where the offering was registered or qualified: N/A

C. The number of shares offered: N/A

D. The number of shares sold: N/A

E. The price at which the shares were offered, and the amount actually paid to the issuer: N/A

F. The trading status of the shares: N/A

G. Whether the certificates or other documents that evidence the shares contain a legend (1) stating that the shares have not been registered under the Securities Act and (2) setting forth or referring to the restrictions on transferability and sale of the shares under the Securities Act: All 242,910 shares noted in Item 4A contain a restrictive legend.

Item 5. Financial Statements

Environmental Tectonics Corporation
Consolidated Statements of Operations and Comprehensive Income
(unaudited)

<i>(in thousands, except per share information)</i>	Thirteen weeks ended		Twenty-six weeks ended	
	August 24, 2018	August 25, 2017	August 24, 2018	August 25, 2017
Net sales	\$ 10,250	\$ 10,085	\$ 20,941	\$ 21,574
Cost of goods sold	6,518	6,406	13,313	14,294
Gross profit	3,732	3,679	7,628	7,280
Operating expenses	2,876	2,739	5,794	6,024
Operating income	856	940	1,834	1,256
Other expenses:				
Interest expense, net	267	213	517	410
Other expense, net	111	260	187	239
Other expenses total	378	473	704	649
Income before income taxes	478	467	1,130	607
Income tax provision	20	25	48	43
Net income	458	442	1,082	564
Income attributable to non-controlling interest	(10)	(26)	(8)	(27)
Net income attributable to Environmental Tectonics Corporation	448	416	1,074	537
Foreign currency translation adjustment	269	(234)	224	(286)
Comprehensive income	\$ 717	\$ 182	\$ 1,298	\$ 251
Preferred Stock dividends	(121)	(121)	(242)	(242)
Income attributable to common and participating shareholders	\$ 327	\$ 295	\$ 832	\$ 295
Per share information:				
Basic earnings per common and participating share:				
Distributed earnings per share:				
Common	\$ -	\$ -	\$ -	\$ -
Preferred	\$ 0.02	\$ 0.02	\$ 0.04	\$ 0.04
Undistributed earnings per share:				
Common	\$ 0.02	\$ 0.02	\$ 0.05	\$ 0.02
Preferred	\$ 0.02	\$ 0.02	\$ 0.05	\$ 0.02
Diluted earnings per share	\$ 0.02	\$ 0.02	\$ 0.05	\$ 0.02
Basic weighted average common and participating shares:				
Common weighted average number of shares	9,428	9,428	9,428	9,396
Participating preferred shares	6,125	6,125	6,125	6,116
Total basic weighted average common and participating shares	15,553	15,553	15,553	15,512
Diluted weighted average shares:				
Basic weighted average common and participating shares	15,553	15,553	15,553	15,512
Dilutive effect of stock options	3	-	3	-
Total diluted weighted average shares	15,556	15,553	15,556	15,512

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

Environmental Tectonics Corporation Consolidated Balance Sheets

<i>(in thousands, except share information)</i>	August 24, 2018	February 23, 2018
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 619	\$ 329
Restricted cash	5,949	5,954
Accounts receivable, net	8,511	5,912
Contract assets	19,892	16,548
Inventories, net	2,075	2,377
Prepaid expenses and other current assets	2,891	2,374
Total current assets	39,937	33,494
Property, plant, and equipment, at cost, net	11,879	12,353
Capitalized software development costs, net	91	87
Deferred tax assets, non-current, net	496	489
Total assets	\$ 52,403	\$ 46,423
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt obligations, net of debt issuance costs	\$ 23,698	\$ -
Accounts payable, trade	3,791	3,886
Contract liabilities	7,295	5,930
Accrued taxes	123	162
Accrued interest and dividends	2,760	2,495
Other accrued liabilities, current	3,286	2,715
Total current liabilities	40,953	15,188
Long-term debt obligations, net of debt issuance costs:		
Credit facility payable to bank, net of debt issuance costs	-	20,893
Total long-term debt obligations, net of debt issuance costs	-	20,893
Other accrued liabilities, non-current	742	713
Total liabilities	41,695	36,794
Commitments and contingencies (Note 5)		
Shareholders' equity:		
Cumulative convertible participating Preferred Stock, Series E, \$0.05 par value, 25,000 shares authorized; 12,127 shares outstanding as of August 24, 2018 and February 23, 2018	12,127	12,127
Common Stock, \$0.05 par value, 50,000,000 shares authorized; 9,428,071 shares issued and outstanding as of August 24, 2018 and February 23, 2018	471	471
Additional paid-in capital	8,336	8,563
Accumulated deficit	(9,613)	(10,687)
Accumulated other comprehensive loss	(771)	(995)
Total shareholders' equity before non-controlling interest	10,550	9,479
Non-controlling interest	158	150
Total shareholders' equity	10,708	9,629
Total liabilities and shareholders' equity	\$ 52,403	\$ 46,423

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

Environmental Tectonics Corporation
Consolidated Statements of Cash Flows
(unaudited)

<i>(in thousands)</i>	Twenty-six weeks ended	
	August 24, 2018	August 25, 2017
Cash flows from operating activities:		
Net income	\$ 1,082	\$ 564
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	597	619
Deferred income taxes	(7)	(24)
Increase (decrease) in allowance for doubtful accounts and inventory obsolescence	116	(4)
Accretion of loan origination deferred charge and deferred financing costs	-	17
Stock compensation expense	15	50
Issuance of Common Stock	-	163
Changes in operating assets and liabilities:		
Accounts receivable	(2,733)	2,455
Contract assets	(3,344)	(4,313)
Inventories	320	39
Prepaid expenses and other assets	(517)	(1,198)
Accounts payable, trade	(95)	454
Contract liabilities	1,365	70
Accrued taxes	(39)	91
Accrued interest and dividends	23	15
Other accrued liabilities	600	398
Net cash used in operating activities	(2,617)	(604)
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(76)	(288)
Capitalized software development costs	(51)	(19)
Net cash used in investing activities	(127)	(307)
Cash flows from financing activities:		
Borrowings under lines of credit	2,805	1,308
Net cash provided by financing activities	2,805	1,308
Effect of exchange rate changes on cash	224	(286)
Net increase in cash, cash equivalents, and restricted cash	285	111
Cash, cash equivalents, and restricted cash at beginning of period	6,283	6,401
Cash, cash equivalents, and restricted cash at end of period	\$ 6,568	\$ 6,512
Less: Restricted cash	(5,949)	(5,956)
Cash and cash equivalents at end of period	\$ 619	\$ 556
Supplemental schedule of cash flow information:		
Interest paid	\$ 535	\$ 364
Income taxes paid	\$ 11	\$ -
Supplemental information on non-cash operating and investing activities:		
Preferred Stock dividends accrued during each respective fiscal period	\$ 242	\$ 242

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

Environmental Tectonics Corporation

Notes to the Consolidated Financial Statements

(unaudited)

(Dollars in thousands, except per share information)

Item 6. Description of Business Operations

ETC was incorporated in 1969 in Pennsylvania. For nearly 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, 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. 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 (“ARFF”) vehicles), fire and emergency training schools, universities, and airports. We also provide ILS for customers who purchase these products or similar products manufactured by other parties.

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 primary and secondary Standard Industrial Classification Codes (“SIC Codes”) are 3842 and 3829, respectively. 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 the 2019 second quarter are references to the thirteen week period ended August 24, 2018. References to the 2018 second quarter are references to the thirteen week period ended August 25, 2017. References to the 2019 first half are references to the twenty-six week period ended August 24, 2018. References to the 2018 first half are references to the twenty-six week period ended August 25, 2017. References to fiscal 2019 are references to the fifty-two week period ending 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.

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying interim consolidated financial statements include the accounts of ETC, our 95%-owned subsidiary in Warsaw, Poland, ETC-PZL Aerospace Industries Sp. z o.o. (“ETC-PZL”), and our formerly 99%-owned subsidiary, Environmental Tectonics Corporation (Europe) Limited (“ETC-Europe”). The Company’s corporate headquarters and main production plant (“ETC-SH”) are located in Southampton, Pennsylvania, USA. ETC-PZL manufactures certain simulators and provides software to support products manufactured domestically within our Aerospace segment. ETC-Europe, which was officially dissolved on August 15, 2017, functioned as a sales office in the United Kingdom. All significant intercompany accounts and transactions have been eliminated in consolidation.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

(Dollars in thousands, except per share information)

The accompanying interim consolidated financial statements have been prepared by ETC, without audit, in conformity with accounting principles generally accepted in the United States of America, consistently applied, and reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are of a normal recurring nature.

Certain information in footnote disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America has been condensed or omitted and the financial results for the periods presented may not be indicative of the full year's results; however, the Company believes that the disclosures are adequate to make the information presented not misleading. These interim consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the Company's Annual Report to Shareholders for fiscal 2018.

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 Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), commonly referred to as Accounting Standards Codification ("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 operations and comprehensive income (loss), changes in shareholders' equity, or cash flows. Accounting policies that were significantly affected by the adoption of ASC 606 are discussed below.

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.

Significant Accounting Policies Update

Other than the changes in our accounting policies related to the adoption of ASC 606, there have been no material changes in the Company's significant accounting policies during fiscal 2019 as compared to what was previously disclosed in the Company's Annual Report to Shareholders for fiscal 2018.

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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

(Dollars in thousands, except per share information)

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. 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.

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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

(Dollars in thousands, except per share information)

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. As of August 24, 2018, our ending sales backlog was \$58,908. We expect to recognize approximately 65% over the next twelve (12) months and approximately 92% over the next twenty-four (24) months as revenue, with the remainder recognized thereafter.

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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

(Dollars in thousands, except per share information)

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 (loss) attributable to ETC are presented below:

	Thirteen weeks ended					
	August 24, 2018			August 25, 2017		
	Aerospace	CIS	Total	Aerospace	CIS	Total
Net income (loss) attributable to ETC	\$ 389	\$ (175)	\$ 214	\$ (496)	\$ 286	\$ (210)

	Twenty-six weeks ended					
	August 24, 2018			August 25, 2017		
	Aerospace	CIS	Total	Aerospace	CIS	Total
Net income (loss) attributable to ETC	\$ 266	\$ (205)	\$ 61	\$ (591)	\$ 53	\$ (538)

The following schedules present the Company's net sales by segment, business unit, and geographic area:

	Thirteen weeks ended							
	August 24, 2018				August 25, 2017			
	Domestic	U.S. Gov't	Inter-national	Total	Domestic	U.S. Gov't	Inter-national	Total
Aerospace Solutions								
Aeromedical Training Solutions	\$ 132	\$ 350	\$ 6,504	\$ 6,986	\$ 826	\$ 559	\$ 4,281	\$ 5,666
Simulation (ADMS)	222	3	1,081	1,306	477	-	612	1,089
Subtotal	354	353	7,585	8,292	1,303	559	4,893	6,755
Commercial/Industrial Systems								
Sterilizers	969	-	-	969	868	-	-	868
Environmental (ETSS)	206	-	51	257	1,721	-	41	1,762
Hyperbaric Chambers	-	-	390	390	196	-	117	313
Service and Spares	342	-	-	342	387	-	-	387
Subtotal	1,517	-	441	1,958	3,172	-	158	3,330
Net sales total	\$ 1,871	\$ 353	\$ 8,026	\$ 10,250	\$ 4,475	\$ 559	\$ 5,051	\$ 10,085

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued
(Dollars in thousands, except per share information)

	Twenty-six weeks ended							
	August 24, 2018				August 25, 2017			
	Domestic	U.S. Gov't	Inter-national	Total	Domestic	U.S. Gov't	Inter-national	Total
Aerospace Solutions								
Aeromedical Training Solutions	\$ 168	\$ 975	\$ 11,495	\$ 12,638	\$ 1,491	\$ 1,159	\$ 10,538	\$ 13,188
Simulation (ADMS)	406	157	1,323	1,886	519	-	955	1,474
Subtotal	574	1,132	12,818	14,524	2,010	1,159	11,493	14,662
Commercial/Industrial Systems								
Sterilizers	2,729	-	-	2,729	1,772	-	-	1,772
Environmental (ETSS)	1,161	-	215	1,376	3,180	49	632	3,861
Hyperbaric Chambers	586	-	846	1,432	358	-	117	475
Service and Spares	880	-	-	880	804	-	-	804
Subtotal	5,356	-	1,061	6,417	6,114	49	749	6,912
Net sales total	\$ 5,930	\$ 1,132	\$ 13,879	\$ 20,941	\$ 8,124	\$ 1,208	\$ 12,242	\$ 21,574

The Company's percentage of total recognized revenue by type of revenue was as follows:

Type of Revenue	Thirteen weeks ended	
	August 24, 2018	August 25, 2017
Products	87.6%	85.5%
Maintenance and support agreements	7.1%	7.5%
Services	3.0%	5.2%
Spare parts	2.3%	1.8%
Total	100.0%	100.0%

Type of Revenue	Twenty-six weeks ended	
	August 24, 2018	August 25, 2017
Products	87.2%	87.7%
Maintenance and support agreements	6.3%	6.5%
Services	4.2%	3.9%
Spare parts	2.3%	1.9%
Total	100.0%	100.0%

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

(Dollars in thousands, except per share information)

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 \$4,398, or 51.7%, of total net accounts receivable as of August 24, 2018 as compared to \$829, or 14.0%, of total net accounts receivable as of February 23, 2018. As of October 24, 2018, the date of issuance of the accompanying interim consolidated financial statements, 95.7% of these receivables outstanding as of August 24, 2018 and 90.1% of these receivables outstanding as of February 23, 2018 have been collected, respectively.

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.

Inventories

Inventories are valued at the lower of cost or market. Cost is determined principally by the first-in, first-out method ("FIFO method"). The costs of finished goods and work-in-process inventories include material, direct engineering, manufacturing labor, and overhead components. Overhead costs allocated to inventory are only those directly related to our manufacturing activities. Where necessary, provision is made for obsolete, slow-moving, or damaged inventory. This provision represents the difference between the cost of the inventory and its estimated market value. In 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.

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.

Note 2. 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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

(Dollars in thousands, except per share information)

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 August 24, 2018 and August 25, 2017, 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 both August 24, 2018 and August 25, 2017, there were outstanding options to purchase the Company's Common Stock totaling 509,500 shares at an average price of \$1.24 per share. Due to the conversion price of Common Stock options, 499,500 shares were excluded from the calculation of diluted earnings per share as of both August 24, 2018 and August 25, 2017 because the effect of their conversion would be anti-dilutive.

Note 3. Long-Term Obligations

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, to which the PNC Daily LIBOR Rate (2.1138% as of September 1, 2018, the date of our most current Revolving Line of Credit statement) is added, was lowered from 3.00% to 2.75%.

Summary of Long-Term Debt Obligations

Long-term debt obligations consist of the following:

	August 24, 2018	February 23, 2018
	(unaudited)	
Credit facility payable to bank	\$ 21,920	\$ 18,809
Borrowed under the ETC-PZL Line of Credit	1,778	2,084
Total long-term debt obligations	23,698	20,893
Less: debt issuance costs	-	-
Total long-term debt obligations, net of debt issuance costs	23,698	20,893
Less: current portion	(23,698)	-
Total long-term debt obligations, net of debt issuance costs, less current portion	\$ -	\$ 20,893

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

(Dollars in thousands, except per share information)

Note 4. Income Taxes

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

Generally, accounting standards require companies to provide for income taxes each quarter based on their estimate of the effective tax rate for the full year. The authoritative guidance for accounting for income taxes allows use of the discrete method when, in certain situations, the actual interim period effective tax rate may be used if it provides a better estimate of income tax expense.

An income tax provision of \$20, primarily related to an increase in unrecognized tax benefits, was recorded in the 2019 second quarter compared to an income tax provision of \$25 recorded in the 2018 second quarter. Effective tax rates were 4.2% and 5.4% for the 2019 second quarter and the 2018 second quarter, respectively. An income tax provision of \$48, also primarily related to an increase in unrecognized tax benefits, was recorded in the 2019 first half compared to an income tax provision of \$43 recorded in the 2018 first half. Effective tax rates were 4.2% and 7.1% for the 2019 first half and the 2018 first half, respectively. As of August 24, 2018, the Company had approximately \$22,048 of federal net loss carryforwards available to offset future income tax liabilities, which begin to expire in 2025. The unrecognized tax benefits, 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.

Note 5. Commitments and Contingencies

Legal Proceedings

U.S. Air Force Centrifuge Contract Settlement

The Company is a party to a firm fixed price contract with the U.S. 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. In the 2019 first quarter, 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.

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.

Note 6. Subsequent Events

The Company has evaluated subsequent events through October 24, 2018, the date of issuance of the accompanying interim consolidated financial statements, and determined that there were no material subsequent events requiring adjustment to, or disclosure in, the accompanying interim consolidated financial statements for the thirteen weeks ended August 24, 2018.

Management's Discussion and Analysis

Forward-looking Statements

Discussions of some of the matters contained in this Quarterly Report include forward-looking statements that may involve risks and uncertainties. Some of these discussions are contained under the caption "Management's Discussion and Analysis". 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 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.

Results of Operations

Thirteen weeks ended August 24, 2018 compared to thirteen weeks ended August 25, 2017

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

Summary Table of Results

(unaudited)

<i>(in thousands, except per share information)</i>	Thirteen weeks ended		Variance (\$)	Variance (%)
	August 24, 2018	August 25, 2017		
Net sales	\$ 10,250	\$ 10,085	\$ 165	1.6
Cost of goods sold	6,518	6,406	112	1.7
Gross profit	3,732	3,679	53	1.4
<i>Gross profit margin %</i>	36.4%	36.5%	-0.1%	-0.3%
Operating expenses	2,876	2,739	137	5.0
Operating income	856	940	(84)	(8.9)
<i>Operating margin %</i>	8.4%	9.3%	-0.9%	-9.7%
Interest expense, net	267	213	54	25.4
Other expense, net	111	260	(149)	(57.3)
Income before income taxes	478	467	11	2.4
<i>Pre-tax margin %</i>	4.7%	4.6%	0.1%	2.2%
Income tax provision	20	25	(5)	(20.0)
Income attributable to non-controlling interest	(10)	(26)	16	(61.5)
Net income attributable to ETC	\$ 448	\$ 416	\$ 32	7.7

Per share information:

Basic earnings per common and participating share:

Distributed earnings per share:

Common	\$ -	\$ -	\$ -	
Preferred	\$ 0.02	\$ 0.02	\$ -	0.0
Undistributed earnings per share:				
Common	\$ 0.02	\$ 0.02	\$ -	0.0
Preferred	\$ 0.02	\$ 0.02	\$ -	0.0
Diluted earnings per share	\$ 0.02	\$ 0.02	\$ -	0.0

Environmental Tectonics Corporation
Management's Discussion and Analysis, continued

Net Income Attributable to ETC

Net income attributable to ETC was \$0.4 million, or \$0.02 diluted earnings per share, in both the 2019 second quarter and the 2018 second quarter. Although most items contributing to net income attributable to ETC remained flat quarter over quarter, there was a \$0.1 million increase in operating expenses that was offset by a \$0.1 million decrease in other expense, net.

Net Sales

Net sales in the 2019 second quarter were \$10.3 million, an increase of \$0.2 million, or 1.6%, compared to 2018 second quarter net sales of \$10.1 million. The increase reflects higher International sales, especially within our Aerospace segment, offset, in part, by a decrease in Domestic sales, especially within our CIS segment.

Gross Profit

Gross profit for both the 2019 second quarter and the 2018 second quarter was \$3.7 million. Gross profit margin as a percentage of net sales also remained relatively flat quarter over quarter at 36.4% for the 2019 second quarter compared to 36.5% for the 2018 second quarter.

Operating Expenses

Operating expenses, including sales and marketing, general and administrative, and research and development, for the 2019 second quarter were \$2.9 million, an increase of \$0.1 million, or 5.0%, compared to \$2.8 million for the 2018 second quarter. The slight increase in operating expenses was due primarily to an increase in commission expense based on a higher concentration of International sales related to ATS products, offset, in part, by the conclusion of a consulting agreement with the Company's former Chief Executive Officer.

Other Expense, Net

Other expense, net for the 2019 second quarter was \$0.1 million compared to \$0.2 million in the 2018 second quarter, a decrease of \$0.1 million due to the combination of a decrease in net realized foreign currency exchange losses and a decrease in letter of credit fees.

Environmental Tectonics Corporation
Management's Discussion and Analysis, continued

Twenty-six weeks ended August 24, 2018 compared to twenty-six weeks ended August 25, 2017

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

Summary Table of Results
(unaudited)

<i>(in thousands, except per share information)</i>	Twenty-six weeks ended		Variance (\$)	Variance (%)
	August 24, 2018	August 25, 2017		
Net sales	\$ 20,941	\$ 21,574	\$ (633)	(2.9)
Cost of goods sold	13,313	14,294	(981)	(6.9)
Gross profit	7,628	7,280	348	4.8
<i>Gross profit margin %</i>	36.4%	33.7%	2.7%	8.0%
Operating expenses	5,794	6,024	(230)	(3.8)
Operating income	1,834	1,256	578	46.0
<i>Operating margin %</i>	8.8%	5.8%	3.0%	51.7%
Interest expense, net	517	410	107	26.1
Other expense, net	187	239	(52)	(21.8)
Income before income taxes	1,130	607	523	86.2
<i>Pre-tax margin %</i>	5.4%	2.8%	2.6%	92.9%
Income tax provision	48	43	5	11.6
Income attributable to non-controlling interest	(8)	(27)	19	(70.4)
Net income attributable to ETC	\$ 1,074	\$ 537	\$ 537	100.0

Per share information:

Basic earnings per common and participating share:

Distributed earnings per share:

Common	\$ -	\$ -	\$ -	
Preferred	\$ 0.04	\$ 0.04	\$ -	0.0
Undistributed earnings per share:				
Common	\$ 0.05	\$ 0.02	\$ 0.03	150.0
Preferred	\$ 0.05	\$ 0.02	\$ 0.03	150.0
Diluted earnings per share	\$ 0.05	\$ 0.02	\$ 0.03	150.0

Net Income Attributable to ETC

Net income attributable to ETC was \$1.0 million, or \$0.05 diluted earnings per share, in the 2019 first half, compared to \$0.5 million during the 2018 first half, equating to \$0.02 diluted earnings per share. The \$0.5 million increase is due to the combined effect of a \$0.3 million increase in gross profit, a \$0.2 million decrease in operating expenses, and a \$0.1 million decrease in other expense, net, offset, in part, by and a \$0.1 million increase in interest expense.

Net Sales

Net sales in the 2019 first half were \$20.9 million, a decrease of \$0.6 million, or 2.9%, compared to 2018 first half net sales of \$21.6 million. The decrease reflects a reduction in Domestic sales, especially within our Environmental and ATS business units, offset, in part, by an increase in International sales, especially within our ATS and Hyperbaric Chambers business units, and an increase in sales of ethylene oxide sterilizers within the Sterilizers business unit to Domestic customers.

Gross Profit

Gross profit for the 2019 first half was \$7.6 million compared to \$7.3 million in the 2018 first half, an increase of \$0.3 million, or 4.8%. The increase in gross profit was due to a higher blended gross profit margin as a percentage of net sales, which increased to 36.4% for the 2019 first half compared to 33.7% for the 2018 first half. The increase in gross profit margin as a percentage of net sales was due primarily to a higher concentration of net sales from more off-the-shelf type products requiring less initial design and engineering work.

Environmental Tectonics Corporation
Management's Discussion and Analysis, continued

Operating Expenses

Operating expenses, including sales and marketing, general and administrative, and research and development, for the 2019 first half were \$5.8 million, a decrease of \$0.2 million, or 3.8%, compared to \$6.0 million for the 2018 first half. The decrease in operating expenses was due primarily to the conclusion of a consulting agreement with the Company's former Chief Executive Officer.

Interest Expense, Net

Interest expense, net for the 2019 first half was \$0.5 million compared to \$0.4 million in the 2018 first half, an increase of \$0.1 million due to the combination of a higher level of bank borrowing and an increase in interest rates.

Other Expense, Net

Other expense, net for the 2019 first half was \$0.2 million compared to \$0.3 million in the 2018 first half, a decrease of \$0.1 million due to the combination of a decrease in net realized foreign currency exchange losses and a decrease in letter of credit fees.

Cash Flows from Operating, Investing, and Financing Activities

During the 2019 first half, as a result of an increase in contract assets and accounts receivable, offset, in part by an increase in contract liabilities, the Company used \$2.6 million of cash for operating activities compared to \$0.6 million during the 2018 first half. Under ASC 606, these accounts represent the timing differences of spending on production activities versus the billing and collecting of customer payments.

Cash used for investing activities primarily relates to funds used for capital expenditures of equipment and software development. The Company's investing activities used \$0.1 million in the 2019 first half compared to \$0.3 million in the 2018 first half.

The Company's financing activities provided \$2.8 million of cash in the 2019 first half from borrowings under the Company's various lines of credit compared to \$1.3 million during the 2018 first half.

Item 7. Description of Facilities

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 use is presented below:

Location	Approximate Square Footage	Function	Owned/Leased	Segment
Southampton, Pennsylvania	83,800	Manufacturing (36,000 sq. ft), NASTAR Center (22,100 sq. ft.), and Corporate Headquarters (25,700 sq. ft.)	Owned	Aerospace CIS
Orlando, Florida	8,700	Product development and administration	Leased	Aerospace
Warsaw, Poland	28,000	Manufacturing, product development, and administration	Leased	Aerospace
Ankara, Turkey	5,700	Software development	Leased	Aerospace CIS
Total	126,200			

The Southampton owned property is encumbered by an Open-End Mortgage and Security Agreement with PNC Bank, which secures the 2016 PNC Credit Facilities. We consider our machinery and plant to be in satisfactory operating condition, and adequate given our expected operations. Significant increases in the level of operations beyond what we expect in the current fiscal year might require us to obtain additional facilities and equipment.

Our National Aerospace Training and Research Center (the "NASTAR Center"), which is included in the Company's Southampton, Pennsylvania owned property, includes the following aerospace training and research equipment:

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

Item 8. Officers, Directors, and Control Persons

	Name / Address **	Title	Ownership Percentage
Directors and Executive Officers:	George K. Anderson, M.D.	Chairman of the Board of Directors	*
	Michael D. Malone	Vice Chairman of the Board of Directors	*
	Linda J. Brent, Ed.D.	Director	*
	Roger Colley	Director	*
	Estate of H.F. Lenfest c/o The Lenfest Group Five Tower Bridge-Suite 460 300 Barr Harbor Drive West Conshohocken, PA 19428	Director	*** 54.2%
	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	*
Control Persons:	T. Todd Martin, III 50 Midtown Park East Mobile, AL 36606		11.0%
	3K Limited Partnership Peter H. Kamin Philip 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 October 24, 2018, the date of issuance of the accompanying interim consolidated financial statements, based on information available to the Company. None of the foregoing Directors and Executive Officers in the last five years has had a legal/disciplinary issue.

Item 9. Third Party Providers

Legal Counsel:

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Philadelphia, PA 19103
(215) 564-8120

Independent Auditor:

RSM US LLP
751 Arbor Way
Blue Bell, PA 19422
(215) 641-8600

Item 10. Management's Certification

I, Mark Prudenti certify that:

- 1 I have reviewed this Quarterly Report of Environmental Tectonics Corporation;
- 2 Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
- 3 Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations, and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.



Mark Prudenti
Chief Financial Officer and Treasurer
Date: October 24, 2018

I, Robert L. Laurent, Jr. certify that:

- 1 I have reviewed this Quarterly Report of Environmental Tectonics Corporation;
- 2 Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
- 3 Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations, and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.



Robert L. Laurent, Jr.
Chief Executive Officer and President
Date: October 24, 2018

INVESTOR CONTACT

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