QUARTERLY REPORT 1

FOR THE FOURTEEN WEEKS
ENDED MAY 31, 2019

ENVIRONMENTAL TECTONICS CORPORATION

Quarterly Report
For the fourteen weeks ended May 31, 2019

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Southampton, Pennsylvania 18966
(Address of Issuer's Principal Executive Office)

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Table of Contents

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 (Stated value of $1,000)
Total shares authorized:	50,000,000 as of May 31, 2019	25,000 as of May 31, 2019
Total shares outstanding:	9,443,785 as of May 31, 2019	12,127 as of May 31, 2019

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 May 31, 2019, which totaled $3,042 thousand, remained unpaid as of August 16, 2019, 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
October 17, 2018	George K. Anderson, M.D.	8,571	Director remuneration at $0.70 per share	$	6,000
October 17, 2018	Michael D. Malone	7,143	Director remuneration at $0.70 per share	$	5,000

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 Common Stock award shares noted in Item 4A contain a restrictive legend.

Item 5. Financial Statements

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

(in thousands, except per share information)	**Fourteen weeks ended May 31, 2019**	**Thirteen weeks ended May 25, 2018**
Net sales	$ 10,816	$ 10,691
Cost of goods sold	8,336	6,795
Gross profit	2,480	3,896
Operating expenses	2,586	2,918
Operating (loss) income	(106)	978
Other expenses:		
Interest expense, net	178	250
Other expense, net	150	76
Other expenses, net total	328	326
(Loss) income before income taxes	(434)	652
Income tax provision	20	28
Net (loss) income	(454)	624
(Income) loss attributable to non-controlling interest	(26)	2
Net (loss) income attributable to Environmental Tectonics Corporation	**(480)**	**626**
Foreign currency translation adjustment	14	(45)
Comprehensive (loss) income	$ (466)	$ 581
Preferred Stock dividends	(130)	(121)
(Loss) income attributable to common and participating shareholders	$ (610)	$ 505
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.02	$ 0.02
Undistributed (loss) earnings per share:		
Common	$ (0.04)	$ 0.03
Preferred	$ (0.04)	$ 0.03
Diluted (loss) earnings per share	**$ (0.04)**	**$ 0.03**
Basic weighted average common and participating shares:		
Common weighted average number of shares	9,444	9,428
Participating preferred shares	6,125	6,125
Total basic weighted average common and participating shares	15,569	15,553
Diluted weighted average shares:		
Basic weighted average common and participating shares	15,569	15,553
Dilutive effect of stock options	15	4
Total diluted weighted average shares	15,584	15,557

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

Environmental Tectonics Corporation
Consolidated Balance Sheets

(in thousands, except share information)		May 31, 2019 (unaudited)		February 22, 2019
ASSETS				
Current assets:				
Cash and cash equivalents	$	3,873	$	5,061
Restricted cash		5,955		5,956
Accounts receivable, net		6,956		2,913
Contract assets		13,648		15,264
Inventories, net		2,965		2,819
Prepaid expenses and other current assets		1,220		1,378
Total current assets		34,617		33,391
Property, plant, and equipment, at cost, net		11,261		11,490
Right-of-use asset		529		-
Capitalized software development costs, net		126		90
Deferred tax assets, non-current, net		438		441
Total assets	**$**	**46,971**	**$**	**45,412**
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable, trade	$	3,962	$	3,607
Contract liabilities		3,635		6,609
Accrued taxes		605		1,703
Accrued interest and dividends		3,119		2,985
Current portion of lease obligations		207		-
Other accrued liabilities, current		4,346		4,814
Total current liabilities		15,874		19,718
Long-term debt obligations, net of debt issuance costs:				
Credit facility payable to bank, net of debt issuance costs		17,968		12,359
Total long-term debt obligations, net of debt issuance costs		17,968		12,359
Lease obligations, non-current		354		-
Other accrued liabilities, non-current		802		798
Total liabilities		34,998		32,875
Commitments and contingencies (Note 6)				
Shareholders' equity:				
Cumulative convertible participating Preferred Stock, Series E, $0.05 par value, 25,000 shares authorized; 12,127 shares outstanding as of May 31, 2019 and February 22, 2019		12,127		12,127
Common Stock, $0.05 par value, 50,000,000 shares authorized; 9,443,785 and 9,428,071 shares issued and outstanding as of May 31, 2019 and February 22, 2019, respectively		472		472
Additional paid-in capital		7,981		8,105
Accumulated deficit		(8,020)		(7,540)
Accumulated other comprehensive loss		(814)		(828)
Total shareholders' equity before non-controlling interest		11,746		12,336
Non-controlling interest		227		201
Total shareholders' equity		11,973		12,537
Total liabilities and shareholders' equity	**$**	**46,971**	**$**	**45,412**

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

Environmental Tectonics Corporation
Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Fourteen weeks ended May 31, 2019	Thirteen weeks ended May 25, 2018
Cash flows from operating activities:		
Net (loss) income	$ (454)	$ 624
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	289	298
Deferred income taxes	3	1
Decrease in allowance for doubtful accounts and inventory obsolescence	(2)	(5)
Stock compensation expense	6	15
Changes in operating assets and liabilities:		
Accounts receivable	(4,043)	3,047
Contract assets	1,616	(4,114)
Inventories	(144)	580
Prepaid expenses and other assets	158	(98)
Accounts payable, trade	355	(1,181)
Contract liabilities	(2,974)	(1,686)
Accrued taxes	(1,098)	5
Accrued interest and dividends	4	16
Other accrued liabilities	(432)	380
Net cash used in operating activities	**(6,716)**	**(2,118)**
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(45)	(37)
Capitalized software development costs	(51)	(39)
Net cash used in investing activities	**(96)**	**(76)**
Cash flows from financing activities:		
Borrowings under lines of credit	5,609	2,608
Net cash provided by financing activities	**5,609**	**2,608**
Effect of exchange rate changes on cash	14	(45)
Net (decrease) increase in cash, cash equivalents, and restricted cash	(1,189)	369
Cash, cash equivalents, and restricted cash at beginning of period	11,017	6,283
Cash, cash equivalents, and restricted cash at end of period	**$ 9,828**	**$ 6,652**
Less: Restricted cash	(5,955)	(5,951)
Cash and cash equivalents at end of period	**$ 3,873**	**$ 701**
Supplemental schedule of cash flow information:		
Interest paid	$ 215	$ 249
Income taxes paid	$ 442	$ 3
Supplemental information on non-cash operating and investing activities:		
Preferred Stock dividends accrued during each respective fiscal period	$ 130	$ 121

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 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. 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 Standard Industrial Classification Code ("SIC Code") is 3569. 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 2020 first quarter are references to the fourteen week period ended May 31, 2019. References to the 2019 first quarter are references to the thirteen week period ended May 25, 2018. References to fiscal 2020 are references to the fifty-three week period ending February 28, 2020. References to fiscal 2019 are references to the fifty-two week period ended February 22, 2019. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2020.

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying interim consolidated financial statements include the accounts of ETC and our 95%-owned subsidiary in Warsaw, Poland, ETC-PZL Aerospace Industries Sp. z o.o. ("ETC-PZL"). 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. All significant intercompany accounts and transactions have been eliminated in consolidation.

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.

(Dollars in thousands, except per share information)

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 2019.

Standards Issued and Implemented

Leases

In February 2016, as part of its initiative to increase transparency and comparability among organizations, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842), which introduces a lessee model that brings most leases on the balance sheet. ASU 2016-02 is 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. As permitted under the standard, we have elected to apply the transition provisions of this new standard prospectively beginning on February 23, 2019; therefore, periods prior to the effective date of adoption will continue to be reported using Accounting Standards Codification ("ASC") 840. Adoption of the new standard did not have a significant impact on our net earnings or cash flows.

Significant Accounting Policies Update

Other than the changes in our accounting policies related to the adoption of ASU 2016-02, there have been no material changes in the Company's significant accounting policies during fiscal 2020 as compared to what was previously disclosed in the Company's Annual Report to Shareholders for fiscal 2019.

Leases

The Company determines if an arrangement is a lease at the inception date. On the Consolidated Balance Sheets, operating leases are included in *Right-of-use asset*, with the related liabilities included in either *Current portion of lease obligations* or *Lease obligations, non-current*. Also on the Consolidated Balance Sheets, finance leases are included in *Property, plant, and equipment, at cost, net*, with the related liabilities included in either *Other accrued liabilities, current*, or *Other accrued liabilities, non-current*.

Right-of-use assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. If a lease does not implicitly state a rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of future payments. Variable components of the lease payments such as fair market value adjustments, utilities, and maintenance costs are expensed as incurred and not included in determining the present value. Lease expense for minimum lease payments are recognized on a straight-line basis over the lease term.

The Company leases certain premises and office equipment under operating leases. As of May 31, 2019, these leases have remaining lease terms of two (2) months to four (4) years, with a weighted average remaining lease term of approximately two and a half (2.5) years. Maturities of operating lease liabilities are as follows:

Fiscal Year	Amount
Fiscal 2020	$ 166
Fiscal 2021	196
Fiscal 2022	203
Fiscal 2023	38
Fiscal 2024	2
Total lease payments	605
Less: imputed interest	(44)
Total future long-term debt obligations	561
Less: current portion	(207)
Total future long-term debt obligations, less current portion	**$ 354**

Total operating lease expense was $86 for the 2020 first quarter, of which $13 was attributable to variable lease expenses. For the 2020 first quarter, cash payments against operating lease liabilities totaled $74 and reclassifications of liabilities to comply with the presentation requirements of ASU 2016-02 totaled $33.

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.

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 May 31, 2019 and May 25, 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 May 31, 2019 and May 25, 2018, there were outstanding options to purchase the Company's Common Stock totaling 746,500 and 509,500 shares at an average price of $1.07 and $1.24 per share, respectively. Due to the conversion price of Common Stock options, 497,500 and 499,500 shares were excluded from the calculation of diluted earnings per share as of May 31, 2019 and May 25, 2018, respectively, because the effect of their conversion would be anti-dilutive.

Note 3. Revenue

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.

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 May 31, 2019, our ending sales backlog was $31,096. We expect to recognize approximately 80% over the next twelve (12) months and approximately 92% over the next twenty-four (24) months as revenue, with the remainder recognized thereafter.

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.

(Dollars in thousands, except per share information)

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

	Fourteen weeks ended May 31, 2019			Thirteen weeks ended May 25, 2018		
	Aerospace	CIS	Total	Aerospace	CIS	Total
Net income (loss) attributable to ETC	$ (332)	$ 151	$ (180)	$ (122)	$ (30)	$ (152)

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

	Fourteen weeks ended May 31, 2019				Thirteen weeks ended May 25, 2018			
	Domestic	U.S. Gov't	Inter-national	Total	Domestic	U.S. Gov't	Inter-national	Total
Aerospace Solutions								
Aeromedical Training Solutions	$ 181	$ 241	$ 4,622	$ 5,044	$ 36	$ 625	$ 4,991	$ 5,652
Simulation (ADMS)	642	3	348	993	184	154	242	580
Subtotal	823	244	4,970	6,037	220	779	5,233	6,232
Commercial/Industrial Systems								
Sterilizers	1,383	-	1,853	3,236	1,760	-	-	1,760
Environmental (ETSS)	118	-	530	648	955	-	164	1,119
Hyperbaric Chambers	-	-	448	448	586	-	456	1,042
Service and Spares	447	-	-	447	538	-	-	538
Subtotal	1,948	-	2,831	4,779	3,839	-	620	4,459
Net sales total	**$ 2,771**	**$ 244**	**$ 7,801**	**$ 10,816**	**$ 4,059**	**$ 779**	**$ 5,853**	**$ 10,691**

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

Type of Revenue	Fourteen weeks ended May 31, 2019	Thirteen weeks ended May 25, 2018
Products	82.5%	86.8%
Maintenance and support agreements	6.7%	5.6%
Services	8.7%	5.4%
Spare parts	2.1%	2.2%
Total	**100.0%**	**100.0%**

Note 4. 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 (2.2243% as of August 1, 2019, the date of our most current Revolving Line of Credit statement) is added, was lowered from 3.00% to 2.75%.

On June 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.

(Dollars in thousands, except per share information)

Summary of Long-Term Debt Obligations

Long-term debt obligations consist of the following:

	May 31, 2019 (unaudited)	February 22, 2019
Credit facility payable to bank	$ 17,968	$ 12,359
Total long-term debt obligations	17,968	12,359
Less: debt issuance costs	-	-
Total long-term debt obligations, net of debt issuance costs	**$ 17,968**	**$ 12,359**

Note 5. 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.

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 2020 first quarter compared to an income tax provision of $28 recorded in the 2019 first quarter. Effective tax rates were -4.6% and 4.3% for the 2020 first quarter and the 2019 first quarter, respectively. As of May 31, 2019, the Company had approximately $20,999 of federal NOL carryforwards available to offset future income tax liabilities, which begin to expire in 2025. The Company continues to record 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. 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 6. 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.

U.S. 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.

Note 7. Subsequent Events

The Company has evaluated subsequent events through August 16, 2019, the date of issuance of the accompanying interim consolidated financial statements, and determined that there were no material subsequent events other than disclosed below requiring adjustment to, or disclosure in, the accompanying interim consolidated financial statements for the fourteen weeks ended May 31, 2019.

On June 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 4 – Long-Term Obligations 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.

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

Fourteen weeks ended May 31, 2019 compared to thirteen weeks ended May 25, 2018

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)

(in thousands, except per share information)	**Fourteen weeks ended May 31, 2019**	**Thirteen weeks ended May 25, 2018**	**Variance ($)**	**Variance (%)**
Net sales	$ 10,816	$ 10,691	$ 125	1.2
Cost of goods sold	8,336	6,795	1,541	22.7
Gross profit	2,480	3,896	(1,416)	(36.3)
Gross profit margin %	*22.9%*	*36.4%*	*-13.5%*	*-37.1%*
Operating expenses	2,586	2,918	(332)	(11.4)
Operating (loss) income	(106)	978	(1,084)	
Operating margin %	*-1.0%*	*9.1%*	*-10.1%*	
Interest expense, net	178	250	(72)	(28.8)
Other expense, net	150	76	74	97.4
(Loss) income before income taxes	(434)	652	(1,086)	
Pre-tax margin %	*-4.0%*	*6.1%*	*-10.1%*	
Income tax provision	20	28	(8)	(28.6)
(Income) loss attributable to non-controlling interest	(26)	2	(28)	
Net (loss) income attributable to ETC	**$ (480)**	**$ 626**	**$ (1,106)**	
Per share information:				
Basic earnings (loss) per common and participating share:				
Distributed earnings per share:				
Common	$ -	$ -	$ -	
Preferred	$ 0.02	$ 0.02	$ -	0.0
Undistributed (loss) earnings per share:				
Common	$ (0.04)	$ 0.03	$ (0.07)	
Preferred	$ (0.04)	$ 0.03	$ (0.07)	
Diluted (loss) earnings per share	**$ (0.04)**	**$ 0.03**	**$ (0.07)**	

Net (Loss) Income Attributable to ETC

Net loss attributable to ETC was $0.5 million, or $0.04 diluted loss per share, in the 2020 first quarter, compared to net income attributable to ETC of $0.6 million during the 2019 first quarter, equating to $0.03 diluted earnings per share. The $1.1 million variance is due to the combined effect of a $1.4 million decrease in gross profit and a $0.1 million increase in other expense, net, offset, in part, by a $0.3 million decrease in operating expenses and a $0.1 million decrease in interest expense.

Net Sales

Net sales in the 2020 first quarter were $10.8 million, an increase of $0.1 million, or 1.2%, compared to 2019 first quarter net sales of $10.7 million. The increase reflects higher International sales of ethylene oxide sterilizers, offset, in part, by a decrease in Domestic sales within our CIS segment.

Gross Profit

Gross profit for the 2020 first quarter was $2.5 million compared to $3.9 million in the 2019 first quarter, a decrease of $1.4 million, or 36.3%. The decrease in gross profit was due to a lower blended gross profit margin as a percentage of net sales, which decreased to 22.9% for the 2020 first quarter compared to 36.4% for the 2019 first quarter. The decrease in gross profit margin as a percentage of net sales was due primarily to the completion and delivery of two (2) significant International ATS contracts during fiscal 2019, which resulted in the Company entering fiscal 2020 with a lower backlog comprised of contracts with comparably lower estimated profit booking rates.

Operating Expenses

Operating expenses, including sales and marketing, general and administrative, and research and development, for the 2020 first quarter were $2.6 million, a decrease of $0.3 million, or 11.4%, compared to $2.9 million for the 2019 first quarter. The decrease in operating expenses was due primarily to the receipt of payments received for research grants, which are recorded as a reduction to research and development costs.

Interest Expense, Net

Interest expense, net for the 2020 first quarter was $0.2 million compared to $0.3 million in the 2019 first quarter, a decrease of $0.1 million due to a lower level of bank borrowing.

Other Expense, Net

Other expense, net for the 2020 first quarter was $0.2 million compared to $0.1 million in the 2019 first quarter, an increase of $0.1 million due to higher letter of credit fees.

Cash Flows from Operating, Investing, and Financing Activities

During the 2020 first quarter, as a result of an increase in accounts receivable and a decrease in contract liabilities and accrued taxes, offset, in part by a decrease in contract assets, the Company used $6.7 million of cash for operating activities compared to $2.1 million during the 2019 first quarter. Under ASC 606, these accounts, other than accrued taxes, 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 both the 2020 first quarter and the 2019 first quarter.

The Company's financing activities provided $5.6 million of cash in the 2020 first quarter from borrowings under the Company's credit facility compared to $2.6 million during the 2019 first quarter.

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	*
	Linda J. Brent, Ed.D.	Director	*
	Roger Colley	Director	*
	Winston E. Scott	Director	*
	Robert L. Laurent, Jr.	Chief Executive Officer, President, and Director	2.0%
	Mark Prudenti	Chief Financial Officer and Treasurer	1.2%
	James D. Cashel	Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer	1.5%
	Thomas G. Loughlin	Chief Operating Officer	1.3%
	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. 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 August 16, 2019, 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: August 16, 2019

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: August 16, 2019