

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K  
FOR ANNUAL AND TRANSITION REPORTS  
PURSUANT TO SECTIONS 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
for the fiscal year ended February 25, 2005

or

Transition report pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.  
Commission File Number 1-10655

**ENVIRONMENTAL TECTONICS CORPORATION**

Pennsylvania

23-1714256

(State or other jurisdiction of incorporation or  
organization)

(I.R.S. Employer Identification No.)

County Line Industrial Park  
Southampton, Pennsylvania 18966

(Address of principal executive offices, Zip Code)

Registrant's telephone number, including area code (215) 355-9100

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$.05 per share	American Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes  No

As of May 6, 2005, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$32,169,000 based upon the closing sale price of the registrant's common stock on the American Stock Exchange of \$5.85 on such date. See footnote (1) below.

As of May 6, 2005, there were 9,019,376 shares of the registrant's common stock issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE.** Portions of Registrant's 2005 Annual Report to Stockholders are incorporated by reference in Part II, Items 5, 6, 7, and 8.

Index to Exhibits appears after page 20 of this Report

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(1) The information provided is not an admission that any person whose holdings are excluded from the figure is not an affiliate or that any person whose holdings are included is an affiliate and any such admission is hereby disclaimed. The information provided is solely for recordkeeping purposes of the Securities and Exchange Commission.

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**ENVIRONMENTAL TECTONICS CORPORATION**  
**ANNUAL REPORT ON FORM 10-K**  
**FOR THE FISCAL YEAR ENDED**  
**FEBRUARY 25, 2005**

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## **FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are based on the Company's current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about the Company 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 revenue, costs of raw materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items and the effects of currency fluctuations, (ii) statements of plans and objectives of the Company or its management or 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, and (vi) statements preceded by, followed by or that include the words "may", "could", "should", "looking forward", "would", "believe", "expect", "anticipate", "estimate", "intend", "plan", or the negative of such terms or similar expressions. These forward-looking statements involve risks and uncertainties which 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. Factors that might cause or contribute to such a material difference include, but are not limited to, those discussed in this Annual Report on Form 10-K, in the section entitled "Risks Particular to Our Business." Shareholders are urged to review these risks carefully prior to making an investment in the Company's common stock.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company

## **PART I**

### **Item 1. Business**

We were incorporated in 1969 in Pennsylvania and are principally engaged in the design, manufacture and sale of software driven products used to create and monitor the physiological effects of motion on humans and equipment and to control, modify, simulate and measure environmental conditions. These products include aircrew training systems, entertainment products, sterilizers, environmental and hyperbaric chambers and other products that involve similar manufacturing techniques and engineering technologies.

### **Segments**

We operate in two primary business segments, Aircrew Training Systems ("ATS") and the Industrial Group.

Aircrew Training Systems. This segment includes three primary product groups: aircrew training devices, entertainment products and disaster management simulation.

Aircrew Training Devices. Our aircrew training devices are used for medical research, advanced tactical and physiological flight training, and for the indoctrination and testing of military and commercial pilots. The major devices that we sell in this business segment are military and commercial flight simulators, night vision trainers, water survival training equipment, disorientation training equipment, human centrifuges, ejection seat trainers and vehicle and tank simulators. We provide operational and maintenance services for installed equipment that we manufacture as well as for equipment produced by others.

Entertainment Products. Our entertainment products consist of motion-based simulation rides and other products for the education and amusement industries.

Disaster Management Simulation. Our Disaster Management Simulation line includes real-time interactive training programs that provide instruction on various disaster situations.

The Aircrew Training System segment generated 60%, 61% and 73% of our consolidated revenues for the fiscal years ended February 25, 2005, February 27, 2004 and February 28, 2003, respectively.

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Industrial Group. This segment includes three primary product lines: sterilizers, environmental systems and other products, and hyperbarics.

Sterilizers. We manufacture steam and gas sterilizers for various industrial and pharmaceutical applications. We concentrate on marketing larger custom-designed sterilizers to the pharmaceutical and medical device industries.

Environmental Systems and Other Products. Our environmental systems business consists of the design and fabrication of sampling and analysis systems, and test equipment and systems. The simulation systems generally consist of an enclosed chamber with instrumentation and equipment which enable the customer to control and modify environmental factors such as temperature, pressure, humidity, wind velocity and gas content to produce desired conditions. These products include controlled air systems for automotive companies and environmental chambers for HVAC and other applications.

Hyperbarics. Our hyperbarics product line includes monoplace (single person) and multiplace (multiple persons) chambers for high altitude training, decompression and wound care applications.

Sales of Industrial Group products generated 40%, 39% and 27% of our consolidated revenues for the years ended February 25, 2005, February 27, 2004 and February 28, 2003, respectively.

We also provide control upgrades, maintenance and repair services and spare parts for equipment which we manufacture and for equipment made by other manufacturers.

For a more complete description of financial information regarding our business segments, see "Note 10, "Business Segment Information" to our consolidated financial statements in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

## **Marketing**

We currently market our products and services primarily through our sales offices and employees. At February 25, 2005, approximately 16 employees were committed to sales and marketing functions. We use branch offices in England, Turkey, Egypt, Singapore, the United Arab Emirates, Malaysia and Japan as well as the services of approximately 100 independent sales organizations in seeking foreign orders for our products.

## **Product Development**

We are continually developing new products and improving existing products in response to inquiries from customers and in response to our determination that particular products should be produced or significantly improved. Although we do not have a separate research and development group, we have several technical personnel whose main activity is the development and integration of new technologies into our existing products. These personnel include the Vice President Engineering Manager and the Vice President of Development whose additional responsibility is the introduction of product extensions and new applications of existing technology.

Within the Aircrew Training Systems segment, product development emphasizes enhancing control systems and software graphics and exploring commercial possibilities. Our product development efforts focus on three areas:

Disaster Management Simulation. During fiscal 2005 we entered into numerous contracts for driver trainer simulators. These included an advanced, interactive virtual-reality based airport ground simulator for the Nashville, TN airport and a simulator for the Airside Operations Training Facility at Minneapolis-St. Paul International Airport. Additionally, we were selected by the Maryland Aviation Administration to perform airport certification and emergency drill training at the Baltimore- Washington International Airport. Exercises included three different scenarios: a security breach, a bomb detection/explosion and a hazardous material spill. And recently we were selected by the South Korean National Fire Academy to provide a virtual-reality based system for training firefighters in South Korea. We will continue to enhance product applications by adding additional software objects and increasing interactivity between the various scenarios.

### G-force and Disorientation Trainers.

During fiscal 2005 we successfully factory tested and shipped the Authentic Tactical Flight Simulator Model 400 (ATFS 400), which we believe is the world's first ground-based simulator capable of creating an authentic simulated tactical maneuvering environment. Utilizing proprietary centrifuge and simulation technology, high-fidelity models of the airplane's dynamic performance, the threats experienced by an aircraft in combat and other battle space factors are integrated into the motion controls to create a fully authentic flight environment for any specific combat aircraft.



We continue to evolve the technology in our GAT-II® General Aviation Trainers and our GYRO line of spatial disorientation devices. During fiscal 2005 we shipped a GYRO-IPT to the U.S. Air Force Research Laboratory (AFRL) to support sustained operations research and development of fatigue countermeasures. We also received an order from the United States Corps of Engineers for a Pilot Selection System to be installed in an international aeromedical center which will incorporate nine GAT simulators and be capable of developing an objective composite profile of pilot candidates.

We plan to incorporate additional advanced tactical flight simulation (TFS) applications into additional products in the ATS line.

### Entertainment

During fiscal 2005 our wholly owned subsidiary, Entertainment Technology Corporation (“EnTCo”), sold its first Monster Truck entertainment simulator to the Incredible Pizza Company. Orders for our Wild Earth simulator were received for placement in the United Kingdom’s Pleasure Beach in Blackpool, the Philadelphia Zoo, Advantage Entertainment Centers in New Jersey and New York, and the San Diego Zoo. Product development in this line will continue to emphasize the educational and amusement entertainment applications of our ATS simulation technology.

We reported research and development expenses of \$856,000, \$358,000 and \$636,000 for the fiscal years ended February 25, 2005, February 27, 2004 and February 28, 2003, respectively. However, most of the cost of our research efforts, which were and continue to be a significant cost of our business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates.

### **Subsidiaries**

We presently have three operating subsidiaries. Entertainment Technology Corporation, our wholly owned subsidiary, is a Pennsylvania corporation that focuses on the development, manufacturing and distribution of our entertainment products. ETC-PZL Aerospace Industries, our 95%-owned subsidiary, is a Polish corporation that manufactures simulators. ETC-Europe, our 99%-owned subsidiary, is a United Kingdom corporation that focuses on generating international sales. We also have a wholly-owned subsidiary, ETC International Corporation, a Barbados corporation that serves as a foreign sales corporation for federal income tax purposes. ETC-Delaware, our wholly-owned subsidiary, is a Delaware corporation that serves as a holding company.

### **Suppliers**

The components being used in the assembly of systems and the parts used to manufacture our products are purchased from equipment manufacturers, electronics supply firms and others. Historically, we have had no difficulty in obtaining supplies. Further, all raw materials, parts, components and other supplies which we use to manufacture our products can be obtained at competitive prices from alternate sources should existing sources of supply become unavailable.

### **Patents and Trademarks**

We presently hold the following patents which we deem significant to our operations:

Patent Number	Title	Expiration Date
4,818,001	“Chamber Door Lock”	4/4/06
5,051,094	“G-Force Trainer”	9/24/08
6,371,110 B1	“Automatic Release Apparatus and Methods for Respirator Devices”	3/25/19
6,818,178 B2	“Method for High Vacuum Sterilization of Closures”	1/15/23

We also hold a trademark on our logo, ETC®, as well as on the following products

BARA-MED®	Medical Hyperbaric Chamber
DATAPRINT®	Digital Printer for Sterilizers
ETC®	Logo for Environmental Tectonics Corporation ( <i>Stylized Mark</i> – See attached sample)
GAT-II®	General Aviation Trainer
G-LAB®	Human Centrifuge/USAF Type

GYROLAB<sup>®</sup>

Spatial Disorientation Device

THE RIDE WORKS<sup>®</sup>

(Facility for) Manufacture of Amusement and Entertainment Rides to  
the order and specification of others.



ETC's UNREGISTERED <sup>TM</sup> TRADEMARKS are:

ADMS <sup>TM</sup>	Advanced Disaster Management Simulator
ATFS <sup>TM</sup>	Advanced Tactical Flight Simulator
Advanced Tactical Flight Simulator <sup>TM</sup>	Advanced Tactical Flight Simulator, ATFS-100, -200, -300, -400
BARA-LAB <sup>TM</sup>	Hyperbaric Chamber (other than medical)
BIG MAC <sup>TM</sup>	Entertainment ride based on a multi-armed Centrifuge Device
CAS <sup>TM</sup>	Conditioned Air Supply
DMI <sup>TM</sup>	Disaster Management Institute
EAGLE-VISION <sup>TM</sup>	Visual Performance/Procedures Trainer
EPC <sup>TM</sup>	Engine Pressure Controller/Environmental System
ETC <sup>TM</sup>	ETC Biomedical Systems ( <i>Stylized "ETC" with caduceus</i> . See sample below).
ETC <sup>TM</sup>	Entertainment Technology Corporation ( <i>Stylized "ETC" and name in color</i> . See sample below).
G-FET <sup>TM</sup>	Human Centrifuge (U.S. Navy type)
G-FET-II <sup>TM</sup>	Human Centrifuge (Malaysian Air Force type)
G-MAST <sup>TM</sup>	Missile Avoidance System (Centrifuge feature)
GRAPH MASTER PROGRAMMER <sup>TM</sup>	Industrial Sterilizer Control
GUARDIAN MONITORING PACKAGE <sup>TM</sup>	GMP features for Sterilizers
GYRO-1 <sup>TM</sup>	Multi-purpose basic Instrument Flight Trainer
GYRO-SAT <sup>TM</sup>	Situational Awareness Trainer (feature of a Gyrolab)
GYROSIM <sup>TM</sup>	Gyrolab as a Simulator
LANE MASTER <sup>TM</sup>	Automobile Emissions Analyzer
MAC <sup>TM</sup>	Entertainment Ride based on a Multi-Armed Centrifuge Device
MRC Monster Roll Cage <sup>TM</sup>	Monster Roll Cage (stylized mark w/ARC) Interactive Simulator in the nature of an amusement ride.
OASIS <sup>TM</sup>	Software-driven tool to build Test and Training Systems and scoring them; curriculum development, capability assessment, etc.
ProFlyer <sup>TM</sup>	Commercial Flight and Navigational Procedures Trainer meeting European regulations for civilian pilot training and certification
PRO-GENESIS <sup>TM</sup>	Control Unit/column for Sterilizers
ProTrainer <sup>TM</sup>	Commercial Instrument Procedures Trainer meeting FAA' PCATD requirements



SMOOTH RIDE™	Computer Control Profile for Hyperbaric Chambers
TNET™ and/or TRAINING NET™	Computer Software for training emergency personnel in firefighting, disaster management, etc.
TESS™	Total Emissions Suppression System, EtO Sterilizer
Thrills Without Ills™	Describing ETC' entertainment rides, particularly those utilizing ETC' Human Centrifuge Technology, which precludes motion sickness commonly associated with motion-based entertainment rides.
VPT-1000™	Visual Procedures Trainer

## Customers

In the current fiscal year and throughout most of our history, we have made a substantial portion of sales to a small number of customers that vary within any given fiscal year. We do not depend upon repeat orders from these same customers. We sell our aircrew training systems principally to U.S. and foreign governmental agencies. We sell sterilizers and environmental systems to commercial and governmental entities worldwide.

In fiscal 2005 only one customer represented 10% or more of sales, the Royal Malaysian Air Force, which generated \$3,388,000 or 12.2% of total sales. We do not have any relationship with this customer other than as a customer. We expect to continue to conduct business with Malaysia in fiscal 2006, albeit at a much reduced level.

## Foreign and Domestic Operations and Export Sales

During the fiscal years ended February 25, 2005, February 27, 2004 and February 28, 2003, approximately \$2,904,000 (10%), \$1,717,000 (7%) and \$4,626,000 (11%), respectively, of our net revenues were attributable to contracts with agencies of the U.S. Government or with other customers who had prime contracts with agencies of the U.S. Government.

During the fiscal years ended February 25, 2005, February 27, 2004 and February 28, 2003, \$12,912,000 (47%), \$15,421,000 (59%) and \$14,805,000 (34%), respectively, of our net revenues were attributable to export sales. Our customers' obligations to us with regards to export sales are normally secured by irrevocable letters of credit based on the creditworthiness of the customer and the geographic area of the world in which they are located.

During the fiscal years ended February 25, 2005, February 27, 2004 and February 28, 2003, \$11,998,000 (43%), \$8,857,000 (34%), and \$23,692,000 (55%), respectively, of our net revenues were attributable to domestic sales to customers other than the U.S. government. (See "Note 10. Business Segment Information" to our consolidated financial statements in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference).

We do not believe that the distribution of our sales between foreign and domestic sales for any particular period is necessarily indicative of the distribution expected for any other period.

We derive a large portion of our sales from long-term contracts requiring more than one year to complete. We account for sales under long-term contracts on the percentage of completion basis. See the section Critical Accounting Policies in the Management's Discussion and Analysis of Financial Condition and Results of Operations and "Note 2. Summary of Significant Accounting Policies" to our consolidated financial statements in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

Our U.S. Government contracts contain standard terms permitting termination for the convenience of the U.S. Government. In the event of termination of a government contract, we are entitled to receive reimbursement on the basis of work completed (cost incurred plus a reasonable profit). We customarily record the amounts that we anticipate to be recovered from termination claims in income as soon as those amounts can be reasonably determined rather than at the time of final settlement. All costs applicable to a termination claim are charged as an offsetting expense concurrently with the recognition of income from the claim.

## Manufacturing Facilities

Our manufacturing facility is located on a five-acre site in Southampton, PA, northwest of Philadelphia. We have approximately 85,000 square feet devoted to manufacturing, assembly and testing. We have two centrifuge bays with specially designed foundations



for testing human centrifuges and other centrifuge-technology-based simulators and amusement rides. ETC is ISO 9001-2000 certified.

### **Backlog**

Our sales backlog at February 25, 2005 and February 27, 2004, for work to be performed and revenue to be recognized under written agreements after such dates, was \$19,084,000 and \$16,914,000, respectively. In addition, our training, maintenance and upgrade contracts backlog at February 25, 2005 and February 27, 2004, for work to be performed and revenue to be recognized after such dates under written agreements, was \$2,232,000 and \$2,637,000, respectively. Of the February 25, 2005 backlog, we have contracts for approximately \$15,243,000 for aircrew training systems and maintenance support, including \$3,422,000 for the Japanese Defense Agency and \$1,746,000 for the Egyptian Air Force. We expect to complete approximately 75% of the February 25, 2005 backlog prior to February 24, 2006, the end of our 2006 fiscal year. Of the February 27, 2004 backlog, we completed approximately 79% by February 25, 2005.

### **Competition**

Our business strategy in recent years has been to seek niche markets in which there is limited competition. However, in some areas of our business we compete with well-established firms, some of which have substantially greater financial and personnel resources than we have.

Some competing firms have technical expertise and production capabilities in one or more of the areas involved in the design and production of physiological flight training equipment, environmental systems, and other specially designed products, and compete with us for this business. The competition for any particular project generally is determined by the technological requirements of the project, with consideration also being given to a bidder's reliability, product performance, past performance and price.

We face competition in the sale of the larger custom-designed industrial sterilizers both from other manufacturers and from our customers' in-house production capabilities.

We believe that we are a significant participant in the markets in which we compete, especially in the market for aircrew training systems where we believe that we are a principal provider of this type of equipment and training in our market area.

### **Compliance with Environmental Laws**

We have not incurred during fiscal 2005, nor do we anticipate incurring during fiscal 2006, any material capital expenditures to maintain compliance with federal, state and local statutes, rules and regulations concerning the discharge of materials into the environment, nor do we anticipate that compliance with these provisions will have a material adverse effect on our earnings or competitive position.

### **Compliance with Export Controls**

Depending on the product, customer, location and the application or use, many of our aeromedical products require an export license from the U.S. Commerce or State Department. Although most of these licenses are readily obtainable in a reasonable timeframe, most of our international contracts for aeromedical equipment include the issuance of an export license as a "force majeure" exception for any contract penalties or liquidated damages.

### **Employees**

On February 25, 2005, we had 232 full-time employees, of which four were employed in executive positions, 79 were engineers, engineering designers, or draftspeople, 47 were administrative (sales, sales support, accounting, etc.) and clerical personnel, and 102 were engaged principally in production, operations and field support.

## **RISKS PARTICULAR TO OUR BUSINESS**

**Our business is subject to numerous risks and uncertainties which could cause our actual operating results and developments to be materially different from those expressed or implied in any of our public announcements or filings including this Annual Report on Form 10-K for the year ended February 25, 2005. These risks and uncertainties include the following items. This list is not exclusive of all the risks and uncertainties associated with our business.**

**We have major litigation and claims in process and these require a significant amount of management time and effort. Additionally, legal costs are a major portion of our general and administrative spending, thus redirecting funds from other operating activities.**

Legal and claims costs in fiscal 2005 were \$3.9 million or 31% of total general and administrative spending. Although this spending level is expected to decrease in fiscal 2006, the cost of pursuing these suits and claims will remain a significant amount.

**There is a risk of an unfavorable outcome in litigation and resulting potential negative financial impact on our operating results.**

In one of the cases of commercial litigation currently in progress, we have been counter-sued for an amount in excess of \$22 million. While we believe we have valid defenses to each of the counterclaims and intend to vigorously defend ourselves against these counterclaims, an unfavorable outcome could result in an adverse material effect on our financial position. With respect to the claim against the U.S. government, historically recoveries have usually exceeded the carrying value of claims. However, these claims require significant management time and effort and normally take multiple years to resolve. Also, there is no assurance that we will always have positive experience with regard to recoveries for our contract claims.

**Our sources of revenues are not consistent; in any given fiscal year a substantial portion of our revenues is derived from a small number of customers that may not be recurring customers in future years.**

In any given fiscal year, a substantial portion of our revenues is typically derived from a small number of customers. For example, in fiscal 2005 we generated approximately 36% of our revenues from sales to four customers, the Royal Malaysian Air Force, the United Kingdom Ministry of Defense, the Army Corp of Engineers, and a domestic customer. In fiscal 2004, we generated approximately 22% of our revenues from sales to two customers, the Royal Malaysian Air Force and the United Kingdom Ministry of Defense. In fiscal 2003, we generated approximately 57% of our revenues from sales to two customers, the Walt Disney Company and the Royal Thai Air Force. We cannot be certain that our most significant customers will continue to order our products and services at the same level at which they have ordered them in the past. Due to the expensive nature and highly specialized market for our products and services, if any of these customers stops purchasing our products and services and we are unable to identify new customers in a timely manner, our business will be adversely affected.

**Our significant debt could adversely affect our financial resources and prevent us from satisfying our debt service obligations.**

We have a significant amount of indebtedness and may also incur additional indebtedness in the future. We may not generate sufficient cash flow from operations, or have future borrowings available to us, sufficient to pay our debt. At May 6, 2005, our total indebtedness was approximately \$14.1 million and our total stockholders' equity was approximately \$24.4 million.

Our ability to make debt payments depends on future performance, which, to a certain extent, is subject to general economic, financial, competitive and other factors, some of which are beyond our control. Based upon our current level of operations and anticipated growth, we believe that cash on hand and available cash flow will be adequate to meet our financial needs. There can be no assurance, however, that our business will generate sufficient cash flow from operations to enable us to pay our debts or to make necessary capital expenditures, or that any refinancing of debt would be available on commercially reasonable terms or at all.

Our substantial indebtedness could have important consequences including:

- our ability to obtain additional financing for working capital, capital expenditures, acquisitions or other purposes may be impaired or unavailable;
- a portion of cash flow will be used to pay interest expense, which will reduce the funds that would otherwise be available for operations and future business opportunities;
- a substantial decrease in net operating cash flows or an increase in expenses could make it difficult for us to meet our debt service requirements and force us to reduce or modify our operations;
- our significant debt may make us more leveraged than our competitors, which may place us at a competitive disadvantage;
- our significant debt may make us more vulnerable to a downturn in our business or in the economy generally;
- some of our existing debt contains financial and restrictive covenants that limit our ability to borrow additional funds, acquire and dispose of assets, and pay cash dividends; and



- our subordinated debt bears a relatively high interest rate, reflecting the unsecured nature and correspondingly higher risk associated with this type of financing. This results in higher interest expense and use of cash.

A portion of our outstanding indebtedness bears interest at variable rates. Any increase in interest rates will reduce funds available to us for our operations and future business opportunities and will adversely affect our leveraged capital structure.

See the Liquidity and Capital Resources section of the Annual Report to Stockholders attached as Exhibit 13 to this Annual Report on Form 10-K.

**We do not currently have a bank facility which can be used to borrow funds for operating purposes. Additionally, covenants and restrictions in our credit facility, and any additional changes in the facility amount or structure, could limit our ability to take certain actions and fund our operations.**

During fiscal 2005 our bank took certain actions which effectively eliminated our ability to borrow cash under our existing agreement to support operations. Thus, we may need to obtain additional sources of capital in order to continue growing and operating our business. This capital may be difficult to obtain and the cost of this additional capital is likely to be relatively high.

Our credit facility contains significant financial and operating covenants that limit the discretion of our management with respect to certain business matters. These covenants include, among others, restrictions on our ability to:

- declare or pay dividends or any other distributions to our securities holders;
- redeem or repurchase capital stock;
- incur certain additional debt;
- place liens on our assets;
- make certain payments and investments;
- sell or otherwise dispose of assets; and
- acquire or be acquired by other entities.

We must also meet certain financial ratios and tests under our credit facility. If we do not comply with the obligations set forth in the credit facility, it could result in an event of default, and possibly the acceleration of the related debt and the acceleration of debt under other instruments evidencing debt that may contain cross-acceleration or cross-default provisions. Negative operating results would impact our future compliance with these covenants and could adversely affect our business.

See the Liquidity and Capital Resources section of the Annual Report to Stockholders attached as Exhibit 13 to this Annual Report on Form 10-K.

**Our operations involve rapidly evolving products and technological change.**

The rapid change of technology is a key feature of all of the industries in which our businesses operate. To succeed in the future, we will need to continue to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. Historically, our technology has been developed through both customer-funded and internally funded research and development, and we expect this practice will continue to be required in the future. We cannot guarantee that we will continue to maintain comparable levels of research and development nor that this development will be customer-funded in the same ratio going forward. Reinvestment of operating funds and profits in an amount greater than currently earned may be required. Even so, we cannot assure you that we will successfully identify new opportunities and continue to have the financial resources required to develop new products profitably. At the same time, products and technologies developed by others may render our products and systems obsolete or non-competitive.

**Delays in the delivery of our products may prevent us from invoicing our costs and estimated earnings on uncompleted contracts.**

In accordance with generally accepted accounting principles for long-term contracts, we record an asset for our costs and estimated earnings that exceed the amount we are able to bill our customers on uncompleted contracts. At February 25, 2005, \$1.8 million of our costs and estimated earnings that exceeded our billings on uncompleted contracts related to two contracts with two different customers. We are not able to bill these amounts unless we meet



certain contractual milestones related to the production,

delivery and integration of our products. Normally there will be a lag normally ranging from 24 to 36 months between performance and associated costs for these types of projects and billing and collection of payments. Our failure to meet these milestones by delivering and integrating our products in a timely manner may impact our ability to recover our costs and estimated earnings that exceeded our billings on uncompleted contracts, which could severely impact our cash flow.

**In the event we suffer production delays, we may be required to pay certain customers substantial liquidated damages and other penalties.**

The variety and complexity of our high technology product lines require us to deal with suppliers and subcontractors supplying highly specialized parts, operating highly sophisticated equipment and performing highly technical calculations. The processes of planning and managing production, inventory levels and delivery schedules are also highly complex and specialized. Many of our products must be custom designed and manufactured, which is not only complicated and expensive, but can also require long periods of time to accomplish. Slight errors in design, planning and managing production, inventory levels, delivery schedules, or manufacturing can result in unsatisfactory products that may not be correctable. If we are unable to meet our delivery schedules, we may be subject to penalties, including liquidated damages that are included in some of our customer contracts. While our actual losses have been minimal, we may incur substantial liquidated damages in the future in connection with product delays.

**If the commercial simulation business conducted by our Aircrew Training Systems Segment declines, our sales will decrease.**

We have no assurance that our commercial simulation business will continue to succeed. Although our commercial simulation business was minimal in fiscal 2005, this segment historically contributes to our gross revenues in each fiscal year. This business is subject to many risks including:

- the uncertainty of economic conditions;
- increased competition;
- changes in technology; and
- the need for timely performance by subcontractors located throughout the world on contracts for which we are the prime contractor.

If we do not adequately address these risks, then our commercial simulation business may decline which will adversely affect our business.

**Our fixed-price and cost-reimbursable contracts may commit us to unfavorable terms.**

We provide our products and services primarily through fixed-price or cost-reimbursable contracts. Fixed-price contracts provided approximately 94% of our sales for the fiscal year ended February 25, 2005. Under a fixed-price contract, we agree to perform the scope of work required by the contract for a predetermined contract price. Although a fixed-price contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract. Therefore, unless there are customer-requested changes in scope or other changes in specifications which are reimbursable, we fully absorb cost overruns on fixed-price contracts and this reduces our profit margin on the contract. These cost overruns may result in us recognizing a loss on the contract. A further risk associated with fixed-price contracts is the difficulty of estimating sales and costs that are related to performance in accordance with contract specifications. Our failure to anticipate technical problems, estimate costs accurately or control costs during performance of a fixed-price contract may reduce our profitability or cause a loss.

We did not have any sales for cost-reimbursable contracts for the fiscal year ended February 25, 2005. On a cost-reimbursable contract, we are paid up to predetermined funding levels determined by our customers on allowable incurred costs and generally a fee representing a profit on those costs, which can be fixed or variable depending on the contract's pricing arrangement. Therefore, on a cost-reimbursable contract we do not bear the risks of unexpected cost overruns. U.S. Government regulations require that we notify our customer of any cost overruns or under runs on a cost-reimbursable contract on a timely basis. Should we be awarded any cost-reimbursable contracts in the future and incur costs in excess of the funding limitation specified in the cost-reimbursable contracts, we may not be able to recover those cost overruns.

**Cost estimates used to account for contracts under the percentage of completion method may vary over time and impact future performance under these contracts.**

We record sales and profits on a significant portion of our contracts using the percentage-of-completion method of accounting. This means that we calculate a ratio of costs incurred to costs expected to be incurred for each fixed-price job and then



multiply that same ratio by the fixed-price contract value to determine total revenue to be recognized to date for each fixed-price job. As a result, contract price and cost estimates on fixed-price contracts are reviewed periodically as the work progresses, and adjustments are reflected in income in the period when the estimates are revised. To the extent that these adjustments result in a loss, reduction or elimination of previously reported profits, we would recognize a charge against current earnings, which could be material and have a negative effect on our business, financial condition or results of operations. Although we believe that adequate provisions for losses for our fixed-prices contracts are recorded in our financial statements as required under accounting principles generally accepted in the United States of America, we cannot assure you that our contract loss provisions, which are based on estimates, will be adequate to cover all actual future losses.

**Our contracts and subcontracts that are funded by the U.S. government or foreign governments are subject to government regulations and audits and other requirements.**

Government contracts require compliance with various contract provisions and procurement regulations. The adoption of new or modified procurement regulations could have a material adverse effect on our business, financial condition or results of operations or increase the costs of competing for or performing government contracts. If we violate any of these regulations, then we may be subject to termination of these contracts, imposition of fines or exclusion from government contracting and government-approved subcontracting for some specific time period. In addition, our contract costs and revenues are subject to adjustment as a result of audits by government auditors. We reflect any adjustments required by government auditors in our financial statements. Although we have thus far not been required to make any material audit adjustments, adjustments may be required in the future. In connection with our government contracts, we have been required to obtain bonds, letters of credit or similar credit enhancements. We cannot assure you that we will be successful in obtaining these types of credit enhancements or that the credit enhancements available will be affordable in the future.

**Our contracts that are funded by the U.S. government or foreign governments are subject to a competitive bidding process that may affect our ability to win contract awards or renewals in the future.**

Government contracts generally are awarded to us through a formal competitive bidding process in which we may have many competitors. Upon expiration, government contracts may be subject, once again, to the competitive bidding process. We cannot assure you that we will be successful in winning contract awards or renewals in the future. Our failure to renew or replace government contracts when they expire could have a material adverse effect on our business, financial condition or results of operations. Our contracts with domestic or foreign government agencies are subject to competition and are awarded on the basis of technical merit, personnel qualifications, experience and price. Our business, financial condition and results of operations could be materially adversely affected to the extent that government agencies believe our competitors offer a more attractive combination of the foregoing factors. In addition, new government contract awards also are subject to protest by competitors at the time of award that can result in the re-opening of the competition or evaluation process, the award of a contract to a competitor, or the re-opening of the competitive bidding process. We consider bid protests to be a customary element in the process of procuring government contracts. Other characteristics of the government contract market that may affect our operating results include the complexity of designs, the difficulty of forecasting costs and schedules when bidding on developmental and highly sophisticated technical work, and the speed with which product lines become obsolete due to technological advances and other factors characteristic of the market. Our earnings may vary materially on some contracts depending upon the types of government long-term contracts undertaken, the costs incurred in their performance, and the achievement of other performance objectives.

**Our commercial contracts are subject to competition and strict performance and other requirements.**

Although significant portions of our revenues are generated from the sale of our services and products in commercial markets, we cannot assure you that we will continue to compete successfully in these markets. Many of our commercial contracts contain fixed pricing. This subjects us to substantial risks relating to unexpected cost increases and other factors outside of our control. We may fail to anticipate technical problems, estimate costs accurately, or control costs during performance of a fixed-price contract. Any of these failures may reduce our profit or cause a loss under our commercial contracts. In addition, a significant portion of our revenues (49% in fiscal 2005) on fixed-price contracts is recognized on a percentage-of-completion basis. This means that we calculate a ratio of costs incurred to costs expected to be incurred for each fixed-price job and then multiply that same ratio by the fixed-price contract value to determine total revenue to be recognized to date for each fixed-price job. As a result, contract price and cost estimates on fixed-price contracts are reviewed periodically as the work progresses, and adjustments are reflected in income in the period when the estimates are revised. To the extent that these adjustments result in a loss, reduction or elimination of previously reported profits, we would recognize a charge against current earnings, which could be material and have a negative effect on our business, financial condition or results of operations.

In connection with certain commercial contracts, we have been required to obtain bonds, letters of credit, or similar credit enhancements. We cannot assure you that we will be successful in obtaining these types of credit enhancements or that the credit enhancements available will be affordable in the future.

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Under the terms of our commercial contracts, we typically must agree to meet strict performance obligations and project milestones, which we may not be able to satisfy. If we fail to meet these performance obligations and milestones, the other party may terminate the contract and, under certain circumstances, recover liquidated damages or other penalties from us which could have a negative effect on our business, financial condition or results of operations.

**There are certain risks inherent in our international business activities, which constitute a significant portion of our business.**

Our international business activities expose us to a variety of risks. Our international business accounted for approximately 47% of our sales in fiscal 2005 and 59% of our sales in fiscal 2004. We expect that international sales will continue to be a significant portion of our overall business in the foreseeable future. Our international business experiences many of the same risks our domestic business encounters as well as additional risks such as:

- the effects of terrorism;
- exchange rate fluctuations;
- a general decline in the strength of the global economy;
- the effect of foreign military or political conflicts and turmoil;
- U.S. foreign policy decisions;
- the extent, if any, of anti-American sentiment;
- changes in foreign governmental trade, monetary and fiscal policies and laws;
- export controls; and
- political and economic instability.

The majority of our contracts are denominated in U.S. Dollars. Although we may be exposed to currency fluctuations, we are not engaged in any material hedging activities to offset this risk. With respect to currency risk, where we have a contract which is denominated in a foreign currency, we often establish local in-country bank accounts and fund in-country expenses in the local currency, thus creating a “natural” currency hedge for a portion of the contract.

Our international transactions frequently involve increased financial and legal risks arising from stringent contractual terms and conditions and widely differing legal systems, customs and standards in foreign countries. In addition, our international sales often include sales to various foreign government armed forces, with many of the same inherent risks associated with U.S. government sales discussed in this Annual Report on Form 10-K.

**Legislative actions, higher director and officer insurance costs and potential new accounting pronouncements are likely to cause our general and administrative expenses to increase and impact our future financial condition and results of operations.**

In order to comply with the Sarbanes-Oxley Act of 2002, as well as changes to the American Stock Exchange listing standards and rules adopted by the Securities and Exchange Commission, we have been required to strengthen our internal controls, hire additional personnel and retain additional outside legal, accounting and advisory services, all of which have caused and will continue to cause our general and administrative costs to increase. Although we have not experienced any claims, insurers have increased and are likely to continue to increase premiums as a result of the high claims rates they have incurred with other companies over the past year, and so our premiums for our directors’ and officers’ insurance policies are likely to increase. Changes in the accounting rules and auditing standards, including legislative and other proposals to account for employee stock options as a compensation expense among others, could materially increase the expenses that we incur and report under generally accepted accounting principles and adversely affect our operating results.

**Our sales backlog is not necessarily indicative of revenues that we will actually realize in fiscal year 2005 or at all.**

We may not actually generate revenues in fiscal 2006 for all items included in our estimated backlog at the end of our 2005 fiscal year. At February 25, 2005, our sales backlog was \$21.3 million. While we estimate that approximately 75% of this backlog is expected to be completed prior to the end of our 2006 fiscal year, we are not certain that these projects will be completed so that we can record these revenues by such date, or at all. During fiscal 2005 we shipped approximately 79% of our February 27, 2004 backlog. Our backlog includes the total value of all contracts less the revenue earned on those contracts through the measurement date. Many of our government contracts are multi-year contracts and contracts with option years, and portions of these contracts are carried forward from one

year to the next as part of our backlog. Certain of our large contracts provide that we will not receive payment until the services under those contracts are requested and performed. We cannot assure that cancellations or adjustments in the terms of these contracts might not occur.

**Our operations could be hurt by terrorist attacks, war, disease and other activities or occurrences that make air travel difficult or reduce the willingness of our commercial airline customers to purchase our simulation products.**

The demand for our various commercial simulation products and services is heavily dependent upon new orders from our commercial airline customers. In the event terrorist attacks, war or other activities or occurrences make air travel difficult or reduce the demand or willingness of our customers to purchase our commercial simulation products, our revenue may decline.

Geo-political and other factors may also limit or restrict our employees' ability to gain entrance to foreign locations to sell products or perform contract services.

**There is limited trading activity in our common stock which could make it more difficult for our investors to sell their shares of our common stock.**

Our common stock is listed on the American Stock Exchange. Our average daily trading volume during fiscal 2005 was less than 3,900 shares. This limited trading activity may make it more difficult for investors to sell larger blocks of our common stock at prevailing prices as there are generally a small number of participants in the market for our common stock and such sales may lower the market price of our common stock.

**The market price of our common stock may be volatile.**

The market price of securities of thinly traded public companies has historically faced significant volatility. Although our common stock is traded on the American Stock Exchange, it does not experience a significant average daily trading volume. Accordingly, if one stockholder elects to either purchase or sell a block of our common stock, it may have an effect on the price of our common stock. In addition, the stock market in recent years has experienced significant price and volume fluctuations that often have been unrelated or disproportionate to the operating performance of particular companies. Many factors that have influenced trading prices will vary from period to period, including:

- actual or anticipated operating results;
- changes in estimates by analysts;
- market conditions in the industry;
- announcements by competitors;
- results of litigation;
- regulatory actions; and
- general economic conditions.

Any of these events would likely affect the market price of our common stock.

**Our quarterly operating results may vary significantly from quarter to quarter.**

Our revenues and earnings may fluctuate from quarter to quarter based on factors that include the following:

- the number, size and scope of our projects;
- equipment purchases and other expenditures required for our business;
- the number of bid and proposal efforts undertaken;
- delays in sales or production;
- the level of employee productivity;
- the adequacy of our provisions for losses;
- the accuracy of our estimate of resources required to complete ongoing projects; and
- general economic conditions.

Demand for our products and services in each of the markets we serve can vary significantly from quarter to quarter



due to revisions in customer budgets or schedules and other factors beyond our control. Due to all of the foregoing factors, our results of operations

may fall below the expectations of securities analysts and investors in a particular period. In this event, the price of our common stock may decline.

**Our officers and directors own a significant amount of our common stock which permits them to exert significant influence over the direction of our business and affairs.**

As of May 6, 2005, our directors and executive officers own an aggregate of approximately 49.3% of our outstanding common stock. Accordingly, these persons, if they act together, will be able to exert control over the direction of our business and affairs.

**Item 2. Properties**

We own our executive offices and principal production facilities located on a five acre site in the County Line Industrial Park, Southampton, Pennsylvania in an approximately 100,000 square foot steel and masonry building. Approximately 85,000 square feet of the building is devoted to manufacturing and 15,000 square feet of this building is devoted to office space. The original building was erected in 1969 and additions were most recently made in 2001. We have pledged this property as collateral to secure the performance of our obligations under our revolving credit facility with PNC Bank, National Association and our subordinated debt financing with H.F. Lenfest. Additionally, we rent office space at various sales and support locations throughout the world and at ETC-PZL Aerospace Industries, our Polish subsidiary.

We consider our machinery and plant to be in satisfactory operating condition. Increases in the level of operations beyond what we expect in the current fiscal year might require us to obtain additional facilities and equipment.

**Item 3. Legal Proceedings**

In April 2003, Boenning & Scattergood, Inc. (“B&S”) filed suit against us in the Court of Common Pleas in Philadelphia, Pennsylvania, seeking payment of \$902,000 for financing fees allegedly due to B&S pursuant to the terms of an agreement for investment banking services which was entered into with a predecessor of B&S (the “B&S Agreement”). B&S alleged that it contacted the investors in our February 2003 financing transaction and that it earned the claimed financing fees pursuant to the terms of the B&S Agreement. We have responded to the complaint and have also filed a counterclaim for breach of contract and professional malpractice. We believe that we have valid defenses to each of the claims of B&S and intend to vigorously defend ourselves against these claims. We have had some settlement discussions but, as of the date of the filing of this Report on Form 10-K, no agreement had been reached. At this time, we are unable to predict the outcome of this matter.

In June 2003, Associated Mezzanine Investors, LLC (“AMI”) filed suit against us in the United States District Court for the Eastern District of Pennsylvania seeking payment of \$196,000 for costs, fees and expenses allegedly due to AMI pursuant to the terms of an agreement which we entered into with AMI (the “AMI Agreement”). AMI claimed that it located suitable investors for our February 2003 financing transaction and that it earned the claimed fees and is entitled to reimbursement of the claimed costs and expenses pursuant to the terms of the AMI Agreement. In March 2004, this suit was settled without any material impact on our results of operations.

In June 2003, Entertainment Technology Corporation (“EnTCo”), our wholly-owned subsidiary, filed suit against Walt Disney World Co. and other entities (“Disney”) in the United States District Court for the Eastern District of Pennsylvania, alleging breach of contract for, among other things, failure to pay all amounts due under contract for the design and production of the amusement park ride “Mission: Space” located in Disney’s Epcot Center. In response, in August 2003, Disney filed counterclaims against both EnTCo and us (under a guarantee) for, among other things, alleged failures in performance and design in the contract. Disney is seeking damages in excess of \$65 million plus punitive damages. Both EnTCo and we believe that we have valid defenses to each of Disney’s counterclaims and intend to vigorously defend ourselves against these counterclaims. At this time, discovery is completed, summary judgment motions have been filed, and the case is scheduled to be placed in the trial pool on June 27, 2005. Neither EnTCo nor we are able to predict the outcome of this matter.

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against us. In our opinion, 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 have a significant effect on our financial position or results of operations if disposed of unfavorably.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

No matters were presented to our stockholders during the fourth quarter of fiscal 2005.

### **PART II**

#### **Item 5. Market for the Registrant's Common Stock and Related Security Holder Matters**

On February 14, 2005 H.F. Lenfest, a Director of ETC, purchased 373,831 shares of unregistered common stock for an aggregate price of \$1,999,995.85, or \$5.35 per share, the closing price of ETC's common stock on February 11, 2005, the trading day immediately prior to the purchase of the shares. None of these shares have been registered with the Securities and Exchange Commission or any state securities commission. These shares cannot be sold or transferred without complying with such federal and state securities laws. Under the American Stock Exchange listing rules, shareholder approval will be required for this transaction and this item will be included as a proxy item at our annual meeting in 2005. However, given the amount and nature of stock holdings by related parties, shareholder approval is expected to be received. The proceeds are being used for general corporate purposes.

Additionally, see information appearing under the heading "Market for the Registrant's Common Stock and Related Stockholder Matters" in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

#### **Item 6. Selected Consolidated Financial Data**

See information appearing under the heading "Financial Review" in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

#### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

See information appearing under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to various market risks, including changes in interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates. We do not enter into derivatives or other financial instruments for trading or speculative purposes. We also have not entered into financial instruments to manage and reduce the impact of changes in interest rates and foreign currency exchange rates although we may enter into such transactions in the future. A portion of our indebtedness bears interest at rates that vary with the prime rate of interest. Accordingly, any increases in the applicable prime rate of interest will reduce our earnings. With respect to currency risk, where we have a contract which is denominated in a foreign currency, we often establish local in-country bank accounts and fund in-country expenses in the local currency, thus creating a "natural" currency hedge for a portion of the contract. .

#### **Item 8. Financial Statements and Supplementary Data**

See the information appearing under the headings "Consolidated Financial Statements" and "Notes to Consolidated Financial Statements" in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

#### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

#### **Item 9A. Controls and Procedures**

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of February 25, 2005 (the "Evaluation Date"), and, based on this evaluation, our chief executive officer and chief financial officer have concluded that these controls and procedures were effective as of the Evaluation Date. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date.

Disclosure controls and procedures (as defined in Rules 13a-14(c) and 15(d)-14(c) under the Securities Exchange Act of 1934, as amended) are our internal controls and other procedures that are designed to ensure that information we are required to



disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

### PART III

#### Item 10. Directors and Executive Officers of the Registrant

The following table sets forth certain information, as of May 6, 2005, with respect to our directors and executive officers:

Name	Age	Served as Director or Officer Since (1)	Positions and Offices
William F. Mitchell (2)	63	1969	Chairman of the Board, President and Director
Pete L. Stephens, M.D. (3)	67	1974	Director
Howard W. Kelley (4)	63	2002	Director
George K. Anderson, M.D. (5)	59	2003	Director
H.F. Lenfest (6)	75	2003	Director
Duane D. Deaner (7)	57	1996	Chief Financial Officer

- (1) Directors are elected for one-year terms.
- (2) Mr. Mitchell has been our Chairman of the Board, President and Chief Executive Officer since 1969, except for the period from January 24, 1986 through January 24, 1987, when he was engaged principally in soliciting sales for our products in the overseas markets. Mr. Mitchell received a Bachelor of Science degree in physics from Drexel University and has completed graduate work in mechanical and electrical engineering. He is a member of the ASME and Drexel University engineering advisory boards. Additionally, he is a member of the Society of Automotive/Aerospace Engineering, the International Society of Pharmaceutical Engineering, the Undersea and Hyperbaric Medical Society, the Aerospace Medical Association, the American Society of Mechanical Engineering and the Institute of Environmental Sciences.
- (3) Recently retired from the practice of medicine, Dr. Stephens had been a physician engaged in private practice for 30 years. Dr. Stephens graduated from Bethany College and the Medical College of Virginia. He presently serves as Chairman of the Board of Directors of Lowcountry Block and Paver, a manufacturing company located in South Carolina.
- (4) Mr. Kelley is President of Sally Corporation, Jacksonville, Florida, which is one of the oldest and largest designers and fabricators of animation robotics and dark ride attractions used worldwide in theme parks, museums and entertainment attractions. He previously spent over 25 years in the broadcasting industry, including ten years in television management as a news director and later as Vice President and General Manager of Channel 12 WTLV (NBC) in Jacksonville, Florida. He is the former Chairman of the Board of Tempus Software, a medical software development firm located in Jacksonville, Florida. He has also previously served as broadcast strategic planner for a major U.S. communications company and as director of several U.S. technology firms with international business activities. In the academic arena, Mr. Kelley serves as an executive professor at the University of North Florida College of Business Administration, and is a college adjunct instructor on Internet technology and E-commerce on the Internet. He is a graduate of the University of Florida and Harvard Business School PMD.
- (5) Dr. Anderson is an experienced physician executive and preventive medicine leader. He began his professional career as an Air Force flight surgeon, serving overseas medical duty in Korea and Germany as well as aerospace medicine leadership positions in the United States. Following 30 years of military service, he transitioned to physician executive positions in the private sector. Subsequent to his retirement from the military, he served as Chief Executive Officer of the Koop Foundation from 1997 to 1998 and as President and Chief Executive Officer at Oceania, Inc., a medical software company, from 1999 to 2001. Dr. Anderson's positions in the Air Force include serving as Deputy Assistant Director of Defense (Health Services Operations and Readiness), Commander of the Human Systems Center, Air Force Material command, which included the Armstrong Laboratory, the School of Aerospace Medicine and the Human Systems Program Office. He retired from active duty in the grade of Major General.
- (6) Mr. Lenfest practiced law with Davis Polk & Wardwell before joining Triangle Publications, Inc., in Philadelphia as Associate Counsel in 1965. In 1970, Mr. Lenfest was placed in charge of Triangle's Communications Division, serving as Editorial Director and Publisher of Seventeen Magazine and President of the CATV Operations. In 1974, Mr. Lenfest, with the support of two investors, formed Lenfest Communications, Inc., which purchased Suburban Cable TV Company and

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Lebanon Valley Cable TV Company from Triangle with a total of 7,600 subscribers. In January 2000, Mr. Lenfest sold his cable television operations, which by then served 1.2 million subscribers, to Comcast Corporation but still retains interests in companies principally involved in national satellite promotion of cable programming and software for marketing cable advertising and marketing promotions. Additionally, Mr. Lenfest is the owner of various other businesses in Pennsylvania and Maryland and is active in many philanthropic activities including as Chairman of the Board of the Philadelphia Museum of Art and the Lenfest Foundation. Mr. Lenfest is a graduate of Washington and Lee University and Columbia Law School.

(7) Mr. Deaner has served as our Chief Financial Officer since January 1996. Mr. Deaner served as Vice President of Finance for Pennfield Precision Incorporated from September 1988 to December 1995. Mr. Deaner received an MBA in Finance from Temple University and a B.A. in Mathematics from Millersville University in Pennsylvania.

#### **Committees of the Board of Directors**

During the fiscal year ended February 25, 2005, the Board of Directors held three meetings. All members of the Board of Directors attended all of the meetings of the Board of Directors held while they were members of the Board of Directors except for Mr. Lenfest, who did not attend two meetings.

During the fiscal year ended February 25, 2005, we had an Audit Committee consisting of Messrs. Kelley, Stephens and Anderson. Mr. Kelley serves as the Chairman and the “financial expert” (as defined by the American Stock Exchange) and has been designated as the Audit Committee Financial Expert as defined by the rules of the Securities and Exchange Commission. In addition, all members of the Audit Committee meet the financial literacy requirements of the American Stock Exchange and are independent under the rules of the American Stock Exchange. The Audit Committee held four meetings during the year ended February 25, 2005. Among other responsibilities, the Audit Committee meets (via face-to face or via telephone) with the external auditors to review and make recommendations to management concerning (if appropriate) the quarterly and annual financial results and the reports on Forms 10-Q and 10-K. The Audit Committee is directly responsible for the appointment, compensation, retention and oversight of our independent accountants in their preparation or issuance of an audit report or the performance of other audit and review services.

Messrs. Kelley, Stephens and Anderson also served on our Compensation Committee during the year ended February 25, 2005, with Dr. Stephens serving as Chairman. The Compensation Committee is charged with reviewing the compensation and incentive plans of officers and key personnel. This Committee met for its annual review in March 2005.

Messrs. Kelley, Stephens and Anderson also served on our Nominating and Governance Committee during the year ended February 25, 2005, with Dr. Anderson serving as Chairman. The Nominating and Governance Committee is charged with finding and recommending new Board members and with ensuring our compliance with all regulatory governance requirements. This Committee met for its annual review in March 2005.

Messrs. Kelley, Stephens and Anderson also served on our Committee to Recommend Directors Compensation. During fiscal 2005, our directors who did not serve as officers were paid a fee of \$2,000 (either in cash or equivalent value of common stock of the Company) per quarter for attending Board of Directors and committee meetings. At a meeting subsequent to fiscal year end, the Board of Directors approved a compensation plan for both new and existing members which would include options to purchase common stock of the company at yet-to-be determined levels.

#### **Code of Ethics**

We have adopted a Code of Ethics, which applies to our chief executive officer, chief financial officer, controller and other senior financial officers. We have also adopted a Company Code of Conduct that applies to our directors, officers and all employees. The Code of Ethics and the Company Code of Conduct were each approved and adopted by our Board of Directors in April 2004. The Code of Ethics and the Company Code of Conduct are posted on our website, which is located at [www.etcusa.com](http://www.etcusa.com). We will also disclose any amendments or waivers to the Code of Ethics or the Company Code of Conduct on our website.

In addition, we have adopted a Whistleblower Policy and an Insider Trading Policy, both of which are posted on our website.

#### **Compliance With Section 16(a) of the Exchange Act**

Section 16(a) of the Securities Exchange Act of 1934 requires our officers and directors, and persons who own more than ten percent of a registered class of our equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission (“SEC”) and the American Stock Exchange. Officers, directors and greater than ten percent shareholders are required by SEC regulations to furnish us with copies of all Section 16(a) reports they file. The rules of the SEC regarding the filing of Section 16(a) reports require that “late filings” of Section 16(a) reports be disclosed in our proxy statement





Based solely on our review of the copies of such forms which we received, or written representations from reporting persons that no Section 16(a) reports were required for those persons, we believe that, during the fiscal year ended February 25, 2005, our officers, directors and greater than ten percent beneficial owners complied with all applicable filing requirements.

## Item 11. Executive Compensation

### SUMMARY COMPENSATION TABLE

The following table sets forth the compensation we paid to our Chief Executive Officer for services rendered during fiscal years 2005, 2004 and 2003. There are no other executive officers whose total annual salary and bonus exceeds \$100,000. The footnotes to the table provide additional information concerning our compensation and benefit programs.

Annual Compensation					
Name and Principal Position	Fiscal Year	Salary (\$)	Bonus \$(1)	Other Annual Compensation (2)	All Other Compensation \$(3)
William F. Mitchell, President and Chief Executive Officer	2005	225,000	0	—	4,958
	2004	225,000	9,172	—	4,707
	2003	225,000	0	—	4,493

- (1) These amounts represent a portion of a deferred bonus from fiscal 1999 due 75% in 1999 and 5% in each of the five following fiscal years. No bonus awards for fiscal 2003, 2004 or 2005 were paid. No deferred bonus amounts from fiscal 1999 were paid in fiscal 2003 or 2005.
- (2) Our executive officers receive certain perquisites. For fiscal years 2003, 2004 and 2005, the perquisites received by Mr. Mitchell did not exceed the lesser of \$50,000 or 10% of his salary and bonus.
- (3) These amounts represent our contribution to ETC's Retirement Savings Plan.

## Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth, as of May 6, 2005, the number of shares and percentage of our common stock owned beneficially by each director, each executive officer named in the Summary Compensation Table, and each person holding, to our knowledge, more than 5% of our outstanding common stock. The table also sets forth the holdings of all directors and executive officers as a group.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Common Stock
William F. Mitchell (2) c/o Environmental Tectonics Corporation County Line Industrial Park Southampton, PA 18966	1,446,398	16.0%
Pete L. Stephens, M.D. (3) 31 Ribaut Drive Hilton Head Island, SC 29926	693,500(4)	7.7%
Howard W. Kelley (3) c/o Sally Corporation 745 West Forsyth Street Jacksonville, FL 32204	2,701	*
T. Todd Martin, III 50 Midtown Park East Mobile, AL 36606	1,405,420(5)	15.6%

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Common Stock
H.F. Lenfest (3) c/o The Lenfest Group 1332 Enterprise Drive West Chester, PA 19380	3,195,060(6)	29.5%
Emerald Advisors, Inc. 1703 Oregon Pike Suite 101 Lancaster, PA 17601	1,012,348(7)	11.2%
George K. Anderson, M.D. (3) 8 Little Harbor Way Annapolis, MD 21403	1,000	*
All directors and executive officers as a group (6 persons)	5,351,540(8)	49.3%

\* less than 1%

- (1) Beneficial ownership has been determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934. Unless otherwise noted, we believe that all persons named in the table have sole voting and investment power with respect to all shares of our common stock beneficially owned by them.
- (2) Chairman of the Board, President and Director of the Corporation. Includes 133,200 shares of common stock held by Mr. Mitchell's wife.
- (3) Director of the Company.
- (4) Includes 292,330 shares of common stock held by or for the benefit of Dr. Stephens' wife and two of his children.
- (5) Includes 1,076,720 shares of common stock owned by Advanced Technology Asset Management, LLC (formerly ETC Asset Management, LLC) ("ATAM"), a limited liability company of which T. Todd Martin, III is manager. Also includes 263,500 shares of common stock owned by Mr. Martin, 26,900 shares owned by Allied Williams Co, Inc., a corporation of which Mr. Martin is an officer and director, 17,000 shares owned by Equity Management, LLC, a limited liability company of which Mr. Martin is manager, 14,300 shares owned by Mr. Martin jointly with his spouse, and 7,000 shares owned by trusts of which Mr. Martin is trustee.
- (6) These shares consist of 1,818,181 shares of common stock issuable upon conversion of a promissory note in the principal amount of \$10,000,000.
- (7) Emerald Advisors, Inc. has sole voting power with respect to 511,748 shares of common stock and sole dispositive power over 1,012,348 shares of common stock.
- (8) Includes 12,881 shares of common stock which may be acquired by Duane Deaner, our chief financial officer, upon the exercise of options granted under our Incentive Stock Option Plan that are presently exercisable and 1,818,181 shares of common stock which may be acquired by Mr. Lenfest upon conversion of a promissory note in the principal amount of \$10,000,000 that is presently convertible.

For information regarding our equity compensation plans, please see the Equity Compensation Plan Information section of the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

### Item 13. Certain Relationships and Related Transactions

On February 19, 2003, we completed a refinancing of our indebtedness with the PNC Bank, National Association and H.F. Lenfest in the aggregate amount of \$29,800,000. Pursuant to the terms of a Convertible Note and Warrant Purchase Agreement, dated February 18, 2003, between us and Mr. Lenfest, we issued to Mr. Lenfest (i) a 10% senior subordinated convertible promissory note in the original principal amount of \$10,000,000 and (ii) warrants to purchase 803,048 shares of our common stock. As a condition to closing the financing, we appointed Mr. Lenfest to our Board of Directors. On October 25, 2004, Mr. Lenfest executed a limited Guaranty Agreement which guaranteed the Company's \$5 million Letter of Credit facility with PNC, and in connection therewith, we issued a Stock Purchase Warrant to Mr. Lenfest pursuant to which Mr. Lenfest was entitled to purchase up to 200,000 shares of our



common stock at an exercise price equal to the lesser of \$4.00 per share or 2/3 of the average daily high and low closing price of our common stock during the 25 day trading period immediately preceding the date of exercise. On February 14, 2005 Mr. Lenfest exercised all of his outstanding warrants and received 1,003,048 shares of unregistered common stock. Additionally, also on February 14, 2005, Mr. Lenfest purchased 373,831 shares of unregistered common stock for approximately \$2 million. Under the American Stock Exchange listing rules, shareholder approval will be required for this transaction and this item will be included as a proxy item at our annual meeting in 2005. However, given the amount and nature of stock holdings by related parties, shareholder approval is expected to be received. For a more detailed description of the financing provided by Mr. Lenfest and PNC, see the Liquidity and Capital Resources section of the Annual Report to Stockholders attached as Exhibit 13 to this Annual Report on Form 10-K and incorporated herein by reference.

Prior to the consummation of the refinancing, ATAM, a shareholder and a holder of warrants to purchase 332,820 shares of our common stock, consented to the financing transactions with PNC and Mr. Lenfest including the below market issuance of warrants to Mr. Lenfest. As a result of its consent, ATAM waived, solely in connection with such issuance, the anti-dilution rights contained in its warrant. In exchange for ATAM's consent and waiver, we issued to ATAM warrants to purchase an additional 105,000 shares of common stock. Except for the number of shares issuable upon exercise of the warrants, the new ATAM warrants had substantially the same terms as the warrants issued to Mr. Lenfest. As of the date that these warrants were issued to ATAM, it was the beneficial owner of greater than 5% of our common stock as determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934. In fiscal year 2005 ATAM exercised all its warrants and received a total of 437,820 shares of our common stock. For a more detailed description of the financing provided by Mr. Lenfest and PNC, see the Liquidity and Capital Resources section of the Annual Report to Stockholders attached as Exhibit 13 to this Annual Report on Form 10-K and incorporated herein by reference.

#### Item 14. Information Regarding the Company's Independent Registered Public Accounting Firm

Under the Company's Bylaws and the charter of the Audit Committee of the Board of Directors, authority to select the Company's auditors rests with the Audit Committee of the Board of Directors. Such selection is made through formal act of the Audit Committee. It has not been and is not the Company's policy to submit selection of its auditors to the vote of the shareholders because there is no legal requirement to do so. Grant Thornton LLP, an independent registered public accounting firm, was the Company's auditor for the fiscal year ended February 25, 2005. Auditors have not been selected for the current fiscal year. A representative of Grant Thornton is expected to be present at the Annual Meeting and will be given an opportunity to make a statement to the shareholders, if he or she desires to do so. Grant Thornton's representative will also be available to answer appropriate questions from shareholders.

Set forth below is information relating to the aggregate Grant Thornton LLP fees for professional services provided to the Company for the fiscal year ended February 25, 2005:

##### Audit Fees

The following table presents fees for professional audit services rendered by Grant Thornton LLP for the audit of the Company's annual financial statements for the fiscal years ended February 25, 2005 and February 27, 2004, respectively, and fees billed for other services rendered by Grant Thornton LLP.

	FY 2005	FY 2004
Audit Fees	\$ 96,500	\$ 89,530
Audit related fees (1)	\$ 29,000	\$ 15,143
	<u>          </u>	<u>          </u>
Audit and audit related fees	\$ 125,500	\$ 104,673
Tax fees (2)	\$ 52,757	\$ 37,646
	<u>          </u>	<u>          </u>
Total fees	\$ 178,257	\$ 142,319

(1) Audit related fees consist primarily of interim reviews of the Company's quarterly financial statements, employee benefit plan audits, and assistance with foreign statutory financial statements.

(2) Tax fees consist of tax compliance services and other consultations on miscellaneous tax matters.

## PART IV

### Item 16. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

(a) Exhibits:

<u>Number</u>	<u>Item</u>
3.1	Registrant's Articles of Incorporation, as amended, were filed as Exhibit 3.1. to Registrant's Form 10-K for the year ended February 28, 1997 and are incorporated herein by reference.
3.2	Registrant's By-Laws, as amended, were filed as Exhibit 3(ii) to Registrant's Form 10-K for the year ended February 25, 1994 and are incorporated herein by reference.
4.1	\$10,000,000 Senior Subordinated Convertible Note, dated February 18, 2003, issued by the Registrant in favor of H.F. Lenfest was filed on February 25, 2003 as Exhibit 4.1 to Form 8-K and is incorporated herein by reference.
4.2	Stock Purchase Warrant, dated February 18, 2003, issued by the Registrant in favor of H.F. Lenfest was filed on February 25, 2003 as Exhibit 4.2 to Form 8-K and is incorporated herein by reference.
4.3	Stock Purchase Warrant, dated February 18, 2003, issued by the Registrant in favor of ETC Asset Management, LLC was filed on February 25, 2003 as Exhibit 4.3 to Form 8-K and is incorporated herein by reference.
10.1	Registrant's 1998 Stock Option Plan was filed on October 8, 1998 on Form S-8 and is incorporated herein by reference. *
10.2	Registrant's Employee Stock Purchase Plan was filed on July 6, 1988 as Exhibit A to the Prospectus included in Registrant's Registration Statement (File No. 33-42219) on Form S-8 and is incorporated herein by reference. *
10.3	Registrant's Stock Award Plan adopted April 7, 1993, was filed as Exhibit 10(ix) to the Registrant's Form 10-K for the fiscal year ended February 25, 1994 and is incorporated herein by reference. *
10.4	Stock Purchase Warrant dated as of December 26, 2001, issued by the Registrant to the Registrant Asset Management, LLC was filed as Exhibit 10.7 to the Registrant's Form 10-K for the fiscal year ended February 22, 2002 and is incorporated herein by reference.
10.5	Credit Agreement, dated as of February 18, 2003 between the Registrant and PNC Bank, National Association was filed on February 25, 2003 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
10.6	Amendment to Credit Agreement, dated as of April 30, 2003, between the Registrant and PNC Bank was filed as Exhibit 10.6 to the Registrant's Form 10-K for the fiscal year ended February 28, 2003 and is incorporated herein by reference.
10.7	Amended and Restated Revolving Credit Note, dated April 30, 2003, issued by the Registrant in favor of PNC Bank was filed as Exhibit 10.6 to the Registrant's Form 10-K for the fiscal year ended February 28, 2003 and is incorporated herein by reference.
10.8	Security Agreement, made and entered into as of February 18, 2003, by and between the Registrant, Entertainment Technology Corporation, ETC Delaware, Inc. and PNC Bank was filed on February 25, 2003 as Exhibit 10.3 to Form 8-K and is incorporated herein by reference.
10.9	Pledge Agreement, dated as of February 18, 2003, made by the Registrant in favor of PNC Bank was filed on February 25, 2003 as Exhibit 10.4 to Form 8-K and is incorporated herein by reference.
10.10	Pledge Agreement (Bank Deposits), dated as of February 18, 2003, made by the Registrant in favor of PNC Bank was filed on February 25, 2003 as Exhibit 10.5 to Form 8-K and is incorporated herein by reference.
10.11	Guaranty, dated as of February 18, 2003, made by Entertainment Technology Corporation and ETC Delaware, Inc. in favor of PNC Bank was filed on February 25, 2003 as Exhibit 10.6 to Form 8-K and is incorporated herein by reference.

- 10.12 Open-End Mortgage and Security Agreement, made as of February 18, 2003, by the Registrant in favor of PNC Bank was filed on February 25, 2003 as Exhibit 10.7 to Form 8-K and is incorporated herein by reference.
- 10.13 Convertible Note and Warrant Purchase Agreement, dated February 18, 2003, by and between the Registrant and Lenfest was filed on February 25, 2003 as Exhibit 10.8 to Form 8-K and is incorporated herein by reference.

Number	Item
10.14	Registration Rights Agreement, dated as of February 18, 2003, by and between the Registrant and H.F. Lenfest was filed on February 25, 2003 as Exhibit 10.9 to Form 8-K and is incorporated herein by reference.
10.15	Security Agreement, made and entered into as of February 18, 2003, by and among the Registrant, Entertainment Technology Corporation, ETC Delaware, Inc. and H.F. Lenfest was filed on February 25, 2003 as Exhibit 10.10 to Form 8-K and is incorporated herein by reference.
10.16	Guaranty, dated as of February 18, 2003, made by Entertainment Technology Corporation and ETC Delaware, Inc. in favor of H.F. Lenfest was filed on February 25, 2003 as Exhibit 10.11 to Form 8-K and is incorporated herein by reference.
10.17	Open-End Mortgage and Security Agreement, made as of February 18, 2003, by the Registrant in favor of H.F. Lenfest was filed on February 25, 2003 as Exhibit 10.12 to Form 8-K and is incorporated herein by reference.
10.18	Subordination and Intercreditor Agreement, dated as of February 18, 2003, among PNC Bank, H.F. Lenfest and the Registrant was filed on February 25, 2003 as Exhibit 10.13 to Form 8-K and is incorporated herein by reference.
10.19	Amendment to Credit Agreement, dated as of August 24, 2004, between the Registrant and PNC Bank, National Association, was filed on September 10, 2004 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
10.20	Second Amended and Restated Revolving Credit Note, dated as of August 24, 2004, between the Registrant and PNC Bank, National Association, was filed on September 10, 2004 as Exhibit 10.2 to Form 8-K and is incorporated herein by reference.
10.21	Limited Guaranty Agreement, dated as of August 24, 2004, of H.F. Lenfest in favor of PNC Bank, National Association, was filed on September 10, 2004 as Exhibit 10.3 to Form 8-K and is incorporated herein by reference.
10.22	Stock Purchase Warrant, dated as of September 7, 2004, between the Registrant and H.F. Lenfest, was filed on September 10, 2004 as Exhibit 4.1 to Form 10-K and is incorporated herein by reference.
10.23	Amendment to Credit Agreement, dated as of October 18, 2004, between the Registrant and PNC Bank, National Association, was filed on January 10, 2005 as Exhibit 10.1 to Form 10-Q and is incorporated herein by reference.
10.24	Subscription Agreement, dated as of February 14, 2005, between the Registrant and H.F. Lenfest, was filed on February 16, 2005 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
13	Portions of Registrant's 2005 Annual Report to Shareholders which are incorporated by reference into this Form 10-K
21	Subsidiaries of the Registrant.
23	Consent of Grant Thornton LLP.
31.1	Certification dated May 26, 2005 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by William F. Mitchell, Chief Executive Officer.
31.2	Certification dated May 26, 2005 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by Duane D. Deaner, Chief Financial Officer.
32	Certification dated May 26, 2005 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by William F. Mitchell, Chief Executive Officer and Duane D. Deaner, Chief Financial Officer.

\* Represents a management contract or a compensatory plan or arrangement.

(b) Reports on Form 8-K:





## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### ENVIRONMENTAL TECTONICS CORPORATION

By /s/ William F. Mitchell

\_\_\_\_\_  
William F. Mitchell,  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Position</u>	<u>Date</u>
<u>/s/ William F. Mitchell</u> William F. Mitchell	Chairman of the Board, Chief Executive Officer, President and Director (Principal Executive Officer)	May 26, 2005
<u>/s/ Duane D. Deaner</u> Duane D. Deaner	Chief Financial Officer (Principal Financial and Accounting Officer)	May 26, 2005
<u>/s/ Pete L. Stephens</u> Pete L. Stephens	Director	May 26, 2005
<u>/s/ Howard W. Kelley</u> Howard W. Kelley	Director	May 26, 2005
<u>/s/ H.F. Lenfest</u> H.F. Lenfest	Director	May 26, 2005
<u>/s/ George K. Anderson</u> George K. Anderson, M.D.	Director	May 26, 2005

## EXHIBIT INDEX

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**PORTIONS OF  
ENVIRONMENTAL TECTONICS CORPORATION  
2005  
ANNUAL REPORT TO STOCKHOLDERS**

**FINANCIAL REVIEW**

(amounts in thousands, except share and per share information)

Fiscal Year End	2005	2004	2003	2002	2001
Net sales	\$ 27,814	\$ 25,995	\$ 43,123	\$ 32,527	\$ 32,452
Gross profit	6,176	9,943	14,198	11,465	13,075
Operating (loss)/income	(7,130)	131	4,116	2,873	4,122
Net (loss)/income					
(Loss)/earnings	(8,113)	(793)	2,493	1,741	2,021
per common share:					
Basic	(1.06)	(.11)	.35	.24	.29
Diluted	(1.06)	(.11)	.33	.23	.27
Working capital	29,818	29,907	31,216	30,683	25,070
Long-term obligations	12,087	12,157	12,643	16,688	12,778
Total assets	47,909	48,696	47,698	48,482	40,705
Total stockholders' equity	24,355	25,054	25,907	20,782	18,796
Weighted average common shares:					
Basic	7,656,000	7,163,000	7,153,000	7,143,000	7,087,000
Diluted	7,656,000	7,163,000	7,497,000	7,499,000	7,499,000

All earnings per share and share amounts have been restated to reflect a 2-for-1 stock split effective May 28, 1999. No cash dividends have ever been paid on the Company's common stock, and the Company is prohibited from declaring any cash dividends on its common stock under the terms of its existing credit facilities.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are based on the Company's current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about the Company 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 such 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 raw materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items and the effects of currency fluctuations, (ii) statements of our plans and objectives of the Company or its management or 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; and (vi) statements preceded by, followed by or that include the words, "may," "could," "should," "looking forward," "would," "believe," "expect," "anticipate," "estimate," "intend," "plan," or the negative of such terms or similar expressions. These forward-looking statements involve risks and uncertainties which 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. Factors that might cause or contribute to such a material difference include, but are not limited to, those discussed in the Company's Annual Report on Form 10-K, in the section entitled "Risks Particular to Our Business." Shareholders are urged to review these risks carefully prior to making an investment in the Company's common stock.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company

### Overview

We are principally engaged in the design, manufacture and sale of software driven products used to create and monitor the physiological effects of motion on humans and equipment and to control, modify, simulate and measure environmental conditions. These products include aircrew training systems, entertainment products, sterilizers, environmental and hyperbaric chambers and other products that involve similar manufacturing techniques and engineering technologies.

The following factors had an adverse impact on our performance for the fiscal year ended February 25, 2005:

- unfavorable global economic and political conditions;
- continued product development and marketing costs associated with our ATFS technology;
- continuing logistics and foreign field installation cost overruns in the environmental business;
- higher costs of capital and amortization of deferred finance charges; and
- litigation and claims costs.

Although sales were up from fiscal 2004, our sales efforts continued to be hampered by unfavorable global economic and political conditions. We saw many of our potential new contracts delayed by budget constraints and delays of our customers located throughout the world. This was especially true in our Aircrew Training Systems business, where most of the sales are to international customers.

In the environmental line, we continued to experience logistics and field installation delays and cost overruns on a few international projects. These projects involved large environmental control systems which could not be factory tested in our Southampton, PA manufacturing headquarters before shipment to customer locations, so issues (parts, software modifications, etc.) which normally arise during system start-up had to be addressed in the field. Most of these projects were completed during the year, so we expect gross margins for this group to improve going forward.

Fiscal 2005 saw the continuation of our education and marketing efforts to introduce our Authentic Tactical Flight Simulator ("ATFS") to the U.S. military. The evolution of these exciting and state-of-the-art technologies is an

important step in our goal of integrating flight and aeromedical training in a simulator device. This technology allows a fighter pilot to practice tactical air combat

maneuvers such as dodging enemy missiles, ground fire and aircraft obstacles while experiencing the real life environment of a high-G Force fighter aircraft. These flight trainers provide a low cost and extremely less risky alternative to actual air flight. We believe that armed forces agencies of various governments will appreciate the efficiency of these technologies, especially in this time of fiscal conservatism and budgetary constraints throughout the world.

One of the greatest challenges we face is adequately funding the cash requirements of large, long-term multi-year projects. Although these contracts normally incorporate milestone payments, the cash flows associated with production and material requirements tend to vary significantly over time. These projects are usually cash positive in the early stages and cash negative during the production phase. Funding these contracts requires a significant amount of operating funds and may hamper other types of business. In fiscal 2005 our bank took certain actions which effectively eliminated our ability to borrow cash under our existing agreement to support operations. These actions also resulted in us having to issue additional common stock warrants in consideration for a limited guarantee to secure the Company's letter of credit bank facility which increased amortization expense associated with the deferred finance charges on these warrants. Our liquidity and capitalization improved in fiscal 2005 when we received settlement payments on two international claims. However, we may need to obtain additional sources of capital in order to continue growing and operating our business. Because we have established businesses in many markets, significant fixed assets including a building, and other business assets which can be used for security, we believe that we will be able to locate such additional sources of capital and that the bank actions will not have a long-term material adverse effect on our business.

In addition, we face the following challenges and business goals in order to make fiscal 2006 a successful year:

#### Aircrew Training Systems

- Market all the aeromedical products we technologically enhanced in fiscal 2004 and 2005.

We have heavily invested in enhancing functionality and product capability of three ATS products: our centrifuge-based flight simulator, our General Aviation Trainer (GAT), and our Gyro-IPT. Repeat sales of these state-of-the-art simulators will allow us to recoup the costs of our non-recurring engineering and design effort.

- Continue to evolve Advanced Tactical Flight Simulation (ATFS).

Our challenge will be to find funding to continue this critical development objective, either through U.S. government grants or a customer order.

#### Entertainment

- Develop a business model for the entertainment line which addresses the three types of contractual arrangements which are common in the amusement and educational venues: outright purchases, leasing and revenue sharing. Additionally, we will need to locate the capital required to support this type of business structure.
- Expand the entertainment line by repeat sales and the introduction of story line enhancements.

#### Environmental

- Bring the environmental line back to profitability by refocusing the selling effort towards domestic contracts for standardized products.

#### ADMS

- Develop a service business to supplant the sale of systems. During fiscal 2005 we received a contract to perform airport certification and emergency drill training using software and technology developed for the ADMS line at the Baltimore-Washington International Airport. We believe this is a new and undeveloped market with high potential.

#### Claims/Litigation

- Continue to pursue outstanding commercial litigation and the Company's claim against the U.S. government.

At February 25, 2005, we were involved in major commercial and government litigation which will require a significant amount of our time and effort. These activities will potentially detract from other business issues and require significant funding.





## Liquidity

- We do not currently have a bank facility which can be used to borrow funds for operations.

During fiscal 2005 our bank took certain actions which effectively eliminated our ability to borrow cash under our existing agreement to support operations. Thus, we may need to obtain additional sources of capital in order to continue growing and operating our business. This capital may be difficult to obtain and the cost of this additional capital is likely to be relatively high.

## **Revenue Recognition**

We currently market our products and services primarily through our sales offices and employees. In addition, we also utilize the services of approximately 100 independent sales agents and organizations in seeking foreign orders for our products.

We generally customize our products using our proprietary software based on specifications provided by our customers. Many of these products are capital intensive and take more than one year to manufacture and deliver to the customer. In the ATS segment, we sell our Aircrew Training Devices to military and commercial airline operators both in the United States and internationally. We sell our Entertainment products to amusement parks, zoos and museums. We sell our Disaster Management Simulation products to state and local governments. In our Industrial Group, we sell our sterilizers to pharmaceutical and medical device manufacturers. We sell our Environmental systems primarily to commercial automobile manufacturers and heating, ventilation and air conditioning (HVAC) manufacturers and our Hyperbaric products to the military (mainly larger chambers) and hospitals and clinics (mainly monoplace chambers). To a lesser degree, we provide upgrade, maintenance and repair services for our products and for products manufactured by other parties. .

The Company recognizes revenue using three methods:

On long-term contracts over \$250,000 in value and over six months in length the percentage of completion method is applied based on costs incurred as a percentage of estimated total costs. This percentage is multiplied by the total estimated revenue under a contract to calculate the amount of revenue recognized in an accounting period. Revenue recognized on uncompleted long-term contracts in excess of amounts billed to customers is reflected as a current asset. Amounts billed to customers in excess of revenue recognized on uncompleted long-term contracts are reflected as a current liability. When it is estimated that a contract will result in a loss, the entire amount of the loss is accrued. The effect of revisions in cost and profit estimates for long-term contracts is reflected in the accounting period in which the Company learns the facts which require it to revise its cost and profit estimates. Contract progress billings are based upon contract provisions for customer advance payments, contract costs incurred, and completion of specified contract milestones. Contracts may provide for customer retainage of a portion of amounts billed until contract completion. Retainage is generally due within one year of completion of the contract. Revenue recognition under the percentage of completion method involves significant estimates.

Revenue for contracts under \$250,000, or to be completed in less than six months, and where there are no post-shipment services (such as installation and customer acceptance) is recognized on the date that the finished product is shipped to the customer.

Revenue derived from the sale of parts and services is also recognized on the date that the finished product is shipped to the customer or when the service is completed. Revenue for service contracts is recognized ratably over the life of the contract with related material costs expensed as incurred.

In accordance with accounting principles generally accepted in the United States of America, recognizing revenue on contract claims and disputes, related to customer caused delays, errors in specifications and designs, and other unanticipated causes, and for amounts in excess of contract value, is generally appropriate if it is probable that the claim will result in additional contract revenue and if the Company can reliably estimate the amount of additional contract revenue. However, revenue recorded on a contract claim cannot exceed the incurred contract costs related to that claim. Claims are subject to negotiation, arbitration and audit by the customer or governmental agency.

The Company has operating subsidiaries in the United Kingdom and Poland, maintains regional offices in the Middle East, Asia and Canada, and uses the services of approximately 100 independent sales organizations and agents throughout the world. ETC International Corporation is a holding company established for federal income tax purposes and is not an operating subsidiary. The Company considers its business activities to be divided into two segments: Aircrew Training Systems (ATS) and the Industrial Group.

## Critical Accounting Policies

The discussion and analysis of the Company's financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the Company's financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that reflect significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. The Company believes that its critical accounting policies include those described below. For a detailed discussion on the application of these and other accounting policies, see Note 1 to the Consolidated Financial Statements, Summary of Significant Accounting Policies.

### Revenue Recognition on Long-Term Contracts

On long-term contracts over \$250,000 in value and six months in length, the percentage of completion method is applied based on costs incurred as a percentage of estimated total costs. This percentage is multiplied by the total estimated revenue under a contract to calculate the amount of revenue recognized in an accounting period. Revenue recognized on uncompleted long-term contracts in excess of amounts billed to customers is reflected as a current asset. Amounts billed to customers in excess of revenue recognized on uncompleted long-term contracts are reflected as a current liability. When it is estimated that a contract will result in a loss, the entire amount of the loss is accrued. The effect of revisions in cost and profit estimates for long-term contracts is reflected in the accounting period in which the Company learns the facts which require it to revise its cost and profit estimates. Contract progress billings are based upon contract provisions for customer advance payments, contract costs incurred, and completion of specified contract milestones. Contracts may provide for customer retainage of a portion of amounts billed until contract completion. Retainage is generally due within one year of completion of the contract. Revenue recognition under the percentage of completion method involves significant estimates.

The Company accounts for some its largest contracts, including its contracts with the U.S. and other foreign governments, using the percentage-of-completion method. If the Company does not accurately estimate the total cost to be incurred on this type of contract, or if the Company is unsuccessful in the ultimate collection of associated contract claims, estimated gross margins may be significantly impacted or losses may need to be recognized in future periods. Any resulting reductions in margins or contract losses could be material to the Company's results of operations and financial position.

Revenue for contracts under \$250,000, or to be completed in less than six months, and where there are no post-shipment services (such as installation and customer acceptance) is recognized on the date that the finished product is shipped to the customer or the service is completed.

### Accounts Receivable

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based on payment history and the customer's current creditworthiness. 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 have been identified. While the Company's credit losses have historically been within its expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. Additionally, as a result of the concentration of international receivables, the Company cannot predict the effect, if any, which geopolitical risk and uncertainty will have on the ultimate collection of its international receivables.

In accordance with accounting principles generally accepted in the United States of America, recognizing revenue on contract claims and disputes related to customer caused delays, errors in specifications and designs, and other unanticipated causes, and for amounts in excess of contract value, is generally appropriate if it is probable that the claim will result in additional contract revenue and if the Company can reliably estimate the amount of additional contract revenue. However, revenue recorded on a contract claim cannot exceed the incurred contract costs related to that claim. Claims are subject to negotiation, arbitration and audit by the customer or governmental agency.

## Results of Operations

### Fiscal 2005 versus Fiscal 2004

(\$000)	Summary Table of Results			
	FY 05	FY 04	\$ variance	% variance
			( )=unfavorable	
<b>Sales</b>				
Domestic	\$ 11,998	\$ 8,856	\$ 3,142	35.5%
US Gov't	2,904	1,717	1,187	69.1
Int'l	12,912	15,422	(2,510)	(16.3)
<hr/>				
Total Sales	27,814	25,995	1,819	7.0
Gross Profit	6,176	9,943	(3,767)	(37.9)
SG&A Expenses	12,450	9,454	(2,996)	(31.7)
R&D Expenses	856	358	(498)	(139.1)
Interest Exp	1,792	1,606	(186)	(11.6)
Other Exp., net	308	130	(178)	(136.9)
Income Taxes	(1,117)	(810)	307	37.9
Minority Interest	0	(2)	(2)	(100.0)
<hr/>				
Net Loss	\$ (8,113)	\$ (793)	\$ (7,320)	(923.1%)
<hr/>				
Net Loss per share (diluted)	\$ (1.06)	\$ (0.11)	(0.95)	(863.6%)
<hr/>				

#### Net Loss.

The Company had a net loss of \$8,113,000 or \$1.06 per share (diluted) in 2005 versus a net loss of \$793,000 or \$.11 per share (diluted) in fiscal 2004. Operating loss was \$7,130,000 versus an operating income of \$131,000 in 2004. This decrease was primarily the result of reduced gross profits primarily in sterilizers, Pilot Training Systems (PTS) and simulation coupled with higher expenses in all spending categories. Acting as a partial offset were the increased sales volume and a higher income tax benefit.

#### Sales.

Total sales in fiscal 2005 were \$27,814,000, an increase of \$1,819,000 or 7.0% over 2004, representing significant increases in environmental (\$2,143,000 or 102.6%), hyperbaric (\$1,510,000 or 81.3%) and entertainment (\$1,031,000 or 308.8%) partially offset by a significant (\$2,731,000 or 59.7%) decrease in sterilizer sales. ATS sales were basically flat between the years. Environmental sales benefited from a \$1,907,000 or 158.1% increase in domestic sales primarily for automotive applications. Hyperbaric equipment sales were up domestically primarily due to a large multi-place chamber sale from a domestic customer destined for a Middle Eastern navy. Entertainment sales reflected the first year orders of our "Wild Earth" and "Monster Truck" amusement rides. The decrease in sterilizer sales domestically primarily reflected reduced activity for a large Ethylene Oxide ("ETO")



project. Geographically, domestic sales were up \$3,142,000 or 35.5%, and represented 43.1% of total sales, up from 34.1% in fiscal 2004, primarily reflecting the increased activity as noted above. U.S. government sales increased to \$2,904,000, as compared to \$1,717,000 in fiscal 2004, and represented 10.4% of total sales, up from 6.6% of total sales in fiscal 2004. International sales, including those from the Company's foreign subsidiaries, were down \$2,510,000 or 16.3%, and represented 46.5% of total sales, down from 59.3% in fiscal 2004, primarily reflecting significantly reduced sales for ATS. Throughout the Company's history, most of the sales for Aircrew Training Systems products have been made to international customers.

Only one customer represented 10% or more of sales in fiscal 2005, the Royal Malaysian Air Force, which generated \$3,388,000 or 12.2% of total sales. In fiscal 2005, international sales totaling at least \$500,000 per country were made to customers in Malaysia, the United Kingdom, Egypt, the Czech Republic, Australia, China, Italy and the United Arab Emirates. Fluctuations in sales to international countries from year to year primarily reflect percentage of completion revenue recognition on the level and stage of development and production on multi-year long-term contracts. Open orders for two international customers represented 24.2% of the Company's backlog at February 25, 2005. For a discussion of the additional risks associated with our international operations, see "Risks Particular to Our Business—There are certain risks inherent in our international business activities, which constitute a significant portion of our business," in our Annual Report on Form 10-K.

We have historically experienced significant variability in our sales performance. This reflects the existing sales backlog, product and the nature of contract (size and performance time) mix, the manufacturing cycle and amount of time to effect installation and customer acceptance, and certain factors not in our control such as customer delays and the time required to obtain U.S. Government export licenses. One or a few contract sales may account for a substantial percentage of our quarterly revenue.

#### Domestic Sales.

Overall, domestic sales in fiscal 2005 were \$11,998,000 as compared to \$8,856,000 in fiscal 2004, an increase of \$3,142,000 or 35.5%, reflecting increases in all product types except sterilizers and simulation. Environmental benefited from a 258.1% increase in domestic sales primarily for automotive applications. Hyperbaric was up domestically primarily due to a large multi-place chamber sale. Entertainment sales reflected the first year orders of "Wild Earth" and "Monster Truck" amusement rides. The decrease in sterilizer sales domestically primarily reflected reduced activity for a large project. Domestic sales represented 43.1% of the Company's total sales in fiscal 2005, up from 34.1% in fiscal 2004. Sales to the U.S. Government in fiscal 2005 were \$2,904,000 as compared to \$1,717,000 in fiscal 2004, and represented 6.4% of total sales in fiscal 2005 versus 6.6% in fiscal 2004.

#### International Sales.

International sales in fiscal 2005 were \$12,912,000 as compared to \$15,422,000 in the fiscal 2004, a decrease of \$2,510,000 or 16.3%, and represented 46.4% of total sales as compared to 59.3% in fiscal 2004. Throughout our history, most of the sales for ATS have been made to international customers. In fiscal 2005 international sales totaling at least ten percent of total international sales were made to customers in Malaysia (\$3,388,000) and Egypt (\$2,309,000). In fiscal 2004 international sales totaling at least ten percent of total international sales were made to government or commercial accounts in Malaysia (\$2,874,000) and the United Kingdom (\$3,658,000). Fluctuations in sales to international countries from year to year primarily reflect revenue recognition on the level and stage of development and production on multi-year long-term contracts.

#### Segment Sales.

Segment Sales (\$000 except for %)

	Aircrew Training Systems		Industrial Group		Total	
	\$	%	\$	%	\$	%
Fiscal 2005	16,787	60.3	11,027	39.7	27,814	100.0
Fiscal 2004	15,880	61.1	10,115	38.9	25,995	100.0

On a segment basis, sales of the Company's ATS products, which create and monitor the physiological effects of motion (including spatial disorientation and centrifugal forces) on humans and equipment for medical, training, research and entertainment markets, were \$16,787,000 in fiscal 2005, an increase of \$907,000, or 5.7% over fiscal 2004. Sales of these products accounted for 60.3% of the Company's sales compared to 61.1% in fiscal 2004. The increase in ATS product sales primarily reflected the increased

activity in the entertainment area. Sales in the Company's other segment, the Industrial Group, which designs and produces chambers that create environments that are used for sterilization, research and medical applications, increased \$912,000 to \$11,027,000, an increase of 9.0%, and constituted 39.7% of the Company's total sales compared to 38.9% in fiscal 2004.

Significant claims outstanding at February 25, 2005 included a claim with the U.S. Navy for a submarine decompression chamber (\$3.0 million recorded). Significant claims outstanding at February 27, 2004 included \$2.9 million for the aforementioned U.S. Navy claim and \$2.6 million for an international customer. Effective February 27, 2004 the Company reached an agreement totaling \$10.5 million on a prior international claim. This settlement was paid to the Company in March 2004. On February 8, 2005, the Company reached an agreement totaling \$4.7 million on the remaining international claim. This settlement was paid to the Company in February 2005. Although recorded as a current asset in the financial statements, all remaining claim revenues may not be received in full during fiscal 2006. For a more complete discussion of outstanding claims, see "Note 3. Accounts Receivable" to our consolidated financial statements in the Annual Report to Stockholders following.

#### Gross Profit.

Gross profit for fiscal 2005 decreased by \$3,767,000 or 37.9% from fiscal 2004 reflecting significant reductions in most product categories, most notably sterilizer, PTS and simulation. Sterilizers suffered from the aforementioned significant sales decrease and a reduction of the gross profit rate as a percent of sales on a product mix shift to smaller steam sterilizers. Although sales for PTS were basically flat between the periods, the prior period reflected higher claims settlement revenue which resulted in a higher gross profit rate as a percent of sales. Simulation sales were also basically flat between the periods although the current period included additional product development costs, both to enhance functionality of existing products and to develop product extensions, which negatively impacted gross profit as these costs are primarily charged directly to the cost of sales for specific orders. Acting as a partial offset was an improvement in environmental gross profit rates as a percent of sales, although additional budget revisions for cost overruns primarily for international projects resulted in continued negative rates.

#### Operating Loss.

Operating loss was \$7,130,000 vs. an operating income of \$131,000 in 2004. This decrease was primarily the result of reduced gross profits primarily in sterilizers, Pilot Training Systems (PTS) and simulation coupled with higher expenses in all spending categories. Acting as a partial offset were the increased sales volume.

On a segment basis, ATS had an operating loss of \$4,768,000, a decrease of \$5,999,000 or 487.3% from fiscal 2004, while the Industrial Group had an operating loss of \$1,518,000 in fiscal 2005, a decrease of \$1,270,000 from fiscal 2004. These segment operating results were offset, in part, by unallocated corporate expenses of \$846,000, a decrease of \$6,000 from fiscal 2004.

The decrease in operating income for the ATS segment in fiscal 2005 reflected lower gross margins, both dollar-wise and as a percent of revenues, for all product categories coupled with higher operating expenses, primarily legal and claims expenses. Acting as a partial offset was an increase in sales between the periods.

The Industrial Group segment's decrease in operating income in fiscal 2005 reflected lower gross margins, primarily for sterilizers and parts and service, coupled with a slight increase in operating expenses. Acting as a partial offset was an improved gross profit, both dollar-wise and as a percent of revenue, for the environmental group.

#### Selling and Administrative Expenses.

Selling and administrative expenses increased \$2,996,000 or 31.7% from fiscal 2004. During fiscal 2005 we incurred significant legal costs and claims expenses to support an international claim (which claim was settled on February 8, 2005) and the lawsuit against Disney, which is in the discovery phase. Approximately 44% of selling and administrative costs in fiscal 2005 were related to legal and accounting fees, claim costs and sales commissions. In fiscal 2004, these costs comprised approximately 30% of selling and administrative costs. As a percentage of sales, selling and administrative expenses were 44.8% in fiscal 2005 compared to 36.4% in fiscal 2004.

#### Research and Development Expenses.

Research and development expenses increased \$498,000 or 139.1% in fiscal 2005 as compared to fiscal 2004. This increase reflected both additional spending and the timing of reimbursement for government grants in our Turkish subsidiary under a government research award for two projects. Most of the Company's research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates. Capitalized software development costs for fiscal 2005 were \$1,466,000 compared to \$1,716,000 in fiscal 2004.

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Amortization of software costs, which was charged to cost of sales, was \$988,000 and \$851,000 for fiscal 2005 and fiscal 2004, respectively.

Interest Expense.

Interest expense (net of interest income) increased \$186,000 or 11.6% in fiscal 2005 from fiscal 2004 primarily reflecting increased amortization of both deferred finance expenses from the Company's February 2003 refinancing and subordinated debt discount associated with the Company's subordinated debt. Acting as a partial offset was reduced interest expense for the Company's subordinated debt as the rate was temporarily reduced by two percentage points.

Bank Fees.

Bank fees increased \$72,000 or 21.9% in fiscal 2005 over fiscal 2004 primarily reflecting additional charges for bank agreement covenant violation waivers.

Letter of Credit Fees.

Letter of credit fees decreased \$76,000 or 59.8% in fiscal 2005 versus fiscal 2004 reflecting reduced international contracts and the timing of letter of credit fees.

Other Income/Expense, net.

Other income/expense, net, decreased 182,000 or 55.8% in fiscal 2005 versus fiscal 2004 as the prior period included the proceeds of an insurance reimbursement for a stolen simulator.

(Benefit from)/Provision for Income Taxes.

The fiscal 2005 tax benefit reflects the realization of tax loss carry backs of the current year's loss. During fiscal 2005 the Company applied for and received refunds approximating \$900,000 of these carry backs; at February 25, 2005 an additional \$536,000 remained as an income tax receivable reflecting the balance of these carry backs.

Reflecting the Company's significant losses in the current fiscal year, the Company has approximately \$7.2 million of federal and \$12.5 million of state net loss carry forwards available to offset future income taxes, expiring in 2025. However, due to the uncertain nature of their ultimate realization based on past performance, and the potential that sufficient taxable income may not be generated in the near future, the Company has established a full valuation allowance of the same amount against these carry forward benefits and will recognize these benefits only as reassessment demonstrates that they are realizable. Realization is entirely dependent upon future earnings in specific tax jurisdictions. While the need for this valuation allowance is subject to periodic review, if the allowance is reduced, the tax benefits of the carry forwards will be recorded in future operations as a reduction of the Company's income tax expense.



## Fiscal 2004 versus Fiscal 2003

(\$000)	Summary Table of Results			
	FY 04	FY 03	\$ variance	% variance
			( )=unfavorable	
<b>Sales</b>				
Domestic	\$ 8,856	\$ 23,692	\$ (14,836)	(62.6)%
US Gov't	1,717	4,626	(2,909)	(62.9)
Int'l	15,422	14,805	617	(4.2)
<hr/>				
Total Sales	25,995	43,123	(17,128)	(39.7)
Gross Profit	9,943	14,198	(4,255)	(30.0)
SG&A Expenses	9,454	9,446	(8)	(0.1)
R&D Expenses	358	636	278	43.7
Interest Exp	1,606	518	(1,088)	(210.0)
Other Exp.,net	130	338	208	61.5
Income Taxes	(810)	805	1,615	200.6
Minority Interest	(2)	(38)	(36)	(94.7)
<hr/>				
Net (Loss)/Income	\$ (793)	\$ 2,493	\$ (3,286)	(131.8)%
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Net (Loss)/Income per share				
(diluted)	\$ (.11)	\$ 0.33	\$ (0.44)	(133.3)%
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### Net Loss.

The Company had a net loss of \$793,000 or \$.11 per share (diluted) in 2004 versus net income of \$2,493,000 or \$.33 per share (diluted) in fiscal 2003. Operating income was \$131,000, a decrease of \$3,985,000 or 96.8% over 2003. This decrease was primarily the result of reduced gross profits due to lower sales volume, primarily in domestic entertainment sales, partially offset by lower research and development expenses.

### Sales.

Total sales in fiscal 2004 were \$25,995,000, a decrease of \$17,128,000 or 39.7% over 2003, representing decreases in entertainment (\$16,998,000), hyperbaric (\$1,519,000) and environmental (\$1,701,000). Entertainment suffered from the completion in fiscal 2003 of a large project. Hyperbaric sales reflected reduced effort on a large U.S. government submarine decompression chamber project. Environmental sales were down in the current period as fiscal 2003 reflected significant sales for large chamber projects in China. Providing partial offsets were increased sales for domestic sterilizers (up \$1,662,000) and higher International Aircrew

Training Systems (up \$1,702,000) primarily for International Logistics Services (equipment upgrades and maintenance on various aeromedical equipment). Geographically, domestic sales were down \$14,835,000 or 62.6%, and represented 34.1% of total sales, down from 54.9% in fiscal 2003, primarily reflecting decreased entertainment activity. U.S. government sales decreased to \$1,717,000, as compared to \$4,626,000 in fiscal 2003, and represented 6.6% of total sales, down from 10.8% of total sales in fiscal 2003. International sales, including those from the Company's foreign subsidiaries, were up \$616,000 or 4.2%, and represented 59.3% of total sales, up from 34.3% in fiscal 2003, primarily reflecting an increase in ATS sales. Throughout the Company's history, most of the sales for Aircrew Training products have been made to international customers.

Customers representing 10% or more of sales in fiscal 2004 were the Royal Malaysian Air Force, \$2,874,000 or 11.1%, and the United Kingdom Ministry of Defense, \$2,840,000 or 10.9%. In fiscal 2004, international sales totaling at least \$500,000 per country were made to customers in Malaysia, the United Kingdom, Indonesia, Venezuela, Egypt, Nigeria, Thailand, China and Norway. Fluctuations in sales to international countries from year to year primarily reflect percentage of completion revenue recognition on the level and stage of development and production on multi-year long-term contracts. Open orders for the Royal Malaysian Air Force and a foreign customer constituted 19.4% and 20.0% respectively of the Company's backlog at February 27, 2004. For a discussion of the additional risks associated with our international operations, see "Risks Related to Our Business—There are certain risks inherent in our international business activities, which constitute a significant portion of our business," in our Annual Report on Form 10-K.

Segment Sales (\$000 except for %)

	Aircrew Training Systems		Industrial Group		Total	
	\$	%	\$	%	\$	%
Fiscal 2004	15,880	61.1	10,115	38.9	25,995	100.0
Fiscal 2003	31,612	73.3	11,511	26.7	43,123	100.0

On a segment basis, sales of the Company's ATS products, which create and monitor the physiological effects of motion (including spatial disorientation and centrifugal forces) on humans and equipment for medical, training, research and entertainment markets, were \$15,880,000 in fiscal 2004, a decrease of \$15,732,000, or 49.8% over fiscal 2003. Sales of these products accounted for 61.1% of the Company's sales compared to 73.3% in fiscal 2003. The decrease in ATS product sales primarily reflected the completion in the prior period of a major entertainment contract. Sales in the Company's other segment, the Industrial Group, which designs and produces chambers that create environments that are used for sterilization, research and medical applications, decreased \$1,396,000 to \$10,115,000, a decrease of 12.1%, and constituted 38.9% of the Company's total sales compared to 26.7% in fiscal 2003.

Significant claims outstanding at February 27, 2004 included a claim with the U.S. Navy for a submarine decompression chamber (\$2.9 million recorded) and a claim with an international customer (\$2.6 million recorded). Significant claims outstanding at February 28, 2003 included \$2.1 million for the aforementioned U.S. Navy claim and \$9.5 million for two claims with an international customer. Effective February 27, 2004 the Company reached an agreement totaling \$10.5 million on one of these international claims, thus resolving all outstanding amounts related to this claim. Although recorded as a current asset in the financial statements, all claim revenues may not be received in full during fiscal 2005.

Gross Profit.

Gross profit for fiscal 2004 decreased by \$4,255,000 or 30.0% from fiscal 2003 reflecting the aforementioned sales decrease which was partially offset by a 5.3 percentage point increase in the rate as a percentage of sales. Product development costs, both to enhance functionality of existing products and to develop product extensions, negatively impacted gross profit as these costs are primarily charged directly to the cost of sales for specific orders. Increased rates were evidenced in all business groups except environmental and entertainment, but the primary positive impact came from the ATS group primarily reflecting the aforementioned settlement of an international claim.

Operating Income.

Operating income for fiscal 2004 was \$131,000, a decrease of \$3,985,000 or 96.8% over fiscal 2003. On a segment basis, ATS had an operating income of \$1,231,000, a decrease of \$3,748,000 or 75.3% from fiscal 2003, while the Industrial Group had an operating loss of \$248,000 in fiscal 2004 compared to an operating income of \$52,000 in fiscal 2003. These segment operating results were offset, in part, by unallocated corporate expenses of \$852,000, a decrease of \$63,000 from fiscal 2003.



The decrease in operating income for the ATS segment in fiscal 2004 reflected the aforementioned sales decrease partially offset by higher gross margins as a percentage of sales. The segment also experienced higher selling and marketing expenses including commissions.

The Industrial Group segment's decrease in operating income in fiscal 2004 reflected the aforementioned slight reduction in sales coupled with a 2.9 percentage point drop in the gross profit rate as a percentage of sales partially offset by reduced selling and marketing expenses.

#### Selling and Administrative Expenses.

Selling and administrative expenses were flat between the two periods as increases in legal and accounting costs and sales commissions were offset by reduced claims expenses. Approximately 41% of selling and administrative costs in the current fiscal were related to legal and accounting fees, claim costs and sales commissions. As a percentage of sales, selling and administrative expenses were 36.4% in fiscal 2004 compared to 21.9% in fiscal 2003.

#### Research and Development Expenses.

Research and development expenses decreased \$278,000 or 43.7% in fiscal 2004 as compared to fiscal 2003. This decrease reflected government grants in our Turkish subsidiary under a government research award for work on our multi-axis centrifuge tactical flight simulator. Most of the Company's research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates. Capitalized software development costs for fiscal 2004 were \$1,716,000 compared to \$1,193,000 in fiscal 2003. Amortization of software costs, which was charged to cost of sales, was \$851,000 and \$653,000 for fiscal 2004 and fiscal 2003, respectively.

#### Interest Expense.

Interest expense (net of interest income) increased \$1,088,000 or 210.0% in fiscal 2004 from fiscal 2003 reflecting higher average borrowings at higher rates and increased amortization of both deferred finance expenses from the Company's February 2003 refinancing and subordinated debt discount associated with the Company's subordinated debt. Letter of credit and other income/expenses decreased \$208,000 or 61.5% in fiscal 2004 over fiscal 2003 reflecting reduced letter of credit fees on a lower balance and the net receipt of insurance proceeds for a stolen simulator.

#### Other income/Expense, net.

Given the Company's pre-tax loss for the fiscal period and the impact of some large permanent book/tax differences for some accounts, the Company experienced a domestic tax benefit based on an effective rate of 55.4% and a consolidated rate of 50.5%. Part of the reduction in the effective rate reflected the impact of research and experimentation tax credit refunds. The Company intends to continue to use research and experimentation tax credits, if applicable, to reduce its federal income tax.

During the second quarter of fiscal 2003, the Company reached a settlement with Inland Revenue in Great Britain which resulted in an additional tax assessment of \$15,000. Additionally, during fiscal 2004 the Company successfully concluded an Internal Revenue Service routine audit of the Company's fiscal 2000 tax filing with no additional liability.

### **Liquidity and Capital Resources**

During fiscal 2005, the Company generated \$9,723,000 from operating activities. Most of this cash resulted from the collection of two international contracts totaling approximately \$15.3 million. Additional cash resulted from reductions in costs in excess of billing on long-term contracts and inventory and non-cash expenses such as depreciation and amortization. Cash usages included the net operating loss and a decrease in customer deposits.

The Company's investing activities used \$1,557,000 in fiscal 2005 and consisted of purchases of capital equipment (\$285,000) and capitalized software (\$1,272,000). Given the nature of the Company's market and products, the continued development of generic control and core software and software tools is a critical objective of management.

The Company's financing activities generated \$2,317,000 of cash during fiscal 2005. This primarily reflected cash received from the exercise of common stock warrants and the issuance of common stock. Acting as a partial offset was a significant increase in restricted cash required by PNC Bank to collateralize the Company's outstanding long-term bonds. See "Note 7. Long-Term Obligations and Credit Arrangements" to the Consolidated Financial Statements.



## Refinancing

The Company has historically financed operations through a combination of cash generated from operations, equity offerings, subordinated borrowings and bank debt. On February 19, 2003, the Company refinanced its operations (the "Refinancing"). The Refinancing was effected through the issuance of subordinated, convertible notes to H.F. Lenfest, an individual, and a credit agreement (the "Agreement") with PNC Bank, National Association ("PNC"). The total proceeds from this refinancing were \$29,800,000.

## Bank Credit and Facility

The Agreement has had numerous amendments which are discussed below. Currently, the facility is for \$5,000,000 and use of the facility is restricted to the issuance of international letters of credit. This line is secured by all assets of the Company as well as a \$5 million personal guarantee by Mr. Lenfest.

The PNC credit facility is secured by (i) the grant of a first and prior security interest in all of the personal property of the Company, Entertainment Technology Corporation ("EnTCo"), and ETC Delaware, Inc. ("ETC Delaware"), each a wholly-owned subsidiary of the Company, in favor of PNC; (ii) the Company's grant of a first and prior security interest in all of the Company's accounts, deposits and all other negotiable and non-negotiable instruments owned by the Company in favor of PNC; (iii) the Company's grant of a first and prior mortgage on all of the Company's real property in favor of PNC; and (iv) the Company's grant of a first and prior security interest in all of the Company's rights to (a) all of the shares of capital stock of each of EnTCo and ETC Delaware and (b) 65% of the shares of capital stock owned by the Company of each of its foreign subsidiaries in favor of PNC. In addition, the PNC credit agreement requires that EnTCo and ETC Delaware guarantee the Company's obligations under the PNC facility.

## Agreement Amendments

On April 30, 2003, the Agreement was amended to include: (i) a revolving credit facility in the maximum aggregate principal amount of \$14,800,000 to be used for the Company's working capital and general corporate purposes, including capital expenditures, with a sub-limit for issuances of letters of credit in the maximum aggregate face amount of \$10,300,000, and (ii) a standby letter of credit in the face amount of \$4,750,000 as credit support for the Company's bonds. Additionally, on July 9, 2003, a second amendment to the Agreement was executed which formed an additional \$1,010,000 credit facility for use in financing export contracts which qualify for an EXIM (the Export-Import Bank of the United States) Bank guarantee.

On August 24, 2004, the Agreement was amended to substantially reduce the operating facility and eliminate the associated monthly borrowing base reporting requirements. The revolving facility was reduced from \$14,800,000 to \$5,000,000 and use of the facility was restricted to the issuance of letters of credit, which are frequently a requirement of international contracts. Under the amended Agreement, the Company could no longer borrow cash under the facility. The Company's long-term bonds were left intact. As additional collateral for the revised facility, PNC required the Company to keep \$2,500,000 in a restricted cash account. The annual fee for letters of credit was reduced from 1.75% to 1.0% per annum. Additionally, three of the financial covenants, the Leverage Ratio, the Fixed Charge Ratio and the requirement not to report a net loss in any annual period were eliminated and the Tangible Net Worth requirement was reduced. All other terms and conditions of the revolving loan and the line of credit as set forth in the Agreement remained in effect.

Under the August 24, 2004, amendment the EXIM Bank credit facility was reduced from \$1,010,000 to \$995,000, with all other terms and conditions remaining unchanged. Availability under the EXIM facility was determined based on a borrowing base consisting of a portion of the Company's receivables and inventory.

On October 18, 2004, the Agreement was amended to require the Company to deposit in a restricted cash account an additional amount of \$285,000 to cover the next scheduled payment of principal and interest due April 1, 2005 on the Company's long-term bonds. The Tangible Net Worth covenant requirement was reduced to a) \$14,500,000 for the periods ended November 26, 2004 and February 25, 2005 and b) on the last day of any fiscal quarter ending after February 25, 2005, to be at least equal to the actual Tangible Net Worth on February 25, 2005. Additionally, the fee for the PNC Letter of Credit, which backs the Company's long-term bonds, was increased from 2.0% to 2.5% annually.

On February 22, 2005, the Agreement was again amended. This Amendment required the Company to increase the deposit as security in the restricted cash account to an amount equal to 100% of the sum of the amount available to be drawn on the Bond Letter of Credit (\$4,464,000 at February 25, 2005). Additionally the EXIM borrowing facility was cancelled and the Tangible Net Worth covenant was reduced to \$12,000,000 for all future reporting periods beginning with February 25, 2005. The rate on the Reimbursement Letter of Credit which backs the Company's long-term bonds was reduced to 0.75% per annum.

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As of May 6, 2005 the Company had used approximately \$1,939,000 of the facility for international letters of credit.

#### Subordinated Convertible Debt

In connection with the financing provided by Mr. Lenfest on February 19, 2003, the Company entered into a Convertible Note and Warrant Purchase Agreement with Mr. Lenfest (the "Note"), pursuant to which the Company issued to Mr. Lenfest (i) a senior subordinated convertible promissory note in the original principal amount of \$10,000,000 (the "Note") and (ii) warrants to purchase 803,048 shares of the Company's common stock. Upon the occurrence of certain events, the Company will be obligated to issue additional warrants to Mr. Lenfest. The note accrues interest at the rate of 10% per annum and matures on February 18, 2009. At the Company's option, the quarterly interest payments may be deferred and added to the outstanding principal. The note entitles Mr. Lenfest to convert all or a portion of the outstanding principal of, and accrued and unpaid interest on, the note into shares of common stock at a conversion price of \$6.05 per share. The warrants may be exercised into shares of common stock at an exercise price equal to the lesser of \$4.00 per share or two-thirds of the average of the high and low sale prices of the common stock for the 25 consecutive trading days immediately preceding the date of exercise.

The obligations of the Company to Mr. Lenfest under the Convertible Note and Warrant Purchase Agreement are secured by a second lien on all of the assets of the Company, junior in rights to the lien in favor of PNC Bank, including all real property owned by the Company.

Prior to the consummation of the refinancing, Advanced Technology Asset Management, LLC ("ATAM") (formerly ETC Asset Management, LLC), a shareholder of the Company and a holder of warrants to purchase 332,820 shares of the Company's common stock, consented to the transactions contemplated under the Credit Agreement and the financing provided by Mr. Lenfest, including the below market issuance of warrants to Mr. Lenfest. As a result of its consent, ATAM waived, solely in connection with such issuance, the anti-dilution rights contained in its warrant. In exchange for ATAM's consent, the Company issued to ATAM warrants to purchase an additional 105,000 shares of common stock. Except for the number of shares issuable upon exercise of the warrants, the new ATAM warrants have substantially the same terms as the warrants issued to Mr. Lenfest. In March 2004, ATAM exercised all its warrants and received a total of 437,820 shares of common stock of the Company. The Company received proceeds of \$586,410 from the exercise of these warrants.

As a condition of amending the Agreement on August 24, 2004, Mr. Lenfest, holder of the Company's subordinated debt, agreed to issue to PNC on the Company's behalf a limited guarantee to secure up to \$5,000,000 in principal amount of any letters of credit issued under the amended facility. In consideration for issuing this guarantee, Mr. Lenfest will receive a fee of 0.75% per annum of the average amount of letters of credit outstanding, payable on a quarterly basis, and a warrant to purchase 200,000 shares of stock under the same terms and conditions as his existing warrant for 803,048 shares.

On February 14, 2005, Mr. Lenfest exercised all of his outstanding warrants and received 1,003,048 shares of common stock for approximately \$3.9 million. Additionally, on February 14, 2005, Mr. Lenfest purchased 373,831 shares of the Company's common stock for approximately \$2.0 million.

Under the Note the Company must meet certain financial covenants including a Leverage Ratio, a Fixed Charge Ratio and a Tangible Net Worth Ratio. At February 25, 2005 the Company failed to meet any of these financial covenants but has obtained a waiver from Mr. Lenfest. This waiver applies to the period through February 28, 2006. Except as specified, the waiver does not constitute a modification or alteration of any other terms or conditions in the Note, or a release of any of the lender's rights or remedies, all of which are reserved, nor does it release the Company or any guarantor from any of its duties, obligations, covenants or agreements including the consequences of any Event of Default, except as specified.

#### Long-Term Bonds

On March 15, 2000, the Company issued approximately \$5,500,000 of unregistered Taxable Variable Rate Demand/Fixed Rate Revenue Bonds (Series of 2000). Net proceeds from these bonds were used to repay a \$4,100,000 advance taken on the Company's revolving credit facility and to finance construction of an addition to the Company's main plant in Southampton, Pennsylvania. The bonds are secured by a \$5,000,000 irrevocable direct pay Letter of Credit issued by PNC which expires on February 17, 2006 and which is secured by all assets of the Company. At February 25, 2005 they were also fully cash collateralized. The bonds carry a maturity date of April 1, 2020, bear a variable interest rate which adjusts each week to a rate required to remarket the bonds at full principal value (currently at 3.19% on May 6, 2005) with a cap of 17%, and are subject to mandatory redemption of \$275,000 per year for 19 years and \$245,000 for the 20<sup>th</sup> year.



## Liquidity

Given the Company's inability to borrow cash under the amended Agreement, the Company may need to obtain additional sources of capital in order to continue growing and operating its business. This capital may be difficult to obtain and the cost of this additional capital is likely to be relatively high. However, because we have established businesses in many markets, significant fixed assets including a building, and other valuable business assets which can be used for security, we believe that we will be able to locate such additional capital and that the actions by PNC will not have a long-term material adverse effect on our business.

The Company believes that existing cash balances at February 25, 2005, cash generated from operating activities as well as future availability under its credit agreement will be sufficient to meet its future obligations through at least February 25, 2006.

In reference to the Company's outstanding claims with the U.S. Navy, to the extent the Company is unsuccessful in recovering a significant portion of recorded claim contract costs, and to the extent that significant additional legal expenses are required to bring the dispute to resolution, such events could have a material adverse effect on the Company's liquidity and results of operations. Historically, the Company has had a favorable experience in that recoveries have exceeded recorded claims, including significant settlement agreements in fiscal 2003, 2004 and 2005. (See Note 3 to the Consolidated Financial Statements, Accounts Receivable).

The following table presents our contractual cash flow commitments on long-term debt and operating leases. See Notes 6 and 7 to the Consolidated Financial Statements for additional information on our long-term debt and operating leases.

Payments Due by Period (in thousands)					
	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
	(in thousands)				
Long-term debt, including current maturities	\$ 12,362	\$ 275	\$ 8,817	\$ 550	2,720
Operating leases	740	156	318	188	78
Total	\$ 13,102	\$ 431	\$ 9,135	\$ 738	\$ 2,798

- Long-term debt is reported net of unamortized discount of \$2,008,000 on the Company's subordinated debt. See "Note 7. Long-Term Obligations and Credit Arrangements" to the Consolidated Financial Statements.
- Our sales backlog at February 25, 2005 and February 27, 2004, for work to be performed and revenue to be recognized under written agreements after such dates, was \$19,084,000 and \$16,914,000, respectively. In addition, our training, maintenance and upgrade contracts backlog at February 25, 2005 and February 27, 2004, for work to be performed and revenue to be recognized after such dates under written agreements, was \$2,232,000 and \$2,637,000, respectively. Of the February 25, 2005 backlog, we have contracts for approximately \$15,243,000 for aircrew training systems and maintenance support, including \$3,422,000 for the Japanese Defense Agency and \$1,746,000 for the Egyptian Air Force. We expect to complete approximately 75% of the February 25, 2005 backlog prior to February 24, 2006, the end of our 2006 fiscal year. Of the February 27, 2004 backlog, we completed approximately 79% by February 25, 2005.

The Company's order flow does not follow any seasonal pattern as the Company receives orders in each fiscal quarter of its fiscal year.

## Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements during the fiscal year ended February 25, 2005 that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to the Company's investors.

## Recent Accounting Pronouncements Accounting for Share-Based Payments

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), Share-Based Payments. This statement replaces FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. This statement requires companies to recognize in financial statements the compensation cost relating to share-based transactions including share options, restricted share plans, performance-based awards, share appreciation rights and employee

share purchase plans. The cost of these arrangements will be measured based on the fair value of the equity or liability instruments issued. Public companies will be required to apply Statement 123(R) as of the first

annual reporting period that begins after June 15, 2005 based on a delay granted by the SEC of the implementation of this pronouncement. The Company is not able at this time to determine what impact, if any, adoption of Statement 123(R) will have on the results of operations.

### Accounting for Inventory Costs

In November 2004, the FASB issued FASB Statement 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. While retaining the general principle that inventories are presumed to be stated at cost, Statement 151 amends ARB No. 43 to clarify that:

- abnormal amounts of idle facilities, freight, handling costs, and spoilage should be recognized as charges of the current period.
- allocation of fixed production overheads to inventories should be based on the normal capacity of the production facilities.

The Statement defines normal capacity as the production expected to be achieved over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.

Statement 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005 and should be applied prospectively. Early application is permitted. The Company is not able at this time to determine what impact, if any, adoption of statement 151 will have on the results of operations.

### Market for the Registrant's Common Stock and Related Security Holder Matters

The Company's common stock is traded on the American Stock Exchange under the symbol "ETC." As of May 6, 2005, the Company had 282 shareholders of record.

The following table sets forth the quarterly ranges of high and low sale prices for shares of the common stock for the periods indicated.

	Sale Prices	
	High	Low
<b>Fiscal 2005</b>		
First Quarter	\$ 10.05	\$ 7.25
Second Quarter	8.24	6.47
Third Quarter	7.95	6.18
Fourth Quarter	6.80	5.10
<b>Fiscal 2004</b>		
First Quarter	\$ 6.00	\$ 5.00
Second Quarter	6.10	5.00
Third Quarter	8.70	6.08
Fourth Quarter	9.95	7.00

On May 6, 2005, the closing price of the Company's common stock was \$5.85. The Company has never paid any cash dividends on its common stock and does not anticipate that any cash dividends will be declared or paid in the foreseeable future. The Company's current credit facilities prohibit the payment of any dividends by the Company without the lender's prior written consent.

## Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
<b>Equity compensation plans approved by security holders</b>	276,162	\$ 7.30	588,850
<b>Equity compensation plans not approved by security holders</b>	—	N/A	207,813
<b>Total</b>	<u>276,162</u>	<u>\$ 7.30</u>	<u>796,663</u>

The following plans have not been approved by our stockholders:

### Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan which was adopted by the Board of Directors on November 3, 1987. All employees meeting service requirements, except officers, directors and 10% stockholders, are eligible to voluntarily purchase common stock through payroll deductions up to 10% of salary. The Company makes a matching contribution of 20% of the employee's contribution.

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Environmental Tectonics Corporation

We have audited the accompanying consolidated balance sheets of Environmental Tectonics Corporation and Subsidiaries as of February 25, 2005 and February 27, 2004 and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three fiscal years in the period ended February 25, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Environmental Tectonics Corporation and Subsidiaries as of February 25, 2005 and February 27, 2004, and the consolidated results of its operations and its cash flows for the each of the three fiscal years in the period ended February 25, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited the accompanying Schedule II of Environmental Tectonics Corporation and Subsidiaries as of February 25, 2005 and February 27, 2004 and for each of the three fiscal years in the period ended February 25, 2005. In our opinion, this schedule presents fairly, in all material respects, the information required to be set forth herein.

Philadelphia, Pennsylvania  
April 14, 2005



Retained earnings	7,481	15,594
	<u>          </u>	<u>          </u>
Total stockholders' equity	24,355	25,054
	<u>          </u>	<u>          </u>
Total liabilities and stockholders' equity	\$ 47,909	\$ 48,696
	<u>          </u>	<u>          </u>

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

**Consolidated Statements of Operations (amounts in thousands, except share information)**

	52 Weeks Ended February 25, 2005	52 Weeks Ended February 27, 2004	53 Weeks Ended February 28, 2003
Net sales	\$ 27,814	\$ 25,995	\$ 43,123
Cost of goods sold	21,638	16,052	28,925
<b>Gross profit</b>	<b>6,176</b>	<b>9,943</b>	<b>14,198</b>
Operating expenses:			
Selling and administrative	12,450	9,454	9,446
Research and development	856	358	636
	<b>13,306</b>	<b>9,812</b>	<b>10,082</b>
<b>Operating (loss) income</b>	<b>(7,130)</b>	<b>131</b>	<b>4,116</b>
Other expenses:			
Interest expense (net)	1,791	1,606	518
Bank fees	401	329	228
Letter of credit fees	51	127	154
Other, net	(143)	(326)	(44)
	<b>2,100</b>	<b>1,736</b>	<b>856</b>
<b>(Loss) income before (benefit from) provision for income taxes and minority interest</b>	<b>(9,230)</b>	<b>(1,605)</b>	<b>3,260</b>
<b>(Benefit from) provision for income taxes</b>	<b>(1,117)</b>	<b>(810)</b>	<b>805</b>
<b>(Loss) income before minority interest</b>	<b>(8,113)</b>	<b>(795)</b>	<b>2,455</b>
<b>Loss attributable to minority interest</b>	<b>(0)</b>	<b>(2)</b>	<b>(38)</b>
<b>Net (loss) income</b>	<b>\$ (8,113)</b>	<b>\$ (793)</b>	<b>\$ 2,493</b>
Per share information: (Loss) earnings per common share:			
Basic	\$ (1.06)	\$ (.11)	\$ .35
Diluted	\$ (1.06)	\$ (.11)	\$ .33
Weighted average common shares:			
Basic	7,656,000	7,163,000	7,153,000
Diluted	7,656,000	7,163,000	7,497,000

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



**Consolidated Statements of Changes in Stockholders' Equity (amounts in thousands, except share information)**

For the years ended February 25, 2005, February 27, 2004 and February 28, 2003

	Common Stock		Capital contributed in excess of par value of common stock	Accumulated other comprehensive income (loss)	Retained earnings	Total stockholders' equity
	Shares	Amount				
Balance, February 22, 2002	7,142,946	\$ 357	\$ 6,703	\$ (172)	\$ 13,894	\$ 20,782
Net income for the year	—	—	—	—	2,493	2,493
Foreign currency translation adjustment	—	—	—	3	—	3
Total comprehensive income						2,496
Value of beneficial conversion option associated with issuance of subordinated convertible debt	—	—	1,400	—	—	1,400
Value of warrants issued in connection with issuance of subordinated convertible debt	—	—	1,209	—	—	1,209
Exercise of employee stock options	14,293	1	19	—	—	20
Balance, February 28, 2003	7,157,239	358	9,331	(169)	16,387	25,907
Net loss for the year	—	—	—	—	(793)	(793)
Foreign currency translation adjustment	—	—	—	(160)	—	(160)
Total comprehensive income						(953)
Exercise of employee stock options	19,313	1	99	—	—	100
Balance, February 27, 2004	7,176,552	359	9,430	(329)	15,594	25,054
Net loss for the year	—	—	—	—	(8,113)	(8,113)
Foreign currency translation adjustment	—	—	—	192	—	192
Total comprehensive loss						(7,921)
Value of warrants issued in connection with issuance of guarantee	—	—	571	—	—	571
Exercise of warrants	1,440,868	72	4,406	—	—	4,478
Issuance of common stock	373,831	19	1,981	—	—	2,000
Exercise of employee stock options and Board of Director's compensation	28,125	—	173	—	—	173
Balance, February 25, 2005	9,019,376	\$ 450	\$ 16,561	\$ (137)	\$ 7,481	\$ 24,355

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

**Consolidated Statements of Cash Flows (amounts in thousands)**

	52 Weeks Ended February 25, 2005	52 Weeks Ended February 27, 2004	53 Weeks Ended February 28, 2003
<b>Cash flows from operating activities:</b>			
Net (loss) income	\$ (8,113)	\$ (793)	\$ 2,493
Adjustments to reconcile net (loss) income to net cash provided by/ (used in) operating activities			
Depreciation and amortization	2,414	1,847	1,401
Accretion of debt discount	326	275	—
Increase (decrease) in allowance for accounts receivable and inventory	274	(149)	(19)
Loss attributable to minority interest	—	(2)	(38)
Deferred income taxes (benefit)	(165)	(168)	313
Changes in operating assets and liabilities:			
(Increase) decrease in assets			
Accounts receivable	11,108	(2,973)	3,590
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	2,000	108	3,950
Inventories	1,554	(1,763)	(2,091)
Prepaid expenses and other current assets	318	(720)	62
Other assets	—	(103)	32
Increase (decrease) in liabilities:			
Accounts payable	462	653	(1,660)
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	588	(518)	964
Customer deposits	(1,410)	657	(684)
Accrued income taxes	266	(247)	(731)
Other accrued liabilities	101	1,032	(2)
<b>Net cash provided by (used in) operating activities</b>	<b>9,723</b>	<b>(2,864)</b>	<b>7,580</b>
<b>Cash flows from investing activities:</b>			
Acquisition of equipment	(285)	(475)	(215)
Software development costs	(1,272)	(1,220)	(569)
<b>Net cash used in investing activities</b>	<b>(1,557)</b>	<b>(1,695)</b>	<b>(784)</b>
<b>Cash flows from financing activities:</b>			
Borrowings under credit facility	—	2,514	26,396
Payments under credit facility	(30)	(3,084)	(37,551)
Payments on long-term bonds	(275)	(275)	(275)
Proceeds from subordinated convertible debt	—	—	7,391
Deferred financing costs	—	—	(719)
(Increase) decrease in restricted cash	(3,896)	2,405	(2,620)
Net (decrease) increase in other long-term obligations	(133)	120	(6)
Issuance of common stock/warrants	6,651	100	2,629
<b>Net cash provided by (used in) financing activities</b>	<b>2,317</b>	<b>1,780</b>	<b>(4,755)</b>
Effect of exchange rates on cash	192	(160)	3
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>10,675</b>	<b>(2,939)</b>	<b>2,044</b>
Cash and cash equivalents at beginning of year	1,366	4,305	2,261
<b>Cash and cash equivalents at end of year</b>	<b>\$ 12,041</b>	<b>\$ 1,366</b>	<b>\$ 4,305</b>
<b>Supplemental schedule of cash flow information:</b>			
Interest paid	\$ 909	\$ 854	\$ 480

Income taxes paid	\$	5	\$	78	\$	1,720
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Supplemental information on non-cash operating, investing and financing activities:

During the years ended February 25, 2005, and February 27, 2004, the Company reclassified \$194,000 and \$496,000, respectively, from inventory to capitalized software. Additionally, during the year ended February 25, 2005 the Company recorded \$571,000 in deferred finance charges and credited a corresponding amount to additional paid in capital associated with the issuance of a common stock purchase warrant to H.F. Lenfest.

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

1. Nature of Business:

Environmental Tectonics Corporation (“ETC” or the “Company”) is primarily engaged in the development, marketing and manufacturing of Aircrew Training Systems (ATS) and industrial simulation equipment. The Company utilizes its internally developed software systems in virtually all of its products. ETC focuses on software enhancements, product extensions, new product development and new marketplace applications. Sales of ATS products are made principally to U.S. and foreign government agencies and to the entertainment market. Sales of industrial simulation equipment, which includes sterilizers, environmental systems and hypo/hyperbaric equipment, are made to both commercial customers and governmental agencies worldwide.

2. Summary of Significant Accounting Policies:

Principles of Consolidation:

The consolidated financial statements include the accounts of Environmental Tectonics Corporation, its wholly owned subsidiaries Entertainment Technology Corporation, ETC Delaware, and ETC International Corporation, its 95% owned subsidiary, ETC-PZL Aerospace Industries SP. Z 0.0, and its 99% owned subsidiary, ETC Europe. All material inter-company accounts and transactions have been eliminated in consolidation. The Company’s fiscal year is the 52-or 53-week annual accounting period ending the last Friday in February.

Use of Estimates:

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made for revenue recognition under the percentage of completion method, claims receivable, inventories and computer software costs.

Significant claims outstanding at February 25, 2005 included a claim with the U.S. Navy for a submarine decompression chamber (\$3.0 million recorded). Significant claims outstanding at February 27, 2004 included \$2.9 million for the aforementioned U.S. Navy claim and \$2.6 million for an international customer. Effective February 27, 2004 the Company reached an agreement totaling \$10.5 million on a prior international claim. This settlement was paid to the Company in March 2004. On February 8, 2005, the Company reached an agreement totaling \$4.7 million on the remaining international claim. This settlement was paid to the Company in February 2005. Although recorded as a current asset in the financial statements, all claim revenues may not be received in full during fiscal 2006.

Total claims outstanding at February 25, 2005 were approximately \$5.6 million based on costs incurred through February 2005. However, under generally accepted accounting principles, the Company had recorded only \$3.0 million or 53.6% of this amount on its books.

Revenue Recognition:

Revenue is recognized on long-term contracts over \$250,000 in value and six months in length utilizing the percentage of completion method based on costs incurred as a percentage of estimated total costs. Revenue recognized on uncompleted long-term contracts in excess of amounts billed to customers is reflected as a current asset. Amounts billed to customers in excess of revenue recognized on uncompleted long-term contracts are reflected as a current liability. When it is estimated that a contract will result in a loss, the entire amount of the loss is accrued. The effect of revisions in cost and profit estimates for long-term contracts is reflected in the accounting period in which the facts requiring the revisions become known. Contract progress billings are based upon contract provisions for customer advance payments, contract costs incurred and completion of specified contract milestones. Contracts may provide for customer retainage of a portion of amounts billed until contract completion. Retainage is generally due within one year of completion of the contract. Revenue for contracts under \$250,000 or to be completed in less than six months, and where there are no post-shipment services included in the contract, and revenue on parts and services, are recognized as shipped or when the service is provided. Under these contracts, title passes at shipment. Revenue on those types of contracts where post-shipment services (such as installation and acceptance) are required is recognized upon customer acceptance. Revenue for service contracts is recognized ratably over the life of the contract with related material costs expensed as incurred.

Cash and Cash Equivalents:

Cash and cash equivalents include short-term deposits at market interest rates with original maturities of three months or less. The Company maintains cash balances at several financial institutions located in the Northeast United States and at some locations internationally. Accounts in each domestic institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. During each fiscal year, the Company periodically has cash and cash equivalents in excess of insured amounts. However, significant portions of the Company's funds are with one financial institution, which has had no experience of significant customer losses to date.

Restricted Cash

Restricted cash represents cash deposited in an interest bearing account with PNC which serves as security for their irrevocable direct pay letter of credit issued in the bondholder's favor to secure the Company's long-term bonds. At February 25, 2005 it included an amount equivalent to 101% of the outstanding principal of the bonds plus the mandatory redemption and interest payment which was due and paid on April 1, 2005.

Inventories:

Inventories are valued at the lower of cost or market. Cost is determined principally by the first-in, first-out method. The costs of finished goods and work-in-process inventories include material, direct engineering, manufacturing labor and overhead components. The Company periodically reviews the net realizable value of the inventory and, if necessary, writes down the recorded costs.

Depreciation of Property, Plant and Equipment:

Property, plant and equipment are depreciated over their estimated useful lives by the straight-line method for financial reporting purposes. Accelerated depreciation methods are used for tax purposes. Upon sale or retirement of property, plant and equipment, the costs and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the determination of net income.

Goodwill:

Goodwill of \$662,000 was recorded in fiscal 1999 for the Company's 65% ownership purchase of ETC-PZL Aerospace Industries, SP. Z O.O. On September 27, 2000, the Company purchased an additional 30% ownership for \$300,000 cash, bringing the Company's total ownership to 95%. Goodwill of \$24,000 was recorded in fiscal 2001 for the Company's purchase of 99% of ETC Europe. Based on a test of impairment, the Company did not reduce the net carrying values of goodwill for fiscal years 2005 and 2004.

The following summarizes the goodwill and associated amortization of the elements of goodwill:

(Amounts in thousands)	<b>ETC-PZL</b>	<b>ETC Europe</b>
Goodwill	662	24
Amortization	207	2
Net	455	22

On February 23, 2002, we adopted SFAS No. 142 "Goodwill and Intangible Assets" (SFAS No. 142). SFAS No. 142 includes requirements to annually test goodwill and indefinite lived intangible assets for impairment rather than amortize them. Accordingly, we no longer amortize goodwill.

Capitalized Software Development Costs:

The Company capitalizes the qualifying costs of developing software contained in certain products. Capitalization of costs requires that technological feasibility has been established. When the software is fully documented and tested, capitalization of development costs cease and amortization commences on a straight-line basis over a period ranging from 36 to 60 months, depending upon the life of the product, which, at a minimum, approximates estimated sales. Realization of capitalized software costs is subject to the Company's ability to market the related product in the future and generate cash flows to support future operations. Capitalized software costs totaled \$1,466,000 and \$1,716,000 respectively, for the fiscal years ended February 25, 2005 and February 27, 2004. Related software amortization totaled \$988,000, \$851,000 and \$653,000, respectively, for fiscal 2005, 2004 and 2003.

Research and Development:

Research and development expenses are charged to operations as incurred. During fiscal 2005, 2004 and 2003, the Company incurred research and development costs of approximately \$856,000, \$358,000 and \$636,000, respectively.

Deferred Financing Costs:

Capitalized costs relating to the Company's bond issuance on March 15, 2000 and costs associated with the February 2003 PNC/Lenfest financing are being amortized over the relevant term. Amortization expense relating to deferred financing costs was \$587,000, \$321,000 and \$75,000 in fiscal 2005, 2004 and 2003, respectively. At February 25, 2005 the balance of unamortized deferred finance costs was \$703,000, with \$624,000 classified as current.

During fiscal 2005 the Company recorded \$571,000 in deferred finance charges associated with the issuance of a common stock warrant. Amortization expense related to these costs was \$190,000 for fiscal 2005. See "Note 7. Long-Term Obligations and Credit Arrangements" to the Consolidated Financial Statements.

Income Taxes:

The Company accounts for income taxes using the liability method, which reflects the impact of temporary differences between values recorded for assets and liabilities for financial reporting purposes and values utilized for measurement in accordance with applicable tax laws.

Long-Lived Assets:

In accordance with FASB Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), the company periodically evaluates the period of depreciation or amortization for long-lived assets to determine whether current circumstances warrant revised estimates of useful lives. The company reviews its property and equipment for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the net undiscounted cash flows expected to be generated by the asset. An impairment loss would be recorded for the excess of net book value over the fair value of the asset impaired. The fair value is estimated based on expected discounted future cash flows.

The results of impairment tests are subject to management's estimates and assumptions of projected cash flows and operating results. The company believes that, based on current conditions, materially different reported results are not likely to result from long-lived asset impairments. However, a change in assumptions or market conditions could result in a change in estimated future cash flows and the likelihood of materially different reported results.

Stock Options:

The Company accounts for stock options under the alternate provisions of SFAS No. 123 (discussed below), "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, which contains a fair value-based method for valuing stock-based compensation that entities may use, which measures compensation cost at the grant date based on the fair value of the award. Compensation is then recognized over the service period, which is usually the vesting period. Alternatively, SFAS No. 123 permits entities to continue accounting for employee stock options and similar equity instruments under Accounting Principles Board (APB) Opinion 25, "Accounting for Stock Issued to Employees." Entities that continue to account for stock options using APB Opinion No. 25 are required to make pro-forma disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS No. 123 had been applied.

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Notes to Consolidated Financial Statements

At February 25, 2005, the Company has one stock-based employee compensation plan, which is described more fully in Note 10 to the Consolidated Financial Statements. The Company accounts for this plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	(amounts in thousands)		
	Fiscal Year Ended		
	February 25, 2005	February 27, 2004	February 28, 2003
Net (loss)/income, as reported	\$ (8,113)	\$ (793)	\$ 2,493
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(30)	(27)	(275)
Pro forma net (loss)/income	\$ (8,143)	\$ (820)	\$ 2,218
(Loss)/earnings per share:			
Basic—as reported	\$ (1.06)	\$ (0.11)	\$ .35
Basic—pro forma	\$ (1.06)	\$ (0.11)	\$ .31
Diluted—as reported	\$ (1.06)	\$ (0.11)	\$ .33
Diluted—pro forma	\$ (1.06)	\$ (0.11)	\$ .30

The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted average assumptions used for grants in fiscal 2005: expected volatility of 30.2%; risk-free interest rate of 4.14%; and an expected life of 10 years. There were no grants in fiscal 2003 and fiscal 2004.

Advertising Costs:

The Company expenses advertising costs, which include trade shows, as incurred. Advertising expense was \$310,000, \$324,000 and \$464,000 in fiscal 2005, 2004, and 2003, respectively.

Earnings Per Common Share:

SFAS No. 128, "Earnings Per Share," requires presentation of basic and diluted earnings per share together with disclosure describing the computation of the per share amounts. Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

The following table illustrates the reconciliations of the numerators and denominators of the basic and diluted earnings per share computations.

	Fiscal Year ended February 25, 2005		
	Loss	Weighted average shares	Per share amount
	(amounts in thousands)	(numerator)	(denominator)
Net loss	\$ (8,113)		
Basic loss per share			
Loss applicable to common stockholders	\$ (8,113)	7,656,000	\$ (1.06)



	<u>          </u>	<u>          </u>	<u>          </u>
Effective of dilutive securities			
Stock options		—	
Convertible Debt		—	
Stock warrants		—	
Diluted loss per share			
Loss applicable to common stockholders plus effect of dilutive securities	\$	(8,113)	7,656,000 \$ (1.06)
	<u>          </u>	<u>          </u>	<u>          </u>

Notes to Consolidated Financial Statements

At February 25, 2005, there were stock options to purchase the Company's common stock totaling 276,162 shares that were not included in the computation of diluted loss per share as the effect of such would be anti-dilutive. Additionally, there was subordinated debt with a face value of \$10,000,000, which was convertible at an exercise price of \$6.05 per share, equating to 1,652,893 shares of common stock if fully converted. Upon each conversion of the subordinated note, the holder would be entitled to receive a warrant to purchase additional shares of common stock equal to ten percent of the shares issued pursuant to such conversion. If the entire face value of the subordinated note is converted into shares of common stock, then warrants to purchase an additional 165,289 shares of common stock will be issued, bringing the total shares of common stock to be issued to 1,818,182. None of these shares were included in the computation of diluted earnings per share as the effect would be anti-dilutive.

Fiscal Year ended February 27, 2004			
	Loss (amounts in thousands)	Weighted average shares	Per share amount
	(numerator)	(denominator)	
Net loss	\$ (793)		
Basic loss per share			
Loss applicable to common stockholders	\$ (793)	7,163,000	\$ (.11)
Effective of dilutive securities			
Stock options		—	
Convertible Debt		—	
Stock warrants		—	
Diluted loss per share			
Loss applicable to common stockholders plus effect of dilutive securities	\$ (793)	7,163,000	\$ (.11)

At February 27, 2004, there were stock options to purchase the Company's common stock totaling 376,002 shares that were not included in the computation of diluted loss per share as the effect of such would be anti-dilutive. Additionally, there was subordinated debt with a face value of \$10,000,000, which was convertible at an exercise price of \$6.05 per share, equating to 1,652,893 shares of common stock if fully converted. Upon each conversion of the subordinated note, the holder would be entitled to receive a warrant to purchase additional shares of common stock equal to ten percent of the shares issued pursuant to such conversion. If the entire face value of the subordinated note is converted into shares of common stock, then warrants to purchase an additional 165,289 shares of common stock will be issued, bringing the total shares of common stock to be issued to 1,818,182. Additionally, at February 27, 2004, there were outstanding warrants to purchase the Company's stock totaling 1,240,868 shares. None of these shares were included in the computation of diluted earnings per share as the effect would be anti-dilutive.

Fiscal Year ended February 28, 2003			
	Income (amounts in thousands)	Weighted average shares	Per share amount
	(numerator)	(denominator)	
Net income	\$ 2,493		
Basic earnings per share			
Income available to common stockholders	\$ 2,493	7,153,000	\$ .35
Effective of dilutive securities			
Stock options		22,717	
Convertible Debt		4,151	
Stock warrants		317,407	
Diluted earnings per share			
Income available to common stockholders			

plus effect of dilutive securities	\$	2,493	7,497,275	\$	.33
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Notes to Consolidated Financial Statements

At February 28, 2003, options to purchase the Company's common stock totaling 421,614 shares were outstanding, 341,314 of which were not included in the computation of diluted earnings per share as the effect of such inclusion would be anti-dilutive.

3. Accounts Receivable:

The components of accounts receivable at February 25, 2005 and February 27, 2004 are as follows:

	(amounts in thousands)	
	2005	2004
U.S. government receivables billed and unbilled contract costs subject to negotiation	\$ 3,202	\$ 3,128
U.S. commercial receivables billed	2,331	1,508
International receivables billed and unbilled contract costs subject to negotiation	2,971	14,976
	8,504	19,612
Less allowance for doubtful accounts	(486)	(379)
	\$ 8,018	\$ 19,233

U.S. government receivables billed and unbilled contract costs subject to negotiation:

Unbilled contract costs subject to negotiation as of February 25, 2005, represent claims made against the U.S. Government under a contract for a submarine rescue decompression chamber project. These costs totaling \$3,004,000 were recorded beginning in fiscal year 2002 and include \$1,691,000 recorded during fiscal 2003, \$833,000 recorded during fiscal year 2004 and \$105,000 recorded during fiscal year 2005. In November 2003, the U.S. Government completed an audit of the claim, rejecting most of the items due to audit or engineering reasons. The Company was not provided a copy of the Government's Technical Report that questioned approximately half of the claim costs. The Company has submitted a written rebuttal to the draft report and has formally requested a copy of the Technical Report. On July 22, 2004, the U.S. Government's Contracting Officer issued a final decision on the claim, denying the claim in full. The Company is currently updating the claim for additional costs expended on the claim items after the initial submission and preparing a supplemental claim for additional claim issues. The updated original claim will be converted to a complaint to be filed in the Court of Federal Claims by early July 2005.

This U. S. Government claim has followed the typical process of claim notification, preparation, submittal, government audit and review by the contracting officer. Historically, the Company's experience has indicated that most claims are initially denied in part or in full by the contracting officer (or no decision is forthcoming, which is then taken to be a deemed denial) which then forces the Company to seek relief in a court of law.

The Company considers the recorded costs to be realizable due to the fact that the costs relate to customer caused delays, errors and changes in specifications and designs, disputed liquidated damages and other out of scope items. In the first quarter of fiscal 2005, the Company submitted a supplement to the claim incorporating additional cost items. The U.S. Government, citing failure to deliver the product within contract terms, has assessed liquidated damages but has not offset or withheld any progress payments due to the Company under the contract. The Company disputes the basis for these liquidated damages, noting that applicable U.S. Government purchasing regulations allow for a waiver of these charges if the delay is beyond the control and not due to the fault or negligence of the Company. However, following accounting principles generally accepted in the United States of America, the Company has reduced contract values and corresponding revenue recognition for an estimated amount of \$330,000 to cover a delay through the extended delivery period.

International receivables billed and unbilled contract costs subject to negotiation:

## Notes to Consolidated Financial Statements

International receivables billed include \$700,000 at February 25, 2005 and February 27, 2004, respectively, related to a contract with the Royal Thai Air Force ("RTAF").

In October 1993, the Company was notified by the RTAF that the RTAF was terminating a \$4,600,000 simulator contract with the Company. Although the Company had performed in excess of 90% of the contract, the RTAF alleged a failure to completely perform. In connection with this termination, the RTAF made a call on a \$230,000 performance bond, as well as a draw on an approximately \$1,100,000 advance payment letter of credit. Work under this contract had stopped while under arbitration, but on October 1, 1996, the Thai Trade Arbitration Counsel rendered its decision under which the contract was reinstated in full and the Company was given a period of nine months to complete the remainder of the work. Except as noted in the award, the rights and obligations of the parties remained as stated in the original contract including the potential invoking of penalties or termination of the contract for delay. On December 22, 1997, the Company successfully performed acceptance testing and the unit passed with no discrepancy reports. Although the contract was not completed in the time allotted, the Company has requested an extension on the completion time due to various extenuating circumstances, including allowable "force majeure" events, one of which was a delay in obtaining an export license to ship parts required to complete the trainers. On August 30, 2001, the Company received a payment of \$230,000 representing the amount due on the performance bond.

The open balance of \$700,000 due on the contract represents the total net exposure to the Company on this contract. On June 16, 2003, the Company filed for arbitration in Thailand seeking recovery of the open balance of \$700,000 due on this contract. On October 8, 2003, the Thai government filed their defense with the Thai Arbitration Institute (TAI). Subsequent to year-end all arbitrators had been chosen, including a third (umpire) arbitrator. The Company is currently preparing witness statements in anticipation of the arbitration hearings which are expected to begin in the next few months.

Since the circumstances that caused a delay are commonly considered "force majeure" events, and since the contract under question allows for consideration of "force majeure" events, the Company believes that the open balance related to this contract is collectible and will continue to treat this balance as collectible until a final unappealable legal decision is rendered by a competent Thai tribunal. The Company continues to enjoy a favorable relationship with the RTAF. It currently has both maintenance and upgrade contracts with the RTAF for trainers that are the subject of the dispute and has sold a significant amount of additional equipment to the RTAF since this dispute began. Thus, we do not feel the initiation of legal action against the RTAF has affected our ability to obtain additional contracts with the RTAF. At this point, the Company is not able to determine what, if any, impact the extended completion period will ultimately have upon the receipt of final payment.

Unbilled contract costs subject to negotiation represent a claim (\$2,600,000 recorded as of November 26, 2004) made against an international customer for a contract covering the period from 1997 to the present. On February 8, 2005 the Company reached an agreement totaling \$4.7 million on this claim and these funds were paid to the Company prior to the end of February 2005.

Effective February 27, 2004, the Company reached an agreement totaling \$10.5 million with the same international customer on another claim, thus resolving all outstanding amounts related to that claim. These proceeds were received on March 16, 2004.

Historically, the Company has had positive experience with regard to its contract claims in that recoveries have exceeded the carrying value of claims. However, there is no assurance that the Company will always have positive experience with regard to recoveries for its contract claims.

Claim bookings and settlements in fiscal 2005 reduced operating income by \$1,124,000 and in fiscal 2004 increased operating income by \$1,802,000, respectively. Claim bookings in fiscal 2003 decreased operating income by \$675,000. All amounts are net of associated manufacturing costs and legal expenses.

Net claims receivables were \$3,004,000 and \$5,508,000 at February 25, 2005 and February 27, 2004, respectively.

#### 4. Costs and Estimated Earnings on Uncompleted Contracts:

##### Unbilled costs

Amounts not billed or not yet billable totaled \$11,098,000 at February 25, 2005. Under most of the Company's contracts, invoices are issued upon the attainment of certain contract milestones, for example upon receipt of order, upon engineering drawing submittal, upon design acceptance, or upon shipment. Service contracts are billed monthly or quarterly. Parts and service are billed as shipped or completed.

The following is a summary of long-term contracts in progress at February 25, 2005 and February 27, 2004:



Notes to Consolidated Financial Statements

	(amounts in thousands)	
	2005	2004
Costs incurred on uncompleted long-term contracts	\$ 31,884	\$ 28,802
Estimated earnings	6,824	5,508
	38,708	34,310
Less billings to date	(36,908)	(29,922)
	\$ 1,800	\$ 4,388
	2005	2004
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	\$ 3,333	\$ 5,333
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(1,533)	(945)
	\$ 1,800	\$ 4,388

Included in billings in excess of costs and estimated earnings on uncompleted long-term contracts is a provision for anticipated losses on contracts of \$200,000 in fiscal 2005, 2004 and 2003.

5. Inventories:

Inventories consist of the following:

	(amounts in thousands)			
	Raw Material	Work in Process	Finished Goods	Total
February 25, 2005	\$ 290	\$ 5,293	\$ 2,345	\$ 7,928
February 27, 2004	311	7,803	1,729	9,843

Inventory is presented above net of an allowance for obsolescence of \$731,000 and \$564,000 in fiscal 2005 and 2004, respectively.

6. Property, Plant and Equipment:

The following is a summary of property, plant and equipment, at cost, and estimated useful lives at February 25, 2005 and February 27, 2004:

	(amounts in thousands)		Estimated useful lives
	2005	2004	
Land	\$ 100	\$ 100	
Building and building additions	3,763	3,763	40 years
Machinery and equipment	9,304	9,019	3-5 years
Office furniture and equipment	1,195	1,195	10 years
Building improvements	1,460	1,460	5-10 years
	15,822	15,537	
Less accumulated depreciation	(11,491)	(10,651)	
Property, plant and equipment, net	\$ 4,331	\$ 4,886	

Depreciation expense for the fiscal years ended February 25, 2005, February 27, 2004 and February 28, 2003 was \$840,000, \$675,000 and \$673,000, respectively.



Notes to Consolidated Financial Statements

7. Long-Term Obligations and Credit Arrangements:

Long-term obligations at February 25, 2005 and February 27, 2004 consist of the following:

	(amounts in thousands)	
	2005	2004
Credit facility payable to banks	\$ —	\$ 30
Long term bonds	4,370	4,645
Subordinated convertible debt, net of unamortized discount of \$2,008 and \$2,334 for 2005 and 2004, respectively	7,992	7,666
Term loans payable, accruing interest at between 9% and 9.9% collateralized by priority liens on certain equipment	—	6
Capitalized lease obligations	—	127
	12,362	12,474
Less current portion	(275)	(317)
	\$ 12,087	\$ 12,157

The amounts of future long-term obligations maturing in each of the next five fiscal years are as follows (amounts in thousands):

2006	\$ 275
2007	8,267
2008	275
2009	275
2010 and thereafter	3,270
Total future obligations	\$ 12,362

The approximate average loan balance, maximum aggregate borrowings outstanding at any month-end payable under the credit facility and subordinated debt during the fiscal years, and weighted average interest rate computed by the day's outstanding method as of February 25, 2005 and February 27, 2004 are as follows (amounts in thousands):

	2005	2004
Approximate average loan balance	10,001	10,401
Maximum aggregate	10,030	11,200
Weighted average interest rate	7.85%*	8.45%

\* The weighted average interest rate calculation for fiscal 2005 and 2004 reflects the impact of the \$10,000 senior subordinated debt obtained as part of the February 19, 2003 financing.

Refinancing

The company has historically financed operations through a combination of cash generated from operations, equity offerings, subordinated borrowings and bank debt. On February 19, 2003, the Company refinanced its operations (the "Refinancing"). This refinancing was effected through the issuance of subordinated, convertible notes with H.F. Lenfest, an individual, and a credit agreement (the "Agreement") with PNC Bank, National Association ("PNC"). The total proceeds from this refinancing were \$29,800,000.

Bank Credit and Facility

The Agreement has had numerous amendments which are discussed below. Currently, the facility is for \$5,000,000 and use of the facility is restricted to the issuance of international letters of credit. This line is secured by all assets of the Company as well as a \$5 million personal guarantee by Mr. Lenfest.

The PNC credit facility is secured by (i) the grant of a first and prior security interest in all of the personal property of the Company, Entertainment Technology Corporation ("Entertainment"), and ETC Delaware, Inc. ("ETC Delaware"), each a wholly-



## Notes to Consolidated Financial Statements

owned subsidiary of the Company, in favor of PNC; (ii) the Company's grant of a first and prior security interest in all of the Company's accounts, deposits and all other negotiable and non-negotiable instruments owned by the Company in favor of PNC; (iii) the Company's grant of a first and prior mortgage on all of the Company's real property in favor of PNC; and (iv) the Company's grant of a first and prior security interest in all of the Company's rights to (a) all of the shares of capital stock of each of Entertainment and ETC Delaware and (b) 65% of the shares of capital stock owned by the company of each of its foreign subsidiaries in favor of PNC. In addition, the PNC credit agreement requires that Entertainment and ETC Delaware guarantee the Company's obligations under the PNC facility.

### Agreement Amendments

On April 30, 2003, the Agreement was amended to include: (i) a revolving credit facility in the maximum aggregate principal amount of \$14,800,000 to be used for the Company's working capital and general corporate purposes, including capital expenditures, with a sub-limit for issuances of letters of credit in the maximum aggregate face amount of \$10,300,000, and (ii) a standby letter of credit in the face amount of \$4,750,000 as credit support for the Company's bonds. Additionally, on July 9, 2003, a second amendment to the Agreement was executed which formed an additional \$1,010,000 credit facility for use in financing export contracts which qualify for an EXIM (the Export-Import Bank of the United States) Bank guarantee.

On August 24, 2004, the Agreement was amended to substantially reduce the operating facility and eliminate the associated monthly borrowing base reporting requirements. The revolving facility was reduced from \$14,800,000 to \$5,000,000 and use of the facility was restricted to the issuance of letters of credit, which are frequently a requirement of international contracts. Under the amended Agreement, the Company could no longer borrow cash under the facility. The Company's long-term bonds were left intact. As additional collateral for the revised facility, PNC required the Company to keep \$2,500,000 in a restricted cash account. The annual fee for letters of credit was reduced from 1.75% to 1.0% per annum. Additionally, three of the financial covenants, the Leverage Ratio, the Fixed Charge Ratio and the requirement not to report a net loss in any annual period were eliminated and the Tangible Net Worth requirement was reduced. All other terms and conditions of the revolving loan and the line of credit as set forth in the Agreement remained in effect.

Under the August 24, 2004, amendment the EXIM Bank credit facility was reduced from \$1,010,000 to \$995,000, with all other terms and conditions remaining unchanged. Availability under the EXIM facility was determined based on a borrowing base consisting of a portion of the Company's receivables and inventory and conditions as his existing warrant for 803,048 shares.

On October 18, 2004, the Agreement was amended to require the Company to deposit in a restricted cash account an additional amount of \$285,000 to cover the next scheduled payment of principal and interest due April 1, 2005 on the Company's long-term bonds. The Tangible Net Worth covenant requirement was reduced to a) \$14,500,000 for the periods ended November 26, 2004 and February 25, 2005 and b) on the last day of any fiscal quarter ending after February 25, 2005, to be at least equal to the actual Tangible Net Worth on February 25, 2005. Additionally, the fee for the PNC Letter of Credit, which backs the Company's long-term bonds, was increased from 2.0% to 2.5% annually.

On February 22, 2005, the Agreement was again amended. This Amendment required the Company to increase the deposit as security in the restricted cash account to an amount equal to 100% of the sum of the amount available to be drawn on the Bond Letter of Credit (\$4,464,000 at February 25, 2005). Additionally the EXIM borrowing facility was cancelled and the Tangible Net Worth covenant was reduced to \$12,000,000 for all future reporting periods beginning with February 25, 2005. The rate on the Reimbursement Letter of Credit which backs the Company's long-term bonds was reduced to 0.75% per annum.

As of May 6, 2005 the Company had used approximately \$1,939,000 of the facility for international letters of credit.

### Subordinated Convertible Debt

In connection with the financing provided by Mr. Lenfest, the Company entered into a Convertible Note and Warrant Purchase Agreement with Mr. Lenfest, pursuant to which the Company issued to Mr. Lenfest (i) a senior subordinated convertible promissory note in the original principal amount of \$10,000,000 and (ii) warrants to purchase 803,048 shares of the Company's common stock. Upon the occurrence of certain events, the Company will be obligated to issue additional warrants to Mr. Lenfest. The note accrues interest at the rate of 10% per annum and matures on February 18, 2009. At the Company's option, the quarterly interest payments may be deferred and added to the outstanding principal. The note entitles Mr. Lenfest to convert all or a portion of the outstanding principal of, and accrued and unpaid interest on, the note into shares of common stock at a conversion price of \$6.05 per share. The warrants may be exercised into shares of common stock at an exercise price equal to the lesser of \$4.00 per share or two-thirds of the average of the high and low sale prices of the common stock for the 25 consecutive trading days immediately preceding the date of exercise.



The obligations of the Company to Mr. Lenfest under the Convertible Note and Warrant Purchase Agreement are secured by a second lien on all of the assets of the Company, junior in rights to the lien in favor of PNC Bank, including all real property owned by the Company.

Subordinated Convertible Debt Discount

During fiscal 2003, the Company had recorded \$2,609,000 in additional paid-in capital representing an allocation of the proceeds from the convertible debt element of its financing with PNC and Lenfest. This allocation represents the value assigned to the beneficial conversion option of the Lenfest promissory note and the value of the associated warrants. Such values were derived pursuant to an independent appraisal of these financial instruments obtained by the Company. Accreted interest expense related to the beneficial conversion option and the warrants was \$326,000 in fiscal 2005 and \$275,000 in fiscal 2004.

The following table summarizes the subordinated convertible debt as of February 25, 2005 (amounts in thousands):

face Value	\$	10,000
Less: Value of conversion feature		(1,400)
Less: Value of warrants		(1,209)
		<u>7,391</u>
Accretion 2005:		(326)
Accretion 2004:		(275)
		<u>7,992</u>
Carrying value at February 25, 2005	\$	7,992

Interest expense recorded for these notes was \$800,000 and \$963,000 for fiscal 2005 and 2004, respectively.

Prior to the consummation of the refinancing, Advanced Technology Asset Management, LLC (“ATAM”) (formerly ETC Asset Management, LLC), a shareholder of the Company and a holder of warrants to purchase 332,820 shares of the Company’s common stock, consented to the transactions contemplated under the Credit Agreement and the financing provided by Mr. Lenfest, including the below market issuance of warrants to Mr. Lenfest. As a result of its consent, ATAM waived, solely in connection with such issuance, the anti-dilution rights contained in its warrant. In exchange for ATAM’s consent, the Company issued to ATAM warrants to purchase an additional 105,000 shares of common stock. Except for the number of shares issuable upon exercise of the warrants, the new ATAM warrants have substantially the same terms as the warrants issued to Mr. Lenfest. In March 2004, ATAM exercised all its warrants and received a total of 437,820 shares of common stock of the Company. The Company received proceeds of \$586,000 from the exercise of these warrants.

As a condition of amending the Agreement on August 24, 2004, Mr. Lenfest, holder of the Company’s subordinated debt, agreed to issue to PNC on the Company’s behalf a limited guarantee to secure up to \$5,000,000 in principal amount of any letters of credit issued under the amended facility. In consideration for issuing this guarantee, Mr. Lenfest will receive a fee of 0.75% per annum of the average amount of letters of credit outstanding, payable on a quarterly basis, and a warrant to purchase 200,000 shares of stock under the same terms and conditions as his existing warrant for 803,048 shares.

On February 14, 2005, Mr. Lenfest exercised all of his outstanding warrants and received 1,003,048 shares of common stock for approximately \$3.9 million. Additionally, on February 14, 2005, Mr. Lenfest purchased 373,831 shares of the Company’s common stock for approximately \$2.0 million.

Under the Note the Company must meet certain financial covenants including a Leverage Ratio, a Fixed Charge Ratio and a Tangible Net Worth Ratio. At February 25, 2005 the Company failed to meet any of these financial covenants but has obtained a waiver from Mr. Lenfest. This waiver applies to the period through February 28, 2006. Except as specified, the waiver does not



constitute a modification or alteration of any other terms or conditions in the Note, or a release of any of the lender's rights or remedies, all of which are reserved, nor does it release the Company or any guarantor from any of its duties, obligations, covenants or agreements including the consequences of any Event of Default, except as specified.

#### Long-Term Bonds

On March 15, 2000, the Company issued approximately \$5,500,000 of unregistered Taxable Variable Rate Demand/Fixed Rate Revenue Bonds (Series of 2000). Net proceeds from these bonds were used to repay a \$4,100,000 advance taken on the Company's revolving credit facility and to finance construction of an addition to the Company's main plant in Southampton, Pennsylvania. The bonds are secured by a \$5,000,000 irrevocable direct pay Letter of Credit issued by the Company's main lender which expires on February 17, 2006 and which is secured by all assets of the Company. The bonds carry a maturity date of April 1, 2020, bear a variable interest rate which adjusts each week to a rate required to remarket the bonds at full principal value (currently at 3.19% on May 6, 2005) with a cap of 17%, and are subject to mandatory redemption of \$275,000 per year for 19 years and \$245,000 for the 20<sup>th</sup> year.

The following table summarizes the Company's long-term bonds as of February 25, 2005 (amounts in thousands):

Twenty year variable rate bonds	\$ 5,500
Redemption (mandatory)	(1,130)
	<hr/>
Balance at February 25, 2005	\$ 4,370
	<hr/>

#### Fair Value

The carrying value of these financial instruments approximates their fair values at February 25, 2005.

#### Liquidity

Given the Company's inability to borrow cash under the amended Agreement, the Company may need to obtain additional sources of capital in order to continue growing and operating our business. This capital may be difficult to obtain and the cost of this additional capital is likely to be relatively high. Because we have established businesses in many markets, significant fixed assets including a building and other valuable business assets which can be used for security, we believe that we will be able to locate such additional capital and that the actions by PNC will not have a long-term material adverse effect on our business.

The Company believes that existing cash balances at February 25, 2005, cash generated from operating activities as well as future availability under its credit agreement will be sufficient to meet its future obligations through at least February 25, 2006.

In reference to the Company's outstanding claims with the U.S. Navy, to the extent the Company is unsuccessful in recovering a significant portion of recorded claim contract costs, and to the extent that significant additional legal expenses are required to bring the dispute to resolution, such events could have a material adverse effect on the Company's liquidity and results of operations. Historically, the Company has had a favorable experience in that recoveries have exceeded recorded claims, including significant settlement agreements in fiscal 2003, 2004 and 2005. (See Note 3 to the Consolidated Financial Statements, Accounts Receivable).

#### 8. Leases:

##### Operating Leases

The Company leases certain premises and office equipment under operating leases, which expire over the next five years. Future minimum rental payments required under noncancellable operating leases having a remaining term expiring after one fiscal year as of February 25, 2005 are \$156,000 in 2006; \$118,000 in 2007; \$106,000 in 2008; \$94,000 in 2009; and \$266,000 in 2010 and thereafter.

Total rental expense for all operating leases for the fiscal years ended February 27, 2005, February 28, 2004 and February 22, 2003 was \$198,000, \$241,000 and \$255,000, respectively.

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Notes to Consolidated Financial Statements

9. Income Taxes:

The components of the provision for income taxes are as follows:

	52 Weeks Ended February 25, 2005	(amounts in thousands) 52 Weeks Ended February 27, 2004	53 Weeks Ended February 28, 2003
<b>Currently (receivable)/payable:</b>			
Federal	\$ (909)	\$ (738)	\$ 285
State	—	—	188
Foreign taxes	(44)	96	19
	<u>(953)</u>	<u>(642)</u>	<u>492</u>
<b>Deferred:</b>			
Federal	(199)	(101)	282
State	34	(67)	31
	<u>(165)</u>	<u>(168)</u>	<u>313</u>
	<u>\$ (1,118)</u>	<u>\$ (810)</u>	<u>\$ 805</u>

A reconciliation of the statutory federal income tax rate to the effective tax rate is as follows:

	52 Weeks Ended February 25, 2005	52 Weeks Ended February 27, 2004	53 Weeks Ended February 28, 2003
Statutory income tax	(34.0)%	(34.0)%	34.0%
State income tax, net of federal tax benefit	0.2	(4.1)	3.7
Benefit of foreign sales corporation and extraterritorial income	(0.0)	(9.1)	(4.5)
Research and experimentation and other tax credits	(1.6)	(9.2)	(5.0)
Benefit of foreign and foreign-source income or loss	(0.3)	(0.0)	(0.0)
Change in valuation allowance	24.3	0.0	0.0
Other, net	(0.8)	6.0	(3.5)
	<u>(12.2)%</u>	<u>(50.4)%</u>	<u>24.7%</u>

The tax effects of the primary temporary differences are as follows:

Notes to Consolidated Financial Statements

	(amounts in thousands)		
	2005	2004	2003
<b>Deferred tax assets:</b>			
Net products liability settlement	—	—	75
Vacation reserve	51	44	44
Inventory reserve	214	212	244
Receivable reserve	8	8	168
Warranty reserve	184	142	47
Compensation reserves	136	—	—
Net operating loss and credits	3,172	302	—
Other, net	252	629	111

	4,017	1,337	689
Valuation Reserve	(2,231)	—	—
Total current deferred tax asset	\$ 1,786	\$ 1,337	\$ 689
Deferred tax liabilities:			
Amortization of capitalized software	\$ 1,419	\$ 1,166	\$ 724
Depreciation	367	336	298
Total noncurrent deferred tax liability	\$ 1,786	\$ 1,502	\$ 1,022

Reflecting the Company's significant losses in the current fiscal year, the Company has approximately \$7.2 million of federal and \$12.5 million of state net loss carry forwards available to offset future income tax liabilities, expiring in 2025. However, due to the uncertain nature of their ultimate realization based on past performance, and the potential that sufficient taxable income may not be generated in the near future, the Company has established a full valuation allowance of the same amount against these carry forward benefits and will recognize these benefits only as reassessment demonstrates that they are realizable. Realization is entirely dependent upon future earnings in specific tax jurisdictions. While the need for this valuation allowance is subject to periodic review, if the allowance is reduced, the tax benefits of the carry forwards will be recorded in future operations as a reduction of the Company's income tax expense.

10. Business Segment Information:

The Company primarily manufactures, under contract, various types of high-technology equipment which it has designed and developed. The Company considers its business activities to be divided into two segments: Aircrew Training Systems (ATS) and the Industrial Group. The ATS business produces devices which create and monitor the physiological effects of motion, including spatial disorientation and centrifugal forces for medical, training, research and entertainment markets. The Industrial Group business produces chambers that create environments that are used for sterilization, research and medical applications. The following segment information reflects the accrual basis of accounting.

## Notes to Consolidated Financial Statements

(amounts in thousands)

	ATS	Industrial Group	Total
<b>Fiscal 2005</b>			
Net sales	\$ 16,788	\$ 11,026	\$ 27,814
Interest expense	1,189	602	1,791
Depreciation and amortization	1,337	1,078	2,415
Operating loss	4,768	1,518	6,286
Income tax benefit	715	254	969
Goodwill	477	—	477
Identifiable assets	14,899	7,947	22,846
Expenditures for segment assets	228	57	285
<b>Fiscal 2004</b>			
Net sales	\$ 15,880	\$ 10,115	\$ 25,995
Interest expense	1,293	313	1,606
Depreciation and amortization	881	966	1,847
Operating income/(loss)	1,231	(248)	983
Income tax provision/(benefit)	62	(318)	(256)
Goodwill	477	—	477
Identifiable assets	30,002	7,496	37,498
Expenditures for segment assets	380	95	475
<b>Fiscal 2003</b>			
Net Sales	\$ 31,612	\$ 11,511	\$ 43,123
Interest expense	423	95	518
Depreciation and amortization	1,136	265	1,401
Operating income	4,979	52	5,031
Income tax provision/(benefit)	1,139	(11)	1,128
Goodwill	477	—	477
Identifiable assets	26,481	6,348	32,829
Expenditures for segment assets	406	35	441
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Reconciliation to consolidated amounts:			
Corporate assets	25,063	10,721	14,869
Total assets	\$ 47,909	\$ 48,696	\$ 47,698
Segment operating (loss)/income	\$ (6,286)	\$ 983	\$ 5,031
Less interest expense	(1,791)	(1,606)	(518)
Income taxes (benefit)/provision	(969)	(256)	1,128
Total (loss)/income for segments	(7,108)	(367)	3,385
Corporate home office expense	(846)	(852)	(915)
Interest and other expenses	(308)	(130)	(338)
Income tax benefit	149	554	323
Minority interest	—	2	38
Net (loss)/income	\$ (8,113)	\$ (793)	\$ 2,493

Segment operating income consists of net sales less applicable costs and expenses relating to these revenues. Unallocated expenses including general corporate expenses, letter of credit fees, interest expense, and income taxes have been excluded from the determination of the total profit for segments. General corporate expenses are primarily central administrative office expenses. Property, plant, and equipment are not identified with specific business segments because most of these assets are used in each of the segments.

Approximately 20% of sales totaling \$5,697,000 in 2005 were made to two international customers in the ATS segment. Approximately 22% of sales totaling \$5,714,000 in 2004 were made to two international customers in the ATS segment. Approximately 57% of sales totaling \$24,471,000 in fiscal 2003 were made to one international and one domestic customer in the ATS segment.

Included in the segment information for the year ended February 25, 2005, are export sales of \$12,912,000. Of this amount, there are sales to or relating to governments or commercial accounts in Malaysia of \$3,388,000 and Egypt of \$2,309,000. Sales to the U.S. government and its agencies aggregated \$2,904,000 for the year ended February 25, 2005.

Notes to Consolidated Financial Statements

Included in the segment information for the year ended February 27, 2004, are export sales of \$15,421,000. Of this amount, there are sales to or relating to governments or commercial accounts in Malaysia of \$2,874,000 and the United Kingdom of \$2,840,000. Sales to the U.S. government and its agencies aggregated \$1,717,000 for the year ended February 27, 2004.

Included in the segment information for the year ended February 28, 2003 are export sales of \$14,805,000. Of this amount, there are sales to or relating to governments or commercial accounts in Malaysia of \$7,203,000. Sales to the U.S. government and its agencies aggregated \$4,626,000 for the year ended February 28, 2003.

11. Stock Options:

A summary of the status of the Incentive Stock Option Plan as of and for the fiscal years ended:

	February 25, 2005		February 27, 2004		February 28, 2003	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	376,002	\$ 7.21	421,614	\$ 7.20	448,514	\$ 7.04
Granted	33,586	7.24	—	—	—	—
Exercised	(25,700)	6.35	(17,800)	5.12	(4,150)	4.73
Forfeited	(107,726)	7.18	(27,812)	7.74	(22,750)	4.52
Outstanding at end of year	276,162	7.30	376,002	7.21	421,614	7.20
Options exercisable at year end	242,576		370,564		408,981	
Weighted average fair value of options granted during the year	\$ 3.58		—		—	

The following information applies to options outstanding at February 25, 2005:

Range of exercise prices	Options outstanding			Options exercisable	
	Number Outstanding at February 25, 2005	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at February 25, 2005	Weighted average exercise price
\$2.25 to \$3.38	2,000	1.45 years	\$ 2.25	2,000	\$ 2.25
\$5.00 to \$7.50	85,162	6.2 years	\$ 6.29	51,576	\$ 5.67
\$ 7.81	189,000	4.00 years	\$ 7.81	189,000	\$ 7.81
Total	276,162			242,576	

## 12 Commitments and Contingencies:

## Claims and Litigation:

In April 2003, Boenning & Scattergood, Inc. (“B&S”) filed suit against the Company in the Court of Common Pleas in Philadelphia, Pennsylvania, seeking payment of \$902,000 for financing fees allegedly due to B&S pursuant to the terms of an agreement for investment banking services which was entered into with a predecessor of B&S (the “B&S Agreement”). B&S alleged that it contacted the investors in the Company’s February 2003 financing transaction and that it earned the claimed financing fees pursuant to the terms of the B&S agreement. The Company responded to the complaint and also filed a counterclaim for breach of contract and professional malpractice. The Company believes that it has valid defenses to each of the claims of B&S and intends to vigorously defend itself against these claims. B&S and the Company have had some settlement discussions but, as of the date of the filing of this Report on Form 10-K, no agreement had been reached. At this time, the Company is unable to predict the outcome of this matter.

In June 2003, Associated Mezzanine investors, LLC (“AMI”) filed suit against the Company in the United States District Court for the Eastern District of Pennsylvania seeking payment of \$196,000 for costs, fees and expenses allegedly due to AMI pursuant to the terms of an agreement which the Company entered into with AMI (the “AMI Agreement”). AMI claimed that it located suitable investors for the Company’s February 2003 financing transaction and that it earned the claimed fees and is entitled to reimbursement of the claimed costs and expenses pursuant to the terms of the AMI Agreement. In March 2004, this suit was settled without any material impact on the Company’s results of operations.

In June 2003, Entertainment Technology Corporation (“EnTCo”), our wholly-owned subsidiary, filed suit against Walt Disney World Co. and other entities (“Disney”) in the United States District Court for the Eastern District of Pennsylvania, alleging breach of contract for, among other things, failure to pay all amounts due under contract for the design and production of the amusement park ride “Mission: Space” located in Disney’s Epcot Center. In response, in August 2003, Disney filed counterclaims against both EnTCo and the Company (under a guarantee) for, among other things, alleged failures in performance and design in the contract. Disney is seeking damages in excess of \$65 million plus punitive damages. EnTCo and the Company believe that they have valid defenses to each of Disney’s counterclaims and intend to vigorously defend against these counterclaims. At this time, discovery is completed, summary judgment motions have been filed, and the case is scheduled to be placed in the trial pool on June 27, 2005. EnTCo and the Company are unable to predict the outcome of this matter.

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against the Company. In the opinion of management, 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 have a significant effect on the financial position or results of operations of the Company if disposed of unfavorably.

## 13. Employee Benefit Plan:

The Company maintains a retirement savings 401(k) plan for eligible employees. The Company’s contributions to the plan are based on a percentage of the employees’ qualifying contributions. The Company’s contributions totaled \$106,000, \$107,000 and \$112,000 in fiscal 2005, fiscal 2004, and fiscal 2003, respectively.

The Company has an Employee Stock Purchase Plan which was adopted by the Board of Directors on November 3, 1987. All employees meeting service requirements, except officers, directors and 10% shareholders, are eligible to voluntarily purchase common stock through payroll deductions up to 10% of salary. The Company makes a matching contribution of 20% of the employee’s contribution. The Company has reserved 270,000 shares for issuance under the plan.

## 14. Quarterly Consolidated Financial Information (Unaudited):

Financial data for the interim periods of fiscal 2005, 2004 and 2003 were as follows (amounts in thousands):

Fiscal Year 2005	Quarter Ended			
	May 28	August 27	November 26	February 25
Net sales	\$ 6,175	\$ 6,523	\$ 7,751	\$ 7,365
Gross profit	994	1,021	1,637	2,524
Operating loss	1,645	2,392	2,757	336
Loss before income taxes	2,074	2,819	3,254	1,082
Minority interest	1	—	(1)	—
Net loss	1,461	1,984	3,249	1,419

Loss per common share:				
Basic	.19	.26	.43	.18
Diluted	.19	.26	.43	.18

Notes to Consolidated Financial Statements

Fiscal Year 2004	Quarter Ended			
	May 30	August 29	November 28	February 27
Net sales	\$ 6,130	\$ 4,752	\$ 7,115	\$ 7,998
Gross profit	2,287	1,786	1,774	4,096
Operating income (loss)	520	(395)	(700)	706
Income (loss) before income taxes	133	(862)	(987)	111
Minority interest	(4)	(2)	(3)	6
Net income (loss)	70	(622)	(704)	463
Earnings (loss) per common share:				
Basic	.01	(.09)	(.10)	.06
Diluted	.01	(.09)	(.10)	.06

Fiscal Year 2003	Quarter Ended			
	May 24	August 23	November 22	February 23
Net sales	\$ 11,207	\$ 11,041	\$ 12,162	\$ 8,713
Gross profit	3,583	3,263	3,579	3,773
Operating income	1,075	1,108	874	1,059
Income before income taxes	831	936	584	909
Minority interest	(27)	(5)	(6)	—
Net income	585	736	436	736
Earnings per common share:				
Basic	.08	.10	.06	.10
Diluted	.08	.10	.06	.10



**ENVIRONMENTAL TECTONICS CORPORATION AND SUBSIDIARIES SCHEDULE II  
VALUATION AND QUALIFYING ACCOUNTS**

(amounts in thousands)

Column A	Column B	Column C	Column D	Column E
Description	Balance at Beginning of Period	Charges/ (Credits) to Costs/ Expenses	Reductions (1)	Balance At End of Period
<b>Year ended February 25, 2005:</b>				
Valuation and qualifying accounts related to:				
Accounts receivable	\$ 379	\$ 126	\$ 19	\$ 486
Inventory	\$ 564	\$ 300	\$ 133	\$ 731
Property, plant and equipment	\$ 10,651	\$ 840	\$ —	\$ 11,491
Software development costs	\$ 7,670	\$ 988	\$ —	\$ 8,658
Other assets	\$ 434	\$ 587	\$ —	\$ 1,021
<b>Year ended February 27, 2004:</b>				
Valuation and qualifying accounts related to:				
Accounts receivable	\$ 446	\$ 43	\$ 110	\$ 379
Inventory	\$ 646	\$ 200	\$ 282	\$ 564
Property, plant and equipment	\$ 9,976	\$ 675	\$ —	\$ 10,651
Software development costs	\$ 6,819	\$ 851	\$ —	\$ 7,670
Other assets	\$ 113	\$ 321	\$ —	\$ 434
<b>Year ended February 28, 2003</b>				
Valuation and qualifying accounts related to:				
Accounts receivable	\$ 373	\$ 137	\$ 64	\$ 446
Inventory	\$ 738	\$ 108	\$ 200	\$ 646
Property, plant and equipment	\$ 9,303	\$ 673	\$ —	\$ 9,976
Software development costs	\$ 6,166	\$ 653	\$ —	\$ 6,819
Other assets	\$ 113	\$ —	\$ —	\$ 113

(1) Amounts written off or retired

**EXHIBIT 21**

List of Subsidiaries

<u>Name</u>	<u>Jurisdiction</u>	<u>% Ownership</u>
Entertainment Technology Corporation	PA	100%
ETC International Corporation	Barbados	100%
ETC-PZL Aerospace Industries	Poland	9 5%
ETC-Europe	Great Britain	9 9%
ETC-Delaware	Delaware	100%

**EXHIBIT 23**

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have issued our report dated April 14, 2005, accompanying the consolidated financial statements and schedule included in the Annual Report of Environmental Tectonics Corporation and Subsidiaries on Form 10-K for the year ended February 25, 2005. We hereby consent to the incorporation by reference of said report in the Registration Statements of Environmental Tectonics Corporation and Subsidiaries on Forms S-8 (File No. 333-65469, effective October 8, 1998 and File No. 2-92407, effective August 14, 1984), Form S-3A (File No. 333-29083, effective July 2, 1997) and Forms S-3 (File No. 333-29083, effective June 12, 1997 and File No. 33-42219, effective September 4, 1991).

Philadelphia, Pennsylvania  
May 26, 2005

EXHIBIT 31.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002

I, William F. Mitchell, certify that:

1. I have reviewed this Annual Report on Form 10-K of Environmental Tectonics Corporation;
2. Based on my knowledge, this report 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 26, 2005

By: /s/ William F. Mitchell

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William F. Mitchell  
President and Chief Executive Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002.**

I, Duane D. Deaner, certify that:

1. I have reviewed this Annual Report on Form 10-K of Environmental Tectonics Corporation;
2. Based on my knowledge, this report 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 26, 2005

By: /s/ Duane D. Deaner

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Duane D. Deaner  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Environmental Tectonics Corporation (the "Company") for the fiscal quarter ended February 25, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William F. Mitchell, Chief Executive Officer of the Company, and I, Duane D. Deaner, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ William F. Mitchell

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William F. Mitchell  
Chief Executive Officer

/s/ Duane D. Deaner

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Duane D. Deaner  
Chief Financial Officer

May 26, 2005

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed to be filed by the Company for purpose of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.