

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

ANNUAL REPORT
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 29, 2008

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

(State or other jurisdiction of
incorporation or organization)

23-1714256

(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

Common Stock, par value \$.05 per share

Name of Each Exchange on Which Registered

American Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

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 a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act)

Yes No

As of August 24, 2007, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$18,148,000 based upon the closing sale price of the registrant's common stock on the American Stock Exchange of \$3.25 on such date. See footnote (1) below.

As of May 13, 2008, there were 9,035,355 shares of the registrant's common stock issued and outstanding.

Index to Exhibits appears after page 30 of this Report.

- (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 record keeping purposes of the Securities and Exchange Commission.
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Explanatory Statement

Restatement of previously issued financial statements

Environmental Tectonics Corporation (“ETC” or the “Company”) has restated its previously issued financial statements for the fiscal year ended February 23, 2007 and the 13 and 39 week-periods ended November 24, 2006.

Settlement with U.S. Navy

History of the Claim Receivable

In May 2003, the Company filed a certified claim with the Department of the Navy (the “Government”) seeking costs totaling in excess of \$5.0 million in connection with a contract for submarine rescue decompression chambers.

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 the Company may receive. However, revenue recorded on a contract claim cannot exceed the incurred contract costs related to that claim. Since 2004, the Company had a claim receivable recorded for \$3,004,000. The Company’s Form 10-K as originally filed for February 23, 2007 included this claim receivable. This claim receivable was subsequently deemed to be impaired and reserved in full (see below).

Litigation of the Certified Claim

On July 22, 2004, the Navy’s contracting officer issued a final decision denying the claim in full. In July 2005, the Company converted this claim into a complaint which the Company filed in the United States Court of Federal Claims. On June 14, 2007, the Government amended its filings to add counterclaims pursuant to the anti-fraud provisions of the Contract Disputes Act, the False Claims Act, and the forfeiture statute.

Settlement of Litigation and Subsequent Funding

On June 27, 2007, the Company and the Government filed a Joint Motion to Dismiss with prejudice all of the Company’s claims against the Government, which was granted on June 28, 2007. Additionally, the Company agreed to pay to the Government \$3.55 million to reimburse the Government for estimated work to complete the chambers and for litigation expenses (\$3.3 million recorded in the first quarter of fiscal 2008 and \$250,000 recorded in the second quarter of fiscal 2008) and transfer the submarine rescue decompression chambers to the Navy. As of May 14, 2008, the Company had made all payments required under this settlement agreement and had transferred the chambers to the Government.

To partially fund the settlement, on August 23, 2007 the Company entered into the Series C Preferred Stock Purchase Agreement with H.F. Lenfest (“Lenfest”), a member of ETC’s Board of Directors and a significant shareholder, pursuant to which, among other things, ETC issued and sold 3,300 shares of its newly-created class of Series C Cumulative Convertible Participating Preferred Stock (the “Series C Preferred Stock”) to Lenfest for \$3,300,000. The proceeds from the issuance of the Series C Preferred Stock were restricted solely for use to partially fund the settlement with the Government.

Audit Committee Review and Regulatory Compliance Matters

In July 2007 the Company’s Audit Committee retained independent counsel to review the Government claim issue. While this review was being conducted, the Company could not file its Quarterly Reports on Form 10-Q (“Quarterly Reports”), although preliminary financial results were released and filed on Form 8-K’s for each of the fiscal quarters ended May 25, 2007, August 24, 2007 and November 23, 2007. Since the Company could not file its Quarterly Reports, the Company was notified by the American Stock Exchange (“AMEX”) that it was not in compliance with AMEX’s continued listing standards and in August 2007 the Company submitted a plan to regain compliance. On January 30, 2008, the Company was notified by AMEX that, due to continuing non-compliance with listing standards, they were initiating delisting proceedings. The Company appealed that decision and, on April 9, 2008 representatives of the Company participated in an appeal hearing. As a result of that hearing, on April 16, 2008 the Company was granted a stay of delisting proceedings until May 29, 2008.

As a result of the allegations made by the Department of Justice in connection with the Navy matter, on October 12, 2007, pursuant to the Federal Acquisition Regulations, the Government placed the Company on suspension, which barred the Company from soliciting contract work with any Government agency. On December 12, 2007, the Company executed an Administrative Agreement, which included a program of compliance reviews, audits and reports, and the Government lifted the suspension.

Change in Independent Registered Public Accounting Firm

Following the independent counsel’s review, the Company’s auditors, Grant Thornton LLP, resigned from the Company and rescinded their audit opinion for the fiscal years 2003 through 2007. On January 30, 2008, the Company’s Audit Committee engaged Friedman LLP as the Company’s registered public accounting firm.

Restatement of Previously Filed Financial Statements

Settlement with U.S. Navy

In November 2007, the independent counsel completed its review. Subsequently, the Company's Audit Committee, in conjunction with management, concluded that as of November 2006 the claim receivable of \$3,004,000 had been impaired.

On April 24, 2008, the Company announced that it was restating results for the 13 and 39 week-periods ended November 24, 2006 and the fiscal year ended February 23, 2007. This restatement reflected the formal investigation which concluded that the carrying value of the \$3,004,000 claim receivable had been impaired during the third quarter of fiscal 2007. This impairment resulted from certain allegations made by the Government during that period which resulted in the counterclaim which was filed by the Government against the Company in June 2007.

The restatement for the 13 and 39 week-periods ended November 24, 2006 and the fiscal year ended February 23, 2007 involves one change, namely the recording of a reserve against a claim receivable for the full amount of the carrying value of \$3,004,000 of the claim receivable. The effect of this adjustment results in a corresponding reduction in accounts receivable, an increase in net loss and a reduction in stockholder's equity.

Preferred Stock

In connection with the restatement of the Company's previously issued financial statements for the year ended February 23, 2007, the Company has reclassified the Series B and C Preferred Stock (the "instruments") from equity to mezzanine. The reclassification is due to the preferential redemption feature of the instruments, which provides that a change in ownership would result in a forced liquidation. A forced liquidation is considered outside the control of the Company. Therefore, the preferential treatment upon an act outside the control of the Company precluded equity treatment under the Securities and Exchange Commission Accounting Series Release ("ASR") 268 and Topic D98. Prior year's financial statements have been adjusted to reflect this change.

Due to the Company's accumulated deficit, all dividends accruing for the Series B and Series C Preferred Stock have been recorded in the accompanying financial statements as a reduction in additional paid-in capital.

For the discussion of the restatement adjustments, see Note 1 — Restatement of Previously Issued Financial Statements in the accompanying Notes to the Consolidated Financial Statements. All amounts referenced in this Annual Report for the 13 and 39 week-periods ended November 24, 2006 and the fiscal year ended February 23, 2007 reflect the amounts on a restated basis.

Previously Filed Reports

The Company will not amend its Annual Report on Form 10-K for the fiscal year ended February 23, 2007 or its Quarterly Report on Form 10-Q for the quarterly period ended November 24, 2006. The previously issued financial statements for the fiscal year ended February 23, 2007 and quarterly period ended November 24, 2006 should no longer be relied upon.

Additional Matters Regarding H.F. Lenfest

Lenfest Acquisition Proposal

On February 20, 2008, ETC received a proposal from an affiliate of Lenfest to purchase all of the publicly traded shares of the common stock of the Company not owned by Lenfest at the time the acquisition is consummated. The Board of Directors of the Company has formed a committee (the "Transaction Committee") comprised of independent directors to evaluate the proposal. The Transaction Committee has engaged a financial advisor to assist the Transaction Committee in evaluating the proposal. The Transaction Committee is evaluating the proposal and will make a recommendation with respect to the proposal to the Company's Board of Directors.

Lenfest Letter Agreement

On May 20, 2008, Lenfest agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC may not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of AMEX, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

Failure to Meet Financial Covenants under Credit Agreement

On July 31, 2007, the Company entered into a revolving credit agreement (the "Credit Agreement") in order to refinance its indebtedness with PNC Bank, National Association ("PNC") in the aggregate amount of up to \$15,000,000. This Credit Agreement is a replacement of a credit facility originally entered into with PNC in February 2003.

The Credit Agreement contains affirmative and negative covenants for transactions of this type, including limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business and transactions with affiliates. Under the Credit Agreement, the Company must maintain a minimum Consolidated Tangible Net Worth of \$9,000,000 at the end of each fiscal quarter. At February 29, 2008, the Company failed to meet the Consolidated Tangible Net Worth financial covenant. Additionally, under the Credit Agreement, the Company's events of default include the obligations of Lenfest as guarantor of the line of credit. Lenfest failed to deliver certain financial statements to the bank within the required time as specified in the Credit Agreement, which also was an event of default under the Agreement. On May 29, 2008 the Company received a waiver from PNC Bank, effective for the period ended February 29, 2008. The waiver does not extend beyond February 29, 2008. The Company has also agreed that Lenfest shall deliver certain additional financial statements on or before October 31, 2008, and failure to do so shall constitute an event of default. Management believes that the Bank will not exercise their rights under the default provisions as contained in the Credit Agreement. Lenfest is a guarantor of the Company's borrowings under the Credit Agreement. If the Bank exercises its right to call the Loan the Lenfest Guarantee will become enforceable. As noted earlier, Lenfest is a guarantor of the Company's borrowings under the Credit Agreement and has agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC may not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of

AMEX, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

ENVIRONMENTAL TECTONICS CORPORATION
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED
FEBRUARY 29, 2008

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When used in this Annual Report on Form 10-K, except where the context otherwise requires, the terms "we", "us", "our", "ETC" and the "Company" refer to Environmental Tectonics Corporation.

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 ETC's current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about ETC's 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) the proposed acquisition of the Company by H.F. Lenfest ("Lenfest"), a member of ETC's Board of Directors and a significant shareholder, (ii) the potential delisting of the Company's common stock from the American Stock Exchange as a result of the Company's failure to comply with the AMEX listing standards, (iii) projections of revenues, costs of materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items and the effects of currency fluctuations, (iv) 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, (v) statements of future economic performance, (vi) statements of assumptions and other statements about the Company or its business, (vii) statements made about the possible outcomes of litigation involving the Company, including our outstanding litigation with Disney; (viii) statements regarding the Company's ability to obtain financing to support its operations and other expenses, and (ix) 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. Except as required by federal securities law, 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.

In this report all references to "ETC," "we," "us," or "our," mean Environmental Tectonics Corporation and our subsidiaries.

References to fiscal 2007 or the 2007 fiscal year are references to the year ended February 23, 2007. References to fiscal 2008 or the 2008 fiscal year are references to the year ended February 29, 2008.

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 and services used to recreate 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 (aeromedical, tactical combat and general), disaster management training systems and services, entertainment products, sterilizers (steam and gas), environmental testing products and hyperbaric chambers and other products that involve similar manufacturing techniques and engineering technologies. The Company considers its business activities to be divided into two segments: Training Services Group (TSG) and the Control Systems Group (CSG). Product categories included in TSG are pilot training and flight simulators, disaster management systems and entertainment applications. CSG includes sterilizers, environmental control devices and hyperbaric chambers along with parts and service support.

Marketing

We currently market our products and services primarily through our sales offices and employees. At February 29, 2008, approximately 29 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 TSG segment, product development emphasizes additional functionality and fidelity, enhancing control systems and software graphics and exploring commercial possibilities. Our product development efforts are as follows:

Tactical Flight Combat and G-force / Disorientation Trainers.

In response to the ongoing market budgetary constraints for pilot G-force training and spatial disorientation, in 2004 we began incorporating tactical combat flight capabilities into our human centrifuge technology. Dubbed the Authentic Tactical Fighting System (ATFS), this product was the first fully “flyable” centrifuge-based tactical maneuvering ground based simulator. 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 continued development of this technology through fiscal 2008 including incorporating some of this functionality into our GYROLAB products.

Advanced Disaster Management Simulator (ADMS).

During fiscal 2008, our simulation division continued development of its software-driven disaster scenario products. ETC-PZL, our Polish subsidiary, performed extensive effort on the ADMS software platform (Core 4 generation) while engineers in our Orlando, Florida, branch office continued to expand our library of visual environments and incidents. We now offer training in aircraft accidents, hazardous material incidents, train and tunnel incidents, major traffic accidents, structural fires in high-rise, commercial, industrial and apartment buildings, large wildfires, terrorist attacks, bomb threats and explosions and school shootings.

In March 2008, we were contracted by the New York City Office of Emergency Management to supply a multi-station ADMS COMMAND, our most advanced training system. This contract includes a turnkey, multi-discipline team-training system with a comprehensive library of customized training scenarios. Our simulators will become an integral component of the overall Citywide Incident Management System (CIMS) Training Program for New York City. We also continued work on a contract with the Pennsylvania Southeast Region Counter-Terrorism Task Force (CTTF) to provide an ADMS-TEAM training system.

Internationally, we expanded our presence with sales to Düsseldorf, Germany and Hong Kong.

We will continue to enhance product applications by adding additional software objects and increasing interactivity between the various disaster scenarios.

Subsidiaries

We presently have four 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. NASTAR Center LLC is our wholly owned Delaware subsidiary which houses our NASTAR Center and all its activities. ETC-Delaware, our wholly-owned subsidiary, is a Delaware corporation that serves as an investment 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. Generally, with an occasionally exception, we have historically had no difficulty in obtaining supplies. Further, most of the 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:

<u>Patent Number</u>	<u>Title</u>	<u>Expiration Date</u>
5,051,094	"G-Force Trainer"	9/24/08
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
GAT-II[®]	General Aviation Trainer
G-LAB[®]	Human Centrifuge/USAF Type
GYROLAB[®]	Spatial Disorientation Device
MRC Monster Roll Cage[®]	Interactive Simulator in the Nature of an Amusement Ride Machine that incorporates Virtual Reality Effects
NASTAR[®] CENTER	The National Aerospace Training & Research Center
THE RIDE WORKS[®]	(Facility for) Manufacture of Amusement and Entertainment Rides to the order and specification of others.

ETC's UNREGISTERED (TM) (SM) TRADEMARKS/SERVICE MARKS are:

ADMSTM	Advanced Disaster Management Simulator
ATFSTTM	Authentic Tactical Fighting System
Authentic Tactical Fighting SystemTM	Authentic Tactical Fighting System
BARA-LABTM	Hyperbaric Chamber (other than medical)
BARA•PRESSTM	Hyperbaric Chamber Software
BIG MACTM	Entertainment ride based on a multi-armed Centrifuge Device
CASTM	Conditioned Air Supply
DMITM	Disaster Management Institute
EAGLE-VISIONTM	Visual Performance/Procedures Trainer
EPCTM	Engine Pressure Controller/Environmental System
ETCTM	ETC Biomedical Systems
ETCTM	Entertainment Technology Corporation
G-FETTM	Human Centrifuge (U.S. Navy type)
G-FET-IITM	Human Centrifuge (Malaysian Air Force type)
G-MASTM	Missile Avoidance System (Centrifuge feature)

G-POINTING™	Motion control algorithm feature; namely, a feature of Flight Simulators that duplicates G-force effects experienced during tactical flight in Class 9.
GRAPH MASTER PROGRAMMER™	Industrial Sterilizer Control
GUARDIAN MONITORING PACKAGE™	GMP features for Sterilizers
GYRO-1™	Multi-purpose basic Instrument Flight Trainer
GYRO-SAT™	Situational Awareness Trainer (feature of a Gyrolab)
GYROSIM™	Gyrolab as a Simulator
LANE MASTER™	Automobile Emissions Analyzer
MAC™	Entertainment Ride based on a Multi-Armed Centrifuge Device
OASIS™	Software-driven tool to build Test and Training Systems and scoring them; curriculum development, capability assessment, etc.
ProFlyer™	Commercial Flight and Navigational Procedures Trainer meeting European regulations for civilian pilot training and certification
PRO-GENESIS™	Control Unit/column for Sterilizers
ProTrainer™	Commercial Instrument Procedures Trainer meeting FAA's PCATD requirements
SENTRY 84™	Automobile Emissions Analyzer
SMOOTH RIDE™	Computer Control Profile for Hyperbaric Chambers
TACModule™	Tactical Aircraft Configuration Module
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's entertainment rides, particularly those utilizing ETC's 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 our sales to a small number of customers that vary within any given fiscal year. Generally 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. Most of our CSG products (sterilizers, environmental systems and hyperbaric monoplace chambers) are sold domestically to commercial customers.

In fiscal 2008, sales to one customer (directly and through a contractor) represented individually 10% or more of total sales, General Motors (Michigan, USA) which contributed \$3,898,000 or 17.2% of total sales. International sales totaling at least \$500,000 per country were made to customers in Indonesia and Thailand. Open orders for two international customers represented 51.1% of our backlog at February 29, 2008. We do not have any relationship with these customers other than as customers. We are continuing to conduct business with these customers in fiscal 2009.

Foreign and Domestic Operations and Export Sales

During the fiscal years ended February 29, 2008 and February 23, 2007, approximately \$1,828,000 (8.0%) and \$586,000 (3.4%), 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 29, 2008 and February 23, 2007, \$7,424,000 (32.7%) and \$10,821,000 (62.1%), respectively, of our net revenues were attributable to export sales, including sales in our ETC-PZL subsidiary. 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 29, 2008 and February 23, 2007, \$13,478,000 (59.3%) and \$6,012,000 (34.5%), respectively, of our net revenues were attributable to domestic sales to customers other than the U.S. Government.

See "Note 11. 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 3. 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 for an explanation of percentage of completion accounting.

Our U.S. Government contracts contain standard terms permitting termination either for the convenience of the U.S. Government or for default. In the event of termination for convenience, 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, PA. We have approximately 64,000 square feet devoted to manufacturing, assembly and testing. Our facility includes a specially designed centrifuge bay with a foundation for testing and operating human centrifuges. ETC is ISO 9001-2000 certified.

Sales Backlog

Our sales backlog at February 29, 2008 and February 23, 2007, for work to be performed and revenue to be recognized under written agreements after such dates, was \$37,253,000 and \$13,564,000, respectively. In addition, our training, maintenance and upgrade contracts backlog at February 29, 2008 and February 23, 2007, for work to be performed and revenue to be recognized after such dates under written agreements was \$1,028,000 and \$1,276,000, respectively. Of the February 29, 2008 sales backlog, three product lines each represented at least 10 % of the total backlog: aircrew training systems (\$24,676,000, 64.5%), environmental products (\$4,266,000, 11.1%) and sterilizer products (\$4,128,000, 10.8%). Two international customers in the aircrew training systems line represented \$19,548,000, 79.2%, of the total aircrew training systems backlog.

We expect to complete approximately 70% of the February 29, 2008 sales backlog prior to February 27, 2009, the end of our 2009 fiscal year. Of the February 23, 2007 sales backlog, we completed approximately 69% by February 29, 2008.

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. Awards for any particular project are determined by various factors including the technological requirements of the project, financial stability, reliability, product performance, past performance and price.

Competition for our aeromedical products has increased in recent years. Often there are two main companies that bid on projects for which we submit bids.

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. Most of our competition for environmental products comes from small manufacturers, while the hyperbaric monoplace line has two major competitors.

We believe that we are a significant participant in the markets in which we compete, especially where we have a technical advantage.

Compliance with Environmental Laws

We have not incurred during fiscal 2008, nor do we anticipate incurring during fiscal 2009, 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. We have implemented an Export License Compliance Program which covers all key aspects of the International Traffic in Arms (ITAR), as issued by the U.S. Department of Defense Trade Controls, an arm of the U.S. Department of State. Although most export 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 29, 2008, we had 259 full-time employees, of which four were employed in executive positions, 96 were engineers, engineering designers, or drafts people, 67 were administrative (sales, sales support, accounting, etc.) and clerical personnel, and 92 were engaged principally in production, operations and field support.

Item 1A. Risk Factors

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 29, 2008. These risks and uncertainties include the following items. This list is not inclusive of all the risks and uncertainties associated with our business.

If we are not taken private through the sale transaction proposed by H. F. Lenfest, we will continue to incur the significant costs associated with being a public company and we may need to find additional sources of capital to support our business.

In February 2008, H. F. Lenfest, a member of our Board of Directors and a significant shareholder (“Lenfest”), offered to purchase all of the outstanding shares of our common stock which he did not own. In connection with the offer, the Board of Directors formed a committee comprised of independent directors to evaluate the transaction and make a recommendation to the Board of Directors. The transaction committee has engaged a financial advisor to assist the transaction committee in evaluating the proposal. There can be no assurance that a final agreement will be reached with Lenfest or that, if a final agreement is reached, that we will receive all of the necessary approvals to complete the transaction. If we do not complete the transaction, we will continue to incur the significant costs associated with being a public company and we may need to find additional sources of capital to support our business if Lenfest is unwilling to do so.

We are not in compliance with the listing standards of the American Stock Exchange and may be subject to delisting if we are unable to regain compliance with the applicable listing standards.

Effective with the filing of this Form 10-K for the fiscal year ended February 29, 2008, we have regained compliance with certain listing standards of the American Stock Exchange. We had been out of compliance with the AMEX listing standards as a result of our failure to file certain reports with the SEC. However, as of February 29, 2008, our net equity totaled less than \$6 million. Accordingly, we are not in compliance with Section 1003 of the AMEX Company Guide, which requires listed companies including ETC to have a minimum net equity of \$6 million since we have had losses from operations in our five most recent fiscal years. We are considering what actions we can take, if any, to regain compliance with this listing standard. If we are unable to meet the net equity requirements, it is possible AMEX may initiate delisting proceedings and our common stock may be delisted from trading on the American Stock Exchange. If it were to be delisted, our common stock would be quoted on the Over-The-Counter Bulletin Board if we are current with our SEC reporting obligations and meet the standards for trading on the Over-The-Counter-Bulletin-Board. Otherwise, it is expected that our common stock would be quoted on the Pink Sheets. The trading of our common stock on the Over-The-Counter Bulletin Board or the Pink Sheets will likely have the effect of making purchases and sales more difficult as well as decrease the price of our common stock.

If we cannot identify sufficient funds to operate our business, our results of operations and financial condition would be materially adversely affected.

Since 2003, Lenfest has provided significant funds in the form of subordinated debt, preferred stock, promissory notes, commitments and guarantees which we have used to operate our business. Lenfest has also personally guaranteed our obligations to our commercial lender and has agreed to fund all requests for funds to support our operations through June 30, 2009, on terms and conditions to be mutually agreed upon, provided that we may not request more than \$10 million in financing. Lenfest has agreed, if required, to guarantee our performance under certain contracts. If Lenfest is unable or unwilling to fund our operations and/or guarantee other obligations of ours and we were unable to identify a suitable funding source to replace the financing provided by Lenfest, our results of operations and financial condition would be materially adversely affected.

We continue to 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.

During fiscal 2008, we settled our outstanding litigation with the U.S. Navy and continued our litigation with Disney. Legal and claims costs in fiscal 2008 were approximately \$5.2 million or 34% of total general and administrative spending and 23% of sales. In addition to the actual costs of litigation, including the \$3.55 million paid by us to settle the U. S. Navy matter (See Note 1 — Restatement of Previously Issued Financial Statements in the accompanying Notes to the Consolidated Financial Statements), members of management have devoted, and will continue to devote, significant time and effort to these issues. See Item 3 (Legal Proceedings) for further information on our litigation.

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

During fiscal 2008, we agreed to forgo our recorded \$3.4 claim receivable and pay \$3.55 million to settle our dispute with the U.S. Navy. Also, in our Disney litigation, we have been counter-sued for an amount in excess of \$65 million. While we believe we have valid defenses to Disney's counterclaims and intend to vigorously defend ourselves against these counterclaims, an unfavorable outcome would result in a material adverse effect on our financial position.

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. In fiscal 2008, one customer represented approximately 17% of total sales. In fiscal 2007, we generated approximately 19% of our revenues from sales to one customer. Two customers accounted for 51% of our sales backlog at February 29, 2008. We cannot be certain that our most significant customers at any point in time 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. We may not generate sufficient cash flow from operations, or have future borrowings available to us, sufficient to pay our debt. During fiscal 2008 and 2007, we experienced negative cash flows from operations of approximately \$3.5 million and \$7.0 million, respectively. At May 9, 2008, our total long-term debt was \$19.6 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, future availability under the PNC line of credit and the commitment from Lenfest to fund ETC's operations, will be adequate to meet our future obligations through at least June 30, 2009. 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, that we will be successful in negotiating new financial arrangements, or that any refinancing of debt would be available on commercially reasonable terms.

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 may be required 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;
- 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 potential use of cash; and

- currently our debt bears interest rates which are fixed for short periods of time. However, interest rates on this debt are subject to adjustment at various times based on market conditions and thus will vary with the prime rate of interest. Additionally, it is expected that any additional debt which we might incur would carry a floating rate. If this were the case, any increases in the applicable prime rate of interest would reduce our earnings.

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 have introduced a new business model in one of our divisions. If customers do not purchase these services from us, our business will suffer.

In a major re-engineering of our aeromedical business, we have shifted our business model from primarily relying on producing aeromedical products to a combination of equipment contracts and providing both tactical combat flight training and G-force instruction. In fiscal 2008, we opened the National Aerospace Training and Research Center. This center is an integrated pilot training center offering a complete range of aviation training and research support for military jet pilots and civil aviation as well as space travel and tourism. We have invested and continue to invest a significant amount of capital and resources in creating the NASTAR Center and we cannot be certain that we will generate enough training revenues to recoup the major investment we have made.

We cannot be certain that we will be successful in this new approach of marketing training services. If we are unsuccessful in selling our services, our business will suffer.

We need to attain validation from the U.S. defense agencies of our Authentic Tactical Fighting Systems technology.

A challenging issue for our ATFS technology has been marketing this technology to the world's defense agencies. This is a new technology that goes contrary to conventional training belief that tactical flight and combat skills can only be learned in a flying aircraft. During fiscal 2008 we received awards from the U.S. Navy and the U.S. Air Force to develop Tactical Aircraft Configuration Modules (TacModules) to support research in our ATFS high performance human centrifuge. The ultimate goal is validation of this technology and its applicability to supplant flight training with ground based simulation. At this point we cannot be certain that we will be able to overcome the conventional thinking on training nor achieve an acceptable level of validation with respect to the applicability and efficacy of ATFS training.

Our operations involve rapidly evolving products and technological change.

The rapid change of technology is a key feature of most 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 be assured 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, under the percentage of completion ("POC") accounting method, due to timing differences 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 29, 2008, this asset totaled \$3.4 million. Although a significant portion of these costs have been billed and collected since fiscal year-end, we cannot bill additional amounts unless and until we meet certain contractual milestones related to the production, delivery and integration of our products. Typically, there will be a lag ranging from six to twenty-four 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, which may have an adverse impact on our business.

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

Historically, we have provided our products and services primarily through fixed-price contracts. Fixed-price contracts provided approximately 86% of our sales for the fiscal year ended February 29, 2008 and 92% of our sales for the fiscal year ended February 23, 2007. 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 reduce our profitability and may cause us to incur a loss on the project.

Our contracts and subcontracts that are funded by the U.S. Government or foreign governments are subject to government regulations, 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. During fiscal 2008, we agreed to settle a matter with the U.S. Navy by forgoing our claim for additional payment (a reserve for \$3.0 million was recorded for this matter in fiscal 2007) and agreeing to pay \$3.55 million. Additionally, we received a notice of suspension from the U. S. Navy in October 2007 which rendered us ineligible to solicit or receive additional government contracts. The suspension was lifted in December 2007.

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 be able to compete successfully in these markets. Most of our commercial contracts contain fixed pricing which 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 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.

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 33% of our sales in fiscal 2008 and 62% of our sales in fiscal 2007. 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;
- currency exchange rate fluctuations;
- a longer and more complicated collections cycle;
- a high degree of corruption in some countries;
- 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 which originate from ETC-Southampton are denominated in U.S. dollars. Except for intercompany work, and contracts with U.S. based companies, most of our contracts which originate from ETC-PZL are in Polish Zlotys.

Since most of our production and administrative costs are based in U.S. dollars, the continued weakening of the U.S. dollar currency versus other international currencies may make our pricing un-competitive when compared to foreign local in-country competitors.

Although we may be exposed to currency fluctuations, we are not engaged in any material foreign currency hedging activities to offset this risk. With respect to currency risk, where we have a large on-going 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, banking requirements, 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 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. These and other costs of operating as a public company totaled approximately \$1.2 million in fiscal 2008. We anticipate that public company costs will continue to constitute a significant portion of our general and administrative spending for so long as our stock is publicly traded. Although we have not experienced any director and officer liability claims, these premiums are a significant part of our business insurance premiums and may increase as a result of the (i) high claims rates insurers have incurred with other companies over the past years (ii) the high stock ownership position of some of our non-affiliated shareholders, and (iii) our reduced operating performance. All of these increased costs have had and will continue to have a material adverse effect on our operating results.

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

As stated above, international sales accounted for 33% and 62% of our revenues for fiscal years 2008 and 2007, respectively. 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 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 on the American Stock Exchange during fiscal 2008 was 8,053 shares; on the consolidated markets (which includes shares traded on the American Stock Exchange), the average daily volume was 13,670 shares. This limited trading activity may make it 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. In the event that our common stock is delisted from the American Stock Exchange, it may be more difficult to buy and sell 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 currently 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 a significant 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;
- 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;
- the mix of contracts (POC versus other);
- 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 receivable, inventory and other 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 our 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 15, 2008, our directors and executive officers own an aggregate of approximately 57% on a fully converted basis of our outstanding common stock. Accordingly, our directors and executive officers, 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 92,000 square foot steel and masonry building. Approximately 64,000 square feet of the building is devoted to manufacturing, our NASTAR training center occupies approximately 22,000 square feet, and approximately 5,000 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. Additionally, we rent office space at various sales and support locations throughout the world and in Warsaw, Poland 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

U.S. Navy

In May 2003, the Company filed a certified claim with the Department of the Navy (the “Government”) seeking costs totaling in excess of \$5.0 million in connection with a contract for submarine rescue decompression chambers. On July 22, 2004, the Navy’s contracting officer issued a final decision denying the claim in full. In July 2005, the Company converted this claim into a complaint which the Company filed in the United States Court of Federal Claims. On June 14, 2007, the Government amended its filings to add counterclaims pursuant to the anti-fraud provisions of the Contract Disputes Act, the False Claims Act, and the forfeiture statute. On June 27, 2007, the Company and the Government filed a Joint Motion to Dismiss with prejudice all of the Company’s claims against the Government, which motion was granted on June 28, 2007. Additionally, the Company agreed to pay to the Government \$3.55 million (\$3.3 million recorded in the first quarter of fiscal 2008 and \$250,000 recorded in the second quarter of fiscal 2008) and transfer the submarine rescue decompression chambers to the Navy. In February 2008, the Government approved the settlement. As of May 14, 2008, the Company has made all payments required under this settlement agreement and has delivered the chambers to the Navy.

On October 2, 2007, the Company was suspended by the Department of the Navy from soliciting work for the federal government pursuant to the Federal Acquisition Regulation. Effective December 12, 2007, the Department of the Navy lifted the Company’s suspension pursuant to the execution by the Company and the Department of the Navy of an Administrative Agreement. In accordance with the Administrative Agreement, the Company has established and implemented a program of compliance reviews, audits and reports. See Note 1 — Restatement of Previously Issued Financial Statements in the accompanying Notes to the Consolidated Financial Statements.

Walt Disney World Co.

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 a 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 ETC (under a guarantee) for, among other things, alleged failures in performance and design in the contract. Disney alleges damages ranging from \$36 million to \$65 million plus punitive damages (collectively, the “2003 Litigation”). In December 2005, EnTCo filed a second lawsuit against Disney, alleging breach of confidentiality and unfair trade practices (the “2005 Litigation”). The 2003 Litigation has been stayed until the 2005 Litigation is ready for trial. We believe that we have valid defenses to the counterclaims asserted by Disney in the 2003 Litigation. We are not able to predict the outcome of the 2003 Litigation. On March 26, 2008, the Court granted summary judgment in favor of Disney and against the Company and dismissed the Company’s claim in the 2005 Litigation. On April 7, 2008, the Company filed a motion for reconsideration asking the Court to reconsider its March 2008 decision in the 2005 Litigation. The motion for reconsideration had not been decided as of the filing date of this Annual Report on Form 10-K.

Other Matters

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 2008.

PART II

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

On April 7, 2006, ETC entered into a Preferred Stock Purchase Agreement (the "Lenfest Equity Agreement") with Lenfest. The Lenfest Equity Agreement, which was to end on October 6, 2007, permitted us to unilaterally draw down up to \$15 million in exchange for shares of our newly created Series B Cumulative Convertible Participating Preferred Stock ("Series B Preferred Stock"). The Series B Preferred Stock provides for a dividend equal to six percent per annum. After three years, the Series B Preferred Stock will be convertible, at Lenfest's request, into ETC common shares at a conversion price (the "Conversion Price") which will be set on the day of each draw down. The Conversion Price was equal to the closing price of our common stock on the trading day immediately preceding the day in which the draw down occurs, subject to a floor price of \$4.95 per common share. Drawdowns were not permitted on any day when the Conversion Price was less than this floor price. On the sixth anniversary of the Lenfest Equity Agreement, any issued and outstanding Series B Preferred Stock will be mandatorily converted into ETC common stock at each set Conversion Price. The Lenfest Equity Agreement also allows us to redeem any outstanding Series B Preferred Stock any time within its six-year term of the Lenfest Equity Agreement. Any issued and outstanding Series B Preferred Stock will vote with the ETC common stock on an as converted basis. The Lenfest Equity Agreement was terminated on July 31, 2007 upon execution of the credit agreement with PNC Bank (see following).

In connection with the execution of the Lenfest Equity Agreement, in April 2006 we drew down \$3 million by issuing 3,000 shares of Series B Preferred Stock with a Conversion Price equal to \$4.95 per share. Additionally, on July 31, 2006, we drew down an additional \$3 million by issuing 3,000 shares of Series B Preferred Stock at a conversion price equal to \$6.68 per common share. In each instance, the proceeds were used for general corporate purposes.

On August 23, 2007, the Company entered into the Series C Preferred Stock Purchase Agreement (the "Series C Purchase Agreement") with Lenfest, pursuant to which, among other things, ETC issued and sold 3,300 shares of its newly-created class of Series C Cumulative Convertible Participating Preferred Stock ("Series C Preferred Stock") to Lenfest for \$3,300,000. The proceeds from the issuance of the Series C Preferred Stock were restricted solely for use to partially fund a settlement with the U.S. Navy. The proceeds are presented in the accompanying Consolidated Balance Sheets as Restricted Cash.

The Series C Preferred Stock is convertible by Lenfest at any time into shares of ETC's common stock at a conversion price of \$3.03 per share based on the closing price for ETC's common stock on August 22, 2007, the trading day immediately prior to the issuance. The Series C Preferred Stock votes with ETC's common stock on an as-converted basis and is fully convertible into 1,089,108 shares of ETC common stock. The Series C Preferred Stock automatically converts into ETC common shares on the fifth anniversary of the Acquisition. It carries an annual dividend rate of ten percent (10%).

ETC granted Lenfest certain demand and "piggy back" registration rights pursuant to a Registration Rights Agreement with respect to the shares of common stock issuable upon conversion of the Series C Preferred Stock.

In connection with Lenfest's investment in the Series C Preferred Stock, ETC agreed to amend the terms of the Series B Preferred Stock to (i) increase the annual dividend rate to 10%, (ii) provide for immediate conversion into common stock at the option of Lenfest, and (iii) to remove ETC's right to redeem the Series B Preferred Stock.

In connection with the restatement of the Company's previously issued financial statements for the year ended February 23, 2007, the Company has reclassified the Series B and C Preferred Stock (the "instruments") from equity to mezzanine. The reclassification is due to the preferential redemption feature of the instruments, which provides that a change in ownership would result in a forced liquidation. A forced liquidation is considered outside the control of the Company. Therefore, the preferential treatment upon an act outside the control of the Company precluded equity treatment under the Securities and Exchange Commission Accounting Series Release ("ASR") 268 and Topic D98. Prior year's financial statements have been adjusted to reflect this change.

On March 11, 2008, ETC entered into Amendment No. 1 to Convertible Note and Warrant Purchase Agreement (the "Purchase Agreement Amendment") and First Amendment to Senior Subordinated Convertible Note (the "Note Amendment") with Lenfest with respect to that certain Convertible Note and Warrant Purchase Agreement, dated as of February 18, 2003, by and between ETC and Lenfest (the "Convertible Note and Warrant Purchase Agreement"). Under the terms of the Purchase Agreement Amendment, ETC and Lenfest agreed to amend the financial covenants set forth in the Convertible Note and Warrant Purchase Agreement so that they are the same as the financial covenants contained in ETC's credit agreement with PNC, dated as of July 31, 2007. Under the terms of the Note Amendment, the maturity date of the convertible promissory note in the principal amount of \$10,000,000 issued by ETC to Lenfest pursuant to the Convertible Note and Warrant Purchase Agreement was extended from February 18, 2009 to March 1, 2010. The effective date of the Purchase Agreement Amendment and the Note Amendment is February 19, 2008.

Our common stock is traded on the American Stock Exchange under the symbol "ETC." As of May 13, 2008, the Company had 287 shareholders of record.

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

	Sale Prices	
	High	Low
Fiscal 2008		
First Quarter	\$ 4.78	\$ 3.26
Second Quarter	3.29	2.21
Third Quarter	3.94	2.15
Fourth Quarter	2.50	1.50
Fiscal 2007		
First Quarter	\$ 5.54	\$ 4.60
Second Quarter	7.39	5.16
Third Quarter	6.39	4.71
Fourth Quarter	4.86	3.19

On May 19, 2008, the closing price of our common stock was \$2.28. We have never paid any cash dividends on our common stock and do not anticipate that any cash dividends will be declared or paid in the foreseeable future. Our current subordinated debt agreement with Lenfest prohibits the payment of any dividends without Lenfest's prior written consent.

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 8. Financial Statements and Supplementary Data

See the information appearing under the headings "Consolidated Financial Statements" and "Notes to the 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

On November 28, 2007, Grant Thornton LLP ("Grant"), the independent registered public accounting firm for the Company, resigned. In connection with its resignation, Grant advised the Audit Committee of the Company's Board of Directors ("Audit Committee") that the reason for its resignation is that information has come to Grant's attention that has led it to no longer be able to rely on management's representations and has made it unwilling to be associated with the financial statements prepared by management. In July 2007, the Audit Committee commenced an internal investigation after the Company was notified in June 2007 of the Department of the Navy's counterclaims related to the Company's claim in connection with the contract for its submarine rescue decompression project. In November 2007, the Audit Committee and its counsel informed Grant of certain results of that investigation.

On January 30, 2008, the Company's Audit Committee engaged Friedman LLP as the Company's registered public accounting firm.

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Control and Procedures

As of the end of the period covered by this report, the Company's management conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

(b) Management's Assessment of ETC's Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control — Integrated Framework*, our management concluded that our internal control over financial reporting was not effective as of February 29, 2008 and we do not expect to have all of our material weaknesses corrected until August 29, 2008, which is the end of the Company's second quarter of fiscal 2009.

Material Weaknesses

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected in a timely basis.

Management identified the following material weaknesses in the Company's internal control over financial reporting:

- The Company did not file its Quarterly Reports on Form 10-Q for the quarters ended May 23, 2007, August 24, 2007 and November 23, 2007 on a timely basis.
- Management had a lack of expertise in accounting for complex transactions.
- The Company lacked an independent review of the accounting records.
- Management exhibited a lack of training in compliance with government contracts.

Remediation of Material Weaknesses

On December 12, 2007 the Company entered into an Administrative Agreement with the Department of the Navy. This agreement includes a program of compliance reviews, audits and reports. As part of the agreement, key personnel will receive training in acceptable government contracting practices and procedures.

On February 22, 2008, the Company and the U.S. Navy finalized a settlement agreement which concluded all open matters related to the Company's claim with the U.S. Navy.

On May 29, 2008 the Company filed contemporaneously with the Annual Report on Form 10-K the previously not filed Quarterly Reports on Form 10-Q for the fiscal quarters ended May 23, 2007, August 24, 2007 and November 23, 2007.

Additional highly skilled staff has been hired in the Company's accounting department.

Should additional control deficiencies or material weaknesses be identified, they may have an adverse impact on our business and results of operations or our ability to timely make required SEC filings in the future.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

(c) Changes in Internal Control Over Financial Reporting.

Other than to address the material weaknesses discussed above, there was no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably to materially affect, our internal control over financial reporting.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the internal control system are met. Because of the inherent limitations of any internal control system, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected.

PART III

Item 10. Directors and Executive Officers of the Registrant

The following table sets forth certain information, as of May 13, 2008, with respect to our directors and executive officers:

Name	Age	Served as Director or Officer Since (1)	Positions and Offices
William F. Mitchell (2)	66	1969	Chairman of the Board, President and Director
Howard W. Kelley (3)	66	2002	Director
George K. Anderson, M.D. (4)	62	2003	Director
H.F. Lenfest (5)	78	2003	Director
Alan M. Gemmill (6)	61	2006	Director
Duane D. Deaner (7)	60	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) Mr. Kelley recently retired as 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 remains a director of this company. Mr. Kelly is also director of American Electric Technologies, Inc. (NASDAQ: AETI). AETI is a Houston, Texas-based manufacturer of power delivery equipment for traditional and alternative energy industries. He is also currently president of Aspergantis LLC, a technology and Internet services and consulting company. 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.
- (4) Dr. Anderson is an experienced physician executive. He served in the Air Force as a flight surgeon, aerospace medicine staff officer, and commander of several medical organizations in Korea, Germany, and United States. He retired from active duty in the grade of Major General. Following his thirty years of military service, he transitioned to executive positions in the private sector. He served as Chief Executive Officer of the Koop Foundation from 1997 to 1998 and as Chief Executive Officer at Oceania, Inc., a medical software company, from 1999 to 2001. A period of practice as an independent medical technology consultant was followed by his current role as Executive Director of the Association of Military Surgeons of the United States (AMSUS). AMSUS, the nonprofit Society of the Federal Health agencies, operates from a headquarters located in Bethesda, Maryland.
- (5) 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 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. Mr. Lenfest is the owner of various other businesses and is active in many philanthropic activities including as Chairman of the Board of the Philadelphia

Museum of Art, the Curtis Institute, and the Lenfest Foundation. Mr. Lenfest is a graduate of Washington and Lee University and Columbia Law School.

- (6) Mr. Gemmill is a retired U.S. Navy Rear Admiral. He graduated from the University of Arizona with a B.S. in Aerospace Engineering and began his flying career flying F-4 Phantoms. He graduated first in his class from U.S. Naval Test Pilot School in Patuxent River, Maryland in 1974. After a stint as a test pilot and test pilot instructor, Mr. Gemmill then served numerous positions in Fighter Squadrons including command of F-14 Fighter Squadron 32. He commanded USS San Jose during two deployments to the Arabian Gulf during Desert Shield and Desert Storm, and then commanded the nuclear aircraft carrier USS DWIGHT D EISENHOWER. From 1995 through 1999, he served as Deputy for Readiness and then for Operations for the U.S. Pacific Command and later as Assistant Deputy Chief of Staff for Aviation, U.S. Marine Corps. His last assignment in the Navy was as Head, Aircraft Carriers Program and Head, Naval Aviation Training. Rear Admiral Gemmill has almost 4,000 flight hours and 1,000 carrier landings. He has a Master of Science in Systems Management from the University of Southern California. He is currently Director, Defense Business Services for Bearing Point of McLean, VA.
- (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 29, 2008, the Board of Directors held five meetings. All members of the Board of Directors attended all of the Board meetings.

We have three Board Committees: Audit, Compensation and Governance and Nominating. The members of each committee are identified in the following table and each committee and its function is described below.

Name of Director	Independent	Audit	Compensation	Governance and Nominating
Howard W. Kelley	Yes	Chair	X	X
Dr. George K. Anderson	Yes	X	X	Chair
Alan Mark Gemmill	Yes	X	Chair	X
Number of Meetings Held in Fiscal Year		22	5	5

During the fiscal year ended February 29, 2008, we had an Audit Committee consisting of Messrs. Kelley and Gemmill and Dr. 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. 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 and Gemmill and Dr. Anderson also served on our Compensation Committee during the year ended February 29, 2008, with Mr. Gemmill serving as Chairman. The Compensation Committee is charged with reviewing the compensation and incentive plans of officers and key personnel.

Messrs. Kelley and Gemmill and Dr. Anderson also served on our Nominating and Governance Committee during the year ended February 29, 2008, 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.

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. 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.

Administrative Agreement

On December 12, 2007, the Company entered into an Administrative Agreement with the United States Navy in conjunction with the lifting of a contracting suspension. This agreement includes a program of compliance reviews, audits and reports. See Note 1 — Restatement of Previously Issued Financial Statements in the accompanying Notes to the Consolidated Financial Statements.

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 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 we disclose “late filings” of Section 16(a) reports.

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, Mr. Lenfest had one late filing which resulted from an administrative error. We believe that our greater than ten percent beneficial owners complied with all applicable filing requirements.

Item 11. Executive Compensation

COMPENSATION DISCUSSION AND ANALYSIS

Objectives and Philosophy of Executive Compensation

ETC's executive compensation program is administered by the Compensation Committee of the Board of Directors. The Compensation Committee is composed of Alan M. Gemmill who serves as Chairman, George K. Anderson, M.D., MPH, and Howard W. Kelley, each of whom is independent under the relevant rules of the Securities and Exchange Commission and American Stock Exchange. The Compensation Committee is responsible for developing and implementing an executive compensation program that takes into account ETC's business strategy, the need for highly qualified management and other relevant factors. The executive compensation program is structured to link executive compensation to the overall performance of ETC to more closely align the interests of the executive management team with the interests of ETC's shareholders.

The Compensation Committee's philosophy in establishing its compensation policies is to maximize the possibilities for enhancing shareholder value by closely aligning compensation for ETC's executive officers with the profitability of ETC. In this regard, it is considered essential to the success of ETC that its compensation policies enable ETC to attract, retain and satisfactorily reward executive officers who are contributing to the long-term growth and success of ETC. William F. Mitchell, President and Chief Executive Officer, and Duane D. Deaner, Chief Financial Officer, are ETC's Named Executive Officers under applicable Securities and Exchange Commission regulations.

Primary Components of Executive Compensation

In 2004, the Board of Directors adopted and approved a Compensation Committee Charter which sets forth the principles and policies followed by the Compensation Committee in connection with executive compensation. A copy of ETC's Compensation Charter is available on ETC's corporate website (<http://www.etcusa.com>).

The primary components of ETC's executive compensation program consist of base salary, annual cash bonus incentive opportunities and long-term incentive opportunities in the form of options to acquire common stock.

Base Salary

Base salary levels for ETC's executive officers are set at or below the average base salary levels paid by other companies within ETC's peer group. William F. Mitchell, President and Chief Executive Officer, received a base salary of \$225,000 in the 2008 fiscal year. Duane D. Deaner, Chief Financial Officer, received a base salary of \$102,000 in the 2008 fiscal year. The Compensation Committee has responsibility for setting Mr. Mitchell's base salary and approved Mr. Mitchell's employment agreement at the time it was entered into. Mr. Mitchell has responsibility for setting the base salary of the other officers and employees, including the base salary of Mr. Deaner.

Short-term Incentive Compensation

Based on the Compensation Committee's review of ETC's performance for the fiscal year ended February 29, 2008, and the performance of its management team, no discretionary cash incentive compensation awards were made to any officers or key employees for overall Company performance.

During the fiscal year ended February 29, 2008, certain key employees, including Mr. Deaner, were given the opportunity to earn additional compensation of up to approximately 10% of their base salary by completing specific annual objectives tailored to their individual areas of responsibility. Under this program, in fiscal 2008 a total of \$6,375 was paid to four key employees, including \$1,500 paid to Mr. Deaner. This program must be re-authorized on an annual basis and is subject to cancellation at any time.

Long-Term Incentive Compensation

ETC's 1998 Incentive Stock Option Plan is a long-term plan designed not only to provide incentives to management, but also to align a significant portion of the executive compensation program with shareholder interests. The 1998 Incentive Stock Option Plan permits ETC to grant certain officers and employees a right to purchase shares of stock at the fair market value per share at the date the option is granted. No options were granted to executive officers and employees in fiscal 2008. In granting stock options to officers and employees, the Compensation Committee takes into account ETC's financial performance, its long-term strategic goal of increasing shareholder value, the employee's level of responsibility and his continuing contributions to ETC. The amount of the award to any

employee is based on the employee's base salary and the total award for any employee is limited to one percent (1%) of total outstanding shares on award date. Mr. Mitchell has never received any options to purchase shares of ETC's common stock under this program.

Option Grant Date Pricing

The Compensation Committee administers ETC's 1998 Incentive Stock Option Plan. Mr. Mitchell makes recommendations with respect to option grants but all other determinations to award options to purchase ETC's common stock are made by the Compensation Committee and in all instances the exercise price is equal to ETC's stock price on the date the Compensation Committee approves such option grants.

Given the relatively low amount of option grants made by ETC (no options were awarded in fiscal 2008), the Compensation Committee does not actively attempt to coordinate option grants based on the presence or absence of material non-public information.

Chief Executive Officer Employment Agreement

On July 24, 2006, ETC entered into an employment agreement with William F. Mitchell pursuant to which Mr. Mitchell is employed as the President and Chief Executive Officer. Mr. Mitchell has been the Chairman of the Board, President and Chief Executive Officer of ETC since 1969, except for the period from January 24, 1986 to January 24, 1987 during which he was engaged principally in soliciting sales for ETC's products in the overseas market. Under Mr. Mitchell's employment agreement, he is entitled to receive a base salary of \$225,000, which is subject to increase annually based on a review of Mr. Mitchell's performance by ETC's Board of Directors. Mr. Mitchell is also entitled to receive a bonus based on a formula and targets set forth in the CEO Plan.

The term of the employment agreement is three years, and, if ETC does not renew the employment agreement for additional three-year periods, Mr. Mitchell is entitled to terminate the employment agreement and receive certain benefits under the terms of the employment agreement including, without limitation, three years of base salary, bonuses and participation in various benefit plans. The employment agreement also provides Mr. Mitchell with three years of base salary, bonuses, and participation in various benefit plans of ETC if his employment is terminated due to a disability, by ETC without cause, or if Mr. Mitchell terminates his employment with ETC for good reason, including a change in control of ETC, each as defined in the employment agreement.

Chief Financial Officer Employment Agreement

On November 1, 2005, ETC entered into an employment agreement with Duane D. Deaner pursuant to which Mr. Deaner continues to be employed as the Chief Financial Officer. Mr. Deaner has been the Chief Financial Officer of ETC since 1996. Under Mr. Deaner's employment agreement, he is entitled to receive a base salary of \$102,000, which is subject to increase annually based on a review of his performance. Mr. Deaner is also entitled to receive a bonus based on specific annual objectives tailored to his individual area of responsibility.

The original term of the employment agreement was two years and has been renewed. If ETC does not renew the employment agreement for additional two-year periods, Mr. Deaner is entitled to terminate the employment agreement and receive certain benefits under the terms of the employment agreement including, without limitation, two years of base salary, bonuses and participation in various benefit plans. The employment agreement also provides Mr. Deaner with two years of base salary, bonuses, and participation in various benefit plans of ETC if his employment is terminated due to a disability, by ETC without cause, or if Mr. Deaner terminates his employment with ETC for good reason, including a change in control of ETC, each as defined in his employment agreement.

SUMMARY COMPENSATION TABLE

The following Summary Compensation Table sets forth the compensation of our Named Executive Officers for the fiscal years ended February 29, 2008 and February 23, 2007.

Name and Principal Position (a)	Year (b)	Salary (c)	Bonus (d)	Stock Awards (e)	Option Awards (f)	Non-Equity Incentive Plan Compensation (g)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (h)	All Other Compensation (i)	Total (j)
William F. Mitchell ¹ Chairman of the Board, Chief Executive Officer, President and Director	2008	\$225,000	—	—	—	—	—	\$ 69,000 ²	\$294,000
	2007	\$225,000						\$ 75,000 ³	\$ 300,000
Duane D. Deaner ⁴ Chief Financial Officer	2008	\$ 102,000	\$ 1,500	—	—	—	—	\$ 3,000 ⁵	\$ 107,000
	2007	\$ 98,000	\$ 6,000					\$ 3,000 ⁶	\$ 107,000

The elements of the Summary Compensation Table are discussed in the Compensation Discussion and Analysis above.

- ¹ ETC is party to an employment agreement with Mr. Mitchell, pursuant to which Mr. Mitchell serves as President and Chief Executive Officer. The terms and conditions of Mr. Mitchell's employment agreement is summarized above under "Primary Components of Executive Compensation-Chief Executive Officer Employment Agreement."
- ² Consists of \$54,000 paid to Mr. Mitchell in connection with ETC's use of Mr. Mitchell's properties, \$6,000 in automobile allowance payments for Mr. Mitchell's company automobile, \$6,000 in life insurance premium payments and \$3,000 contribution on behalf of Mr. Mitchell pursuant to ETC's Retirement Savings Plan.
- ³ Consists of \$60,000 paid to Mr. Mitchell in connection with ETC's use of Mr. Mitchell's properties, \$6,000 in automobile allowance payments for Mr. Mitchell's company automobile, \$6,000 in life insurance premium payments and \$3,000 contribution on behalf of Mr. Mitchell pursuant to ETC's Retirement Savings Plan.
- ⁴ ETC is a party to an employment agreement with Mr. Deaner, pursuant to which Mr. Deaner serves as Chief Financial Officer. The terms and conditions of Mr. Deaner's employment agreement is summarized above under "Primary Components of Executive Compensation-Chief Financial Officer Employment Agreement."
- ⁵ Consists of ETC's contribution on behalf of Mr. Deaner pursuant to ETC's Retirement Savings Plan.
- ⁶ Consists of ETC's contribution on behalf of Mr. Deaner pursuant to ETC's Retirement Savings Plan.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

This table summarizes the equity awards held by our Named Executive Officers as of February 29, 2008.

Name (a)	Number of Securities Underlying Unexercised Options (#) Exercisable (b)	Number of Securities Underlying Unexercised Options (#) Unexercisable (c)	Option Exercise Price (\$) (e)	Option Expiration Date (f)
William F. Mitchell Chairman of the Board, Chief Executive Officer, President and Director	—	—	—	—
Duane D. Deaner Chief Financial Officer	10,000 2,881 5,233 321	— — 1,745 321	\$ 7.81 \$ 7.375 \$ 7.24 \$ 6.07	2/25/09 1/03/11 9/15/14 9/21/16

Potential Payments Upon Termination or Change-In-Control

As discussed in the Compensation Discussion and Analysis above, we entered into an employment contract with Mr. Mitchell, our Chief Executive Officer, on July 24, 2006, which provides Mr. Mitchell with three years of base salary, bonuses and participation in various benefit plans of ETC if his employment is terminated due to a disability, by ETC without cause, or if Mr. Mitchell terminates his employment with ETC for good reason, including a change in control of ETC, each as defined in his employment agreement. If ETC were to complete a transaction pursuant to which Lenfest purchases all of the common stock of ETC not currently owned by Lenfest, the change in control provision would be triggered.

Also, as discussed in the Compensation Discussion and Analysis above, we entered into an employment contract with Mr. Deaner, our Chief Financial Officer, on November 1, 2005, which provides Mr. Deaner with two years of base salary, bonuses and participation in various benefit plans of ETC if his employment is terminated due to a disability, by ETC without cause, or if Mr. Deaner terminates his employment with ETC for good reason, including a change in control of ETC, each as defined in his employment agreement. If ETC were to complete a transaction pursuant to which Lenfest purchases all of the common stock of ETC not currently owned by Lenfest, the change in control provision would be triggered.

Compensation of Directors

During fiscal 2008, 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. Additionally, under a plan approved by our shareholders at the 2005 Annual Meeting of Shareholders, non-employee directors may be awarded options to purchase common stock of the Company at fair market value. Pursuant to this plan, in February 2006, awards to purchase common stock were given as follows: Dr. Anderson, 50,000 options; Mr. Kelley, 25,000 options; and Mr. Gemmill, 5,000 options. No options were awarded to our directors in fiscal 2007 or fiscal 2008.

FISCAL 2008 DIRECTOR COMPENSATION TABLE

Name (a)	Fees Earned or Paid in Cash (\$) (b)	Stock Awards (\$) ⁷ (c)	Option Awards (\$) (d)	Non-Equity Incentive Plan Compensation (\$) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$) (f)	All Other Compensation (\$) (g)	Total (\$) (h)
William F. Mitchell ⁸	—	—	—	—	—	—	—
George K. Anderson, M.D. ⁹	\$ 8,000	—	—	—	—	—	\$ 8,000
Alan M. Gemmill ¹⁰	\$ 8,000	—	—	—	—	—	\$ 8,000
Howard W. Kelley ¹¹	—	\$ 8,000	—	—	—	—	\$ 8,000
H. F. Lenfest ¹²	—	\$ 8,000	—	—	—	—	\$ 8,000

⁷ ETC used the closing price of its common stock on the date of grant as reported on the American Stock Exchange to compute the value of these awards.

⁸ Mr. Mitchell did not hold any options to purchase shares of our common stock as of February 29, 2008.

⁹ Dr. Anderson held options to purchase an aggregate of 50,000 shares of our common stock as of February 29, 2008

¹⁰ Mr. Gemmill held options to purchase an aggregate of 5,000 shares of our common stock as of February 29, 2008.

¹¹ Mr. Kelley held options to purchase an aggregate of 25,000 shares of our common stock as of February 29, 2008.

¹² Mr. Lenfest did not hold any options to purchase shares of our common stock as of February 29, 2008.

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

The following table sets forth, as of May 13, 2008, 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	1,068,375(3)	11.8%
Howard W. Kelley (4) c/o Aspergantis LLC 3249 St. Johns Avenue Jacksonville, FL 32205	33,168(5)	*
George K. Anderson, M.D. (4) 8 Little Harbor Way Annapolis, MD 21403	51,100(6)	1.0%
H.F. Lenfest (4) c/o The Lenfest Group Fire Tower Bridge-Suite 460 300 Barr Harbor Drive West Conshohocken, PA 19428	6,332,900(7)	48.7%
Alan M. Gemmill (4) 941 Upper Hastings Way Virginia Beach, VA 23452	5,200(8)	*
T. Todd Martin, III 50 Midtown Park East Mobile, AL 36606	999,592(9)	11.1%
Emerald Advisors, Inc. 1703 Oregon Pike Suite 101 Lancaster, PA 17601	725,998(10)	8.0%
Pete L. Stephens, M.D. 31 Ribaut Drive Hilton Head Island, SC 29926	653,723(11)	7.2%
All directors and executive officers as a group (6 persons)	7,509,178(12)	57.3%

* 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, Chief Executive Officer and Director of the Corporation.
- (3) Includes 45,200 shares of common stock held by Mr. Mitchell's wife.
- (4) Director of the Company.

- (5) Includes 25,000 shares of common stock which may be acquired upon the exercise of options granted under our Non-Employee Director Stock Option Plan that are presently exercisable.
- (6) Includes 50,000 shares of common stock which may be acquired upon the exercise of options granted under our Non-Employee Director Stock Option Plan that are presently exercisable.
- (7) Includes 1,818,181 shares of common stock issuable upon conversion of a promissory note in the principal amount of \$10,000,000, 606,060 shares of common stock issuable upon conversion of 3,000 shares of Series B Preferred Stock issued on April 6, 2006, 449,101 shares of common stock issuable upon conversion of 3,000 shares of Series B Preferred Stock issued on July 31, 2006, and 1,089,108 shares of common stock issuable upon conversion of 3,300 shares of Series C Preferred Stock issued on August 23, 2007.
- (8) Includes 5,000 shares of common stock which may be acquired upon the exercise of options granted under our Non-Employee Director Stock Option Plan that are presently exercisable.
- (9) Includes 938,692 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 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, 7,000 shares owned by trusts of which Mr. Martin is trustee, and 10,000 shares owned by Perdido Investors, LLC, of which Mr. Martin is the manager.
- (10) Emerald Advisors, Inc., has sole voting power with respect to 193,833 shares of common stock and sole dispositive power over 592,926 shares of common stock.
- (11) Includes 638,023 shares of common stock held jointly with Dr. Stephens’ wife and 15,700 shares of common stock held by Dr. Stephens’ children.
- (12) Includes 80,000 shares of common stock which may be acquired by members of the Board of Directors upon the exercise of options granted under our Non-Employee Director Stock Option Plan that are presently exercisable, 1,818,181 shares of common stock issuable upon conversion of a promissory note in the principal amount of \$10,000,000, 606,060 shares of common stock issuable upon conversion of 3,000 shares of Preferred Stock issued on April 6, 2006, 449,101 shares of common stock issuable upon conversion of 3,000 shares of Preferred Stock issued on July 31, 2006, and 1,089,108 shares of common stock issuable upon conversion of 3,300 shares of Preferred Stock issued on August 23, 2007, all of which may be acquired by Mr. Lenfest, and 18,435 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.

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 and Director Independence

On February 19, 2003, ETC completed a refinancing of its indebtedness with the PNC Bank, National Association and 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 ETC and Lenfest, ETC issued to 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 common stock. As a condition to closing the financing, ETC appointed Lenfest to its Board of Directors. On October 25, 2004, Lenfest executed a Limited Guaranty Agreement which guaranteed ETC’s \$5 million Letter of Credit facility with PNC, and in connection therewith, ETC issued a Stock Purchase Warrant to Lenfest pursuant to which Lenfest was entitled to purchase up to 200,000 shares of 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 of common stock during the 25 day trading period immediately preceding the date of exercise. On February 14, 2005 Lenfest exercised all of his outstanding warrants and received 1,003,048 shares of unregistered common stock and purchased an additional 373,831 shares of unregistered common stock for approximately \$2 million. Shareholder approval of this transaction was received at ETC’s 2005 annual meeting.

On April 6, 2006, ETC entered into a Preferred Stock Purchase Agreement (the “Lenfest Equity Agreement”) with Lenfest. The Lenfest Equity Agreement permitted ETC to unilaterally draw down up to \$15 million in exchange for shares of Series B Cumulative Convertible Preferred Stock (“Series B Preferred Stock”). The Series B Preferred Stock provides for a dividend equal to six percent per annum. After three years, the Series B Preferred Stock will be convertible, at Lenfest’s request, into ETC common shares at the conversion price set on the day of each draw down. The conversion price equaled the closing price of ETC’s common stock on the trading day immediately preceding the day in which the draw down occurred, subject to a floor price of \$4.95 per common share. On the sixth anniversary of the Lenfest Equity Agreement, any issued and outstanding Series B Preferred Stock will be mandatorily converted into ETC common stock at each set conversion price. The Series B Preferred Stock will vote with the ETC common stock on an as converted basis. In connection with the execution of the Lenfest Equity Agreement, the Company drew down \$3 million by issuing 3,000 shares of Series B Preferred Stock with a conversion price equal to \$4.95 per share. Additionally, on July 31, 2006, ETC drew down an additional \$3 million by issuing 3,000 shares of Series B Preferred Stock at a conversion price equal to \$6.68 per common share.

Effective May 9, 2007, the Company entered into a letter agreement with Lenfest (the "Lenfest Letter Agreement") pursuant to Lenfest agreed to provide financial support to the Company in the form of a guarantee and/or provide access to funding until June 30, 2008.

On July 31, 2007, ETC completed a refinancing of our indebtedness with PNC Bank in the aggregate amount of up to \$15,000,000. This refinancing by ETC is an extension of a credit facility originally entered into with PNC Bank in February 2003. ETC's obligations under the Credit Agreement are secured by a personal guarantee from Lenfest under a Restated Guaranty, dated July 31, 2007, made by Lenfest in favor of PNC. ETC will pay Lenfest an annual cash fee of 1% of the loan commitment for his guarantee.

On August 23, 2007, ETC entered into the Series C Preferred Stock Purchase Agreement (the "Series C Purchase Agreement") with Lenfest, pursuant to which, among other things, ETC issued and sold 3,300 shares of its newly-created class of Series C Cumulative Convertible Participating Preferred Stock (the "Series C Preferred Stock") to Lenfest for \$3,300,000. The Series C Preferred Stock is convertible into shares of ETC's common stock at a conversion price of \$3.03 per share based on the closing price for ETC's common stock on August 22, 2007, the trading day immediately prior to the transaction. The Series C Preferred Stock is convertible into 1,089,108 shares of ETC common stock. The Series C Preferred Stock provides for a dividend equal to 10% per annum. The Series C Preferred Stock is immediately convertible, at Lenfest's request, into shares of ETC common stock at a conversion price equal to \$3.03 per share. On the fifth anniversary of the Series C Purchase Agreement, any issued and outstanding Series C Preferred Stock will be mandatorily converted into ETC common stock at \$3.03 per share. The Series C Preferred Stock is entitled to vote with the ETC common stock on an as converted basis.

ETC granted Lenfest certain demand and "piggy back" registration rights pursuant to a Registration Rights Agreement with respect to the shares of common stock issuable upon conversion of the Series C Preferred Stock.

In connection with Lenfest's investment in the Series C Preferred Stock, ETC agreed to amend the terms of ETC's Series B Preferred Stock to (i) increase the annual dividend rate to 10%, (ii) provide for immediate conversion at the option of Lenfest, and (iii) to remove ETC's right to redeem the Series B Preferred Stock.

In connection with the restatement of the Company's previously issued financial statements for the year ended February 23, 2007, the Company has reclassified the Series B and C Preferred Stock (the "instruments") from equity to mezzanine. The reclassification is due to the preferential redemption feature of the instruments in which a redemption would be triggered by a change in ownership outside the Company's control.

On February 20, 2008, ETC received a proposal from an affiliate of Lenfest to purchase all of the publicly traded shares of ETC common stock not owned by Lenfest at the time the acquisition is consummated. ETC's Board of Directors has formed a committee comprised of independent directors to evaluate the proposal. The transaction committee has engaged a financial advisor to assist the transaction committee in evaluating the proposal. The transaction committee is evaluating the proposal and will make a recommendation with respect to the proposal to ETC's Board of Directors.

On March 11, 2008, ETC entered into Amendment No. 1 to Convertible Note and Warrant Purchase Agreement (the "Purchase Agreement Amendment") and First Amendment to Senior Subordinated Convertible Note (the "Note Amendment") with Lenfest with respect to that certain Convertible Note and Warrant Purchase Agreement, dated as of February 18, 2003, by and between ETC and Lenfest (the "Convertible Note and Warrant Purchase Agreement"). Under the terms of the Purchase Agreement Amendment, ETC and Lenfest agreed to amend the financial covenants set forth in the Convertible Note and Warrant Purchase Agreement so that they are the same as the financial covenants contained in ETC's credit agreement with PNC, dated as of July 31, 2007. Under the terms of the Note Amendment, the maturity date of the convertible promissory note in the principal amount of \$10,000,000 issued by ETC to Lenfest pursuant to the Convertible Note and Warrant Purchase Agreement was extended from February 18, 2009 to March 1, 2010. The effective date of the Purchase Agreement Amendment and the Note Amendment is February 19, 2008.

On May 20, 2008, Lenfest agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC shall not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of the American Stock Exchange, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

Other Related Party Transactions

ETC purchases industrial products from Industrial Instruments Corp. which is owned by Christine and Charles Walter, the daughter and son-in-law of William F. Mitchell, ETC's President and Chief Executive Officer. During fiscal 2008, 2007 and 2006, the Company purchased \$314,928, \$265,092 and \$380,461, respectively, from Industrial Instruments. ETC also rents office space to Industrial Instruments at ETC's corporate headquarters. During fiscal 2008, 2007 and 2006, Industrial Instruments paid to ETC rent in the amounts of \$8,450, \$7,750 and \$9,000, respectively.

ETC purchases travel accommodations from Jet Set, a company that employs Kathleen Mahon, the daughter of Mr. Mitchell. During fiscal 2008, 2007 and 2006, ETC purchased travel through Jet Set totaling \$254,000, \$217,492 and \$231,116, respectively, and Ms. Mahon received approximately \$12,000 from her employer in each fiscal period in commissions on account of such purchases. Ms.

Mahon is also engaged by ETC as a consultant to review expense reports submitted by Company employees. During fiscal 2008, 2007 and 2006, Ms. Mahon received \$11,000 \$10,000 and \$10,000, respectively in consideration of such services.

ETC also employs William F. Mitchell, Jr., the son of Mr. Mitchell, as its Vice President, Contracts/Purchasing, and David Mitchell, the son of Mr. Mitchell, as its Business Unit Manager for Sterilizers. In fiscal 2008, David Mitchell received \$141,000 in compensation from ETC.

Review, Approval or Ratification of Transactions with Related Parties.

We have not adopted any formal policies or procedures for the review, approval or ratification of certain related-party transactions. However, such transactions, if and when they are proposed or have occurred, have traditionally been, and will continue to be, reviewed by our Audit Committee on a case-by-case basis. The Audit Committee may consider any relevant factors when reviewing the appropriateness of a related-party transaction, including, but not limited to, the following: (i) the importance of the transaction to ETC; (ii) the amount involved in the proposed transaction; (iii) the specific interest of the director or executive officer (or immediate family members of same) in the proposed transaction; and (iv) the overall fairness of the terms of the transaction to ETC.

Director Independence.

AMEX rules require that a majority of our board of directors be composed of “independent directors,” which is defined generally as a person other than an officer or employee of a company or its subsidiaries or any other individual having a relationship, which, in the opinion of the company’s board of directors, would interfere with the director’s exercise of independent judgment in carrying out the responsibilities of a director. Messrs. Kelley and Gemmill and Dr. Anderson are our independent directors and constitute a majority of our Board of Directors.

Item 14. Principal Accounting Fees and Services

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 the 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.

On November 28, 2007, Grant Thornton LLP, who had been the Company’s independent registered public accounting firm since 1995, resigned. They were replaced on January 30, 2008 with Friedman, LLP, who were the Company’s independent registered public accounting firm for the fiscal years ended February 23, 2007 and February 29, 2008. Auditors have not been selected for the current fiscal year.

The following table presents fees for professional audit services rendered by Grant Thornton LLP for professional services rendered before their resignation. No fees for Friedman, LLP, after they were engaged, were paid in fiscal 2008. The fees include charges for quarterly financial statement reviews and the annual audit, employee benefit plans, and tax services for the fiscal years ended February 29, 2008 and February 23, 2007.

	<u>FY 2008</u>	<u>FY 2007</u>
Audit Fees	\$ 146,675	\$ 158,862
Audit related fees (1)	<u>57,222</u>	<u>28,669</u>
Audit and audit related fees	203,897	187,531
Tax fees (2)	<u>24,882</u>	<u>29,721</u>
Total fees	<u>\$ 228,779</u>	<u>\$ 217,252</u>

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- (1) Audit related fees consist of fees related to the U. S. Government claim issue and employee benefit plan audits.
(2) Tax fees consist of tax compliance services and other consultations on miscellaneous tax matters.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) Exhibits:

Number	Item
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.
3.1(i)	Statement with respect to shares of Series B Cumulative Convertible Participating Preferred Stock, filed as Exhibit 3(i) 1, to Registrant's Form 8-K dated April 6, 2006, and incorporated herein by reference.
3.1(ii)	Statement with respect to shares of Series C Cumulative Convertible Participating Preferred Stock was filed as Exhibit 3(i) 1, to Registrant's Form 8-K dated August 28, 2007, and incorporated herein by reference.
3.2	Registrant's amended and restated By-Laws were filed as Exhibit 3.2 to Registrant's Form 8-K dated May 25, 2005, 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	Unsecured \$1 million Promissory Note, dated June 28, 2007 executed by the Registrant in favor of H.F. Lenfest, was filed on June 28, 2007 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
4.3	\$15 million Committed Line of Credit Note,, dated as of July 31, 2007 issued by the Registrant in favor of and PNC Bank, National Association, was filed on August 3, 2007 as Exhibit 10.2 to Form 8-K and is incorporated by reference
4.4	First Amendment to Senior Subordinated Convertible Note, effective as of February 19, 2008, by the Registrant in favor of H.F. Lenfest was filed on was filed on March 11, 2008 as Exhibit 10.2 to Form 8-K and is incorporated 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	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.
10.5	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.
10.6	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.
10.7	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.
10.8	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.
10.9	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.
10.10	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.
10.11	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.

Number	Item
10.12	2005 Non-employee Director Stock Option Plan, incorporated by reference to Annex A of Registrant's Definitive Proxy Statement on Schedule 14A filed on August 16, 2005 and incorporated herein by reference. *
10.13	Preferred Stock Purchase Agreement between the Registrant and H.F. Lenfest, dated as of April 6, 2006, filed as Exhibit 10.1 to Registrant's Form 8-K dated April 6, 2006, and incorporated herein by reference.
10.14	Registration Rights Agreement between the Registrant and H.F. Lenfest, dated as of April 6, 2006, filed as Exhibit 10.2 to Registrant's Form 8-K dated April 6, 2006, and incorporated herein by reference.
10.15	Reimbursement Agreement, dated as of November 16, 2006, between the Registrant and PNC Bank, National Association, was filed on November 20, 2006 as Exhibit 10.2 to Form 8-K and is incorporated herein by reference.
10.16	Restated Subordination and Intercreditor Agreement, dated as of November 16, 2006, between the Registrant and H.F. Lenfest, was filed on November 20, 2006 as Exhibit 10.3 to Form 8-K and is incorporated herein by reference.
10.17	Restated Limited Guaranty Agreement, dated as of November 16, 2006, between the Registrant and H.F. Lenfest, was filed on November 20, 2006 as Exhibit 10.4 to Form 8-K and is incorporated herein by reference.
10.18	Employment Agreement, dated as of November 1, 2005, between Registrant and Duane D. Deaner, Chief Financial Officer was filed on May 24, 2007 as Exhibit 10.33 to the Registrant's Form 10-K for the fiscal year ended February 23, 2007, and is incorporated herein by reference.*
10.19	Employment Agreement, dated as of July 24, 2006, between Registrant and William F. Mitchell, was filed on July 24, 2006 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.*
10.20	Credit Agreement, dated as of July 31, 2007 between the Registrant and PNC Bank, National Association, was filed on August 3, 2007 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.21	Agreement between Registrant and H.F. Lenfest, dated as of May 9, 2007 was filed on May 24, 2007 as Exhibit 10.34 to the Registrant's Form 10-K for the fiscal year ended February 23, 2007, and is incorporated herein by reference.
10.22	Amended and Restated Reimbursement Agreement for Letters of Credit, dated as of July 31, 2007 issued by the Registrant in favor of and PNC Bank, National Association was filed on August 3, 2007 as Exhibit 10.2 to Form 8-K and is incorporated by reference.
10.23	Amended and Restated Subordination and Intercreditor Agreement, dated as of July 31, 2007 among the Registrant, PNC Bank, National Association and H.F. Lenfest, was filed on August 3, 2007 as Exhibit 10.2 to Form 8-K and is incorporated by reference.
10.24	Restated Guaranty Agreement, dated as of July 31, 2007 by H.F. Lenfest in favor of PNC Bank, National Association, was filed on August 3, 2007 as Exhibit 10.2 to Form 8-K and is incorporated by reference
10.25	Series C Preferred Stock Purchase Agreement, dated as of August 23, 2007, between the Registrant and H.F. Lenfest as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.26	Registration Rights Agreement, dated as of August 23, 2007, between the Registrant and H.F. Lenfest as Exhibit 10.2 to Form 8-K and is incorporated by reference.
10.27	Letter Agreement, dated as of August 23, 2007, between the Registrant and H.F. Lenfest was filed on August 28, 2007 as Exhibit 10.3 to Form 8-K and is incorporated by reference.
10.28	Administrative Agreement dated as of December 12, 2007 between the Registrant and the Department of the Navy was filed on December 18, 2007 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.29	Credit Agreement and Waiver and Amendment between the Registrant and PNC Bank, National Association, dated January 31, 2008 was filed on February 5, 2008 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.30	Settlement Agreement between the Registrant and the Department of the Navy dated as of February 22, 2008 was filed on February 26, 2008 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.31	Amendment No.1 to Convertible Note and Warrant Purchase Agreement, effective as of February 19, 2008, by and between the Registrant and H.F. Lenfest was filed on March 11, 2008 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.32	Letter Agreement between Registrant and H.F. Lenfest, dated as of May 20, 2008. (Filed herewith)
13	Portions of Registrant's 2008 Annual Report to Shareholders which are incorporated by reference into this Form 10-K.

14 Code of Ethics was filed on May 24, 2007 as Exhibit 14 to Form 10-K and is incorporated by reference.

16.1 Letter from Grant Thornton LLP dated as of November 28, 2007 was filed on December 4, 2007 as Exhibit 16.1 to Form to 8-K and is incorporated by reference.

<u>Number</u>	<u>Item</u>
21	Subsidiaries of the Registrant (Filed herewith).
23	Consent of Friedman LLP dated May 29, 2008. (Filed herewith)
31.1	Certification dated May 29, 2008 pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 made by William F. Mitchell, Chief Executive Officer. (Filed herewith)
31.2	Certification dated May 29, 2008 pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 made by Duane D. Deaner, Chief Financial Officer. (Filed herewith)
32	Certification dated May 29, 2008 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. (Filed herewith)
99.1	Proposal Letter from H.F. Lenfest was filed on February 22, 2008 as Exhibit 99.2 on Form 8-K and is incorporated herein by reference.

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

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, the following persons on behalf of the registrant and in the capacities and on the dates indicated have signed this report below.

<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 29, 2008
<u>/s/ Duane D. Deaner</u> Duane D. Deaner	Chief Financial Officer (Principal Financial and Accounting Officer)	May 29, 2008
<u>/s/ Howard W. Kelley</u> Howard W. Kelley	Director	May 29, 2008
<u>/s/ H.F. Lenfest</u> H.F. Lenfest	Director	May 29, 2008
<u>/s/ George K. Anderson</u> George K. Anderson, M.D.	Director	May 29, 2008
<u>/s/ Alan M. Gemmill</u> Alan M. Gemmill	Director	May 29, 2008

EXHIBIT INDEX

Exhibit No.	Item
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31.2	Certification dated May 29, 2008 pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 made by Duane D. Deaner, Chief Financial Officer.
32	Certification dated May 29, 2008 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.

H. F. Lenfest
300 Barr Harbor Drive, Suite 460
Conshohocken, PA 19428

May 20, 2008

William F. Mitchell
Chief Executive Officer
Environmental Tectonics Corporation
County Line Industrial Park
Southampton, PA 18966

Re: Commitment to Support Environmental Tectonics Corporation

Dear Bill:

By way of this letter I hereby commit to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by me and ETC, provided that ETC shall not request more than \$10 million in the aggregate.

All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of the American Stock Exchange, if required. ETC's objective will be to either replace or supplant any financing I provide with third party commitments on a best efforts basis. However, in any case, I commit to provide ETC with continuous access to funds, in some form, through June 30, 2009.

Very truly yours,

H. F. Lenfest

EXHIBIT 13
PORTIONS OF
ENVIRONMENTAL TECTONICS CORPORATION
2008
ANNUAL REPORT TO STOCKHOLDERS

FINANCIAL REVIEW

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

Fiscal Year End	2008	2007 (restated)*	2006
Net sales	\$ 22,730	\$ 17,419	\$ 25,069
Gross profit	4,246	2,071	5,350
Operating (loss) income	(12,043)	(10,936)	(4,719)
Net loss	(13,895)	(11,944)	(6,714)
Loss per common share:			
Basic	(1.61)	(1.35)	(0.74)
Diluted	(1.61)	(1.35)	(0.74)
Working capital	1,742	5,513	18,262
Long-term obligations	18,192	8,830	8,376
Total assets	37,625	27,325	32,109
Total stockholders' equity	(8,831)	5,787	17,553
Weighted average common shares:			
Basic	9,030,000	9,030,000	9,021,000
Diluted	9,030,000	9,030,000	9,021,000

* restated for reserve of claim receivable. See Note 1 — Subsequent Events in the accompanying notes to the Consolidated Financial Statements.

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 subordinated debt agreement with Lenfest without the prior written consent of Lenfest.

Dividends on the Company's Preferred Stock are accrued per agreement but cash payments have been deferred until the maturity of each respective agreement.

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 ETC's current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about ETC 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 ETC'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) the proposed acquisition of ETC by H.F. Lenfest ("Lenfest"), a member of ETC's Board of Directors and a significant shareholder of ETC, (ii) the potential delisting of the ETC's common stock from the American Stock Exchange ("AMEX") as a result of ETC's failure to comply with AMEX listing standards, (iii) 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, (iv) statements of plans and objectives of ETC 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, (v) statements of future economic performance, (vi) statements or assumptions and other statements about ETC or its business, (vii) statements made about the possible outcomes of litigation involving ETC, including our outstanding litigation with Disney, (viii) statements regarding ETC's ability to obtain financing to support its operations and other expenses, and (ix) 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 ETC's control. Shareholders are urged to review these risks carefully prior to making an investment in ETC's common stock.

ETC cautions that the foregoing list of important factors is not exclusive. Except as required by federal securities law, ETC 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 ETC.

In this report all references to "ETC," "we," "us," or "our," mean Environmental Tectonics Corporation and its subsidiaries.

References to fiscal 2007 or the 2007 fiscal year are references to the year ended February 23, 2007. References to fiscal 2008 or the 2008 fiscal year are references to the year ending February 29, 2008.

Overview

We are principally engaged in the design, manufacture and sale of software driven products and services used to recreate 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 (aero medical, tactical combat and general), disaster management systems and services, entertainment products, sterilizers (steam and gas), environmental testing products and hyperbaric chambers and other products that involve similar manufacturing techniques and engineering technologies. ETC primarily manufactures, under contract, various types of high-technology equipment which it has designed and developed. ETC considers its business activities to be divided into two segments: the Training Services Group (TSG) and the Control Systems Group (CSG). Product categories included in TSG are pilot training and flight simulators, disaster management systems and entertainment applications. CSG includes sterilizers, environmental control devices, hyperbaric chambers along with parts and service support.

The following factors had an adverse impact on our performance for the fiscal year ended February 29, 2008:

- contract awards for aero medical products which occurred late in the fiscal period and which consequently did not contribute materially to our operating results for fiscal 2008;
- the cost of development and marketing efforts for our Authentic Tactical Fighting Systems;
- spending to modify our main facility in Southampton, Pa., and to build equipment for the National Aerospace Training and Research (NASTAR) Center.

In response to the ongoing market budgetary constraints for G-force training and spatial disorientation, in 2004 we began incorporating tactical combat flight capabilities into our human centrifuge technology. Dubbed the Authentic Tactical Fighting System, this product was the first fully "flyable" centrifuge-based tactical maneuvering ground based simulator. 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 have developed this technology through fiscal 2008 and will continue the development in fiscal 2009.

Spending continued in fiscal 2008 to market tactical flight simulation to the world's defense agencies. Our goal is to validate the use of ground-based simulation as an alternative method to actual in-flight training to teach jet pilots tactical flight and combat

skills. In fiscal 2008, we were awarded research contracts from the U. S. Navy and the U. S. Air Force to develop Tactical Aircraft Configuration Modules (TacModules) which will be used in this validation process.

Our third major challenge in this re-engineering of our aero medical business has been a shifting of our business model. In fiscal 2006, we began construction of the National Aerospace Training and Research (NASTAR) Center. This center, which opened in fiscal 2008, is an integrated pilot training center offering a complete range of aviation training and research support for military jet pilots and civil aviation as well as space travel and tourism. The NASTAR Center houses state of the art equipment including the ATFS-400, a GYROLAB GL-2000 Advanced Spatial Disorientation Trainer, a Hypobaric Chamber, an Ejection Seat Trainer, and a Night Vision and Night Vision Goggle Training System. These products represent 37 years of pioneering development and training solutions for the most rigorous stresses encountered during high performance aircraft flight including the effects of altitude exposure, High G-force exposure, spatial disorientation and escape from a disabled aircraft.

- continued development of generation 3 software for our Advanced Disaster Management Scenario product line;
- spending to investigate and evaluate the best way to offer disaster training services;

We have made significant progress in advancing and enhancing our ADMS line of products. Graphics are sharper and more realistic, interactivity and connectivity of objects is tighter, additional disaster scenarios have been added, and we have made the hardware configuration more user friendly. In fiscal 2008, we began development of our fourth generation software platform. In April 2007, we appointed Mr. Marco van Wijngaarden as president of this division. Mr. van Wijngaarden has been the head of training for the Netherlands' National Institute for Safety, a major ADMS user, and is very familiar with the ADMS product line.

- limited revenue generation coupled with high development costs in our low-end entertainment products;

Certain actions by a former major entertainment customer have effectively closed the high-end amusement market to us. Our low-end products have encountered customer resistance due to pricing and those units under a revenue share contract have failed to generate sufficient income to justify an expansion of this line. Consequently, this line has suffered from high development costs with low return. We consider this line to be an opportunistic business and will plan our development accordingly.

- higher costs of capital and amortization of deferred finance charges;

Interest expense for fiscal 2008 was \$1,582,000 or 7.0% of sales. This included approximately \$537,000 of non-cash charges for amortization of debt discount expenses.

- litigation and claims costs;

These two categories of expenses accounted for over 40% of our selling and administrative expenses and approximately 27% of sales. Most of these expenses were related to the U.S. Navy claim issue, which is discussed in Note 1 — Subsequent Events in the accompanying Notes to the Consolidated Financial Statements.

- cash flow;

One of the greatest challenges we faced in fiscal 2008 and continue to face in fiscal 2009 is adequately funding the cash requirements of large, long-term multi-year projects, the costs of technological development of existing products, the cost to modify the building and produce the equipment for the NASTAR Center, and the costs to market our ATFS technology to the U.S. government and international government defense agencies. Although some long-term contracts 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 and the other initiatives throughout fiscal 2008 required a significant amount of operating funds.

On July 31, 2007, the Company entered into a revolving credit agreement (the "Credit Agreement") in order to refinance its indebtedness with PNC Bank, National Association ("PNC") in the aggregate amount of up to \$15,000,000 (the "Credit Agreement"). This Credit Agreement is a replacement of a credit facility originally entered into with PNC in February 2003.

Borrowings are to be used for ETC's working capital or other general business purposes and for issuances of letters of credit. Amounts borrowed under the Credit Agreement may be borrowed, repaid and reborrowed from time to time until June 30, 2009. Borrowings made pursuant to the Credit Agreement will bear interest at either the prime rate (as described in the Note) minus 1.00% or the London Interbank Offered Rate (as described in the Note) plus 0.90%. Additionally, ETC is obligated to pay a fee of 0.125% per annum for unused available funds.

For the purpose of reducing the risk associated with variable interest rates, ETC has entered into an interest rate swap agreement (Swap Agreement) with PNC which provides for a fixed rate through June 30, 2009, the maturity date of the Swap

Agreement, for the borrowings during the first quarter of fiscal 2008. If the Swap Agreement is terminated prior to maturity, an additional payment to PNC or a credit to the Company might be due, based on the relative market rates at the time of termination. The Swap Agreement transaction has been accounted for under FAS No. 133 — “Accounting for Derivative Instruments and Hedging Activities”. At February 28, 2008, ETC recorded a Comprehensive Loss of \$228,000 reflecting the reduced value of the interest rate hedge in the accompanying Consolidated Balance Sheets.

The Credit Agreement contains affirmative and negative covenants for transactions of this type, including limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business and transactions with affiliates. Under the Credit Agreement, the Company must maintain a minimum Consolidated Tangible Net Worth of \$9,000,000 at the end of each fiscal quarter. At February 29, 2008, the Company failed to meet the Consolidated Tangible Net Worth financial covenant. Additionally, under the Credit Agreement, the Company’s events of default include the obligations of Lenfest as guarantor of the line of credit. Lenfest failed to deliver certain financial statements to the bank within the required time as specified in the Credit Agreement, which also was an event of default under the Agreement. On May 29, 2008 the Company received a waiver from PNC Bank, effective for the period ended February 29, 2008. The waiver does not extend beyond February 29, 2008. The Company has also agreed that Lenfest shall deliver certain additional financial statements on or before October 31, 2008, and failure to do so shall constitute an event of default. Management believes that the Bank will not exercise their rights under the default provisions as contained in the Credit Agreement. Lenfest is a guarantor of the Company’s borrowings under the Credit Agreement. If the Bank exercises its right to call the Loan the Lenfest Guarantee will become enforceable. As noted earlier, Lenfest is a guarantor of the Company’s borrowings under the Credit Agreement and has agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC may not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC’s shareholders and in accordance with the rules and regulations of AMEX, if required. ETC’s objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

ETC’s obligations under the Credit Agreement are secured by a personal guarantee from Lenfest under a Restated Guaranty, dated July 31, 2007, made by Lenfest in favor of PNC (the “Restated Guaranty”). ETC will pay Lenfest an annual cash fee of 1% of the loan commitment for his guaranty.

In connection with entering into the Credit Agreement, ETC entered into an Amended and Restated Reimbursement Agreement with PNC (the “Reimbursement Agreement”), and an Amended and Restated Subordination and Intercreditor Agreement with PNC and Lenfest (the “Subordination Agreement”). The Reimbursement Agreement governs letters of credit issued pursuant to the Credit Agreement. Under the Subordination Agreement, Lenfest agreed to continue to subordinate his rights in connection with a convertible promissory note executed by ETC in favor of Lenfest in the original aggregate principal amount of \$10,000,000, dated February 18, 2003, to the rights of PNC in connection with the Line of Credit.

As a stipulation for Lenfest’s guaranty, the Company repaid \$4,000,000 owed to Lenfest under unsecured promissory notes. ETC utilized \$4,000,000 of the facility to repay these balances due Lenfest and \$1,000,000 to fund operations. Additionally, the Company has utilized approximately \$5,077,000 of the line of credit to collateralize its letters of credit. At February 29, 2008, the Company had \$746,000 available under the line of credit.

On August 23, 2007, the Company entered into the Series C Preferred Stock Purchase Agreement (the “Series C Purchase Agreement”) with Lenfest, pursuant to which, among other things, ETC issued and sold 3,300 shares of its newly-created class of Series C Cumulative Convertible Participating Preferred Stock (the “Series C Preferred Stock”) to Lenfest for \$3,300,000. The proceeds from the issuance of the Series C Preferred Stock were restricted solely for use to partially fund the tentative settlement with the U.S. Navy. (See Note 1 — Subsequent Events in the accompanying Notes to the Consolidated Financial Statements). The proceeds are presented in the accompanying Consolidated Balance Sheets as Restricted Cash.

The Series C Preferred Stock is convertible by Lenfest at any time into shares of ETC’s common stock at a conversion price of \$3.03 per share based on the closing price for ETC’s common stock on August 22, 2007, the trading day immediately prior to the issuance. The Series C Preferred Stock votes with ETC’s common stock on an as-converted basis and is fully convertible into 1,089,108 shares of ETC common stock. The Series C Preferred Stock automatically converts into ETC common shares on the fifth anniversary of the Acquisition. It carries an annual dividend rate of ten percent (10%).

ETC granted Lenfest certain demand and “piggy back” registration rights pursuant to a Registration Rights Agreement with respect to the shares of common stock issuable upon conversion of the Series C Preferred Stock.

By way of a letter dated March 29, 2007, Lenfest agreed to allow the Company to defer until April 6, 2012, or earlier if demanded, the payment of accruing dividends on the Series B Preferred Stock issued under the Lenfest Equity Agreement.

As allowed in the Series C Purchase Agreement, the Company is accruing dividends for the outstanding Preferred Stock but has deferred payment of these dividends until a subsequent date, up to and including August 23, 2012.

In connection with Lenfest’s investment in the Series C Preferred Stock, ETC agreed to amend the terms of ETC’s Series B Preferred Stock to (i) increase the annual dividend rate to 10%, (ii) provide for immediate conversion into common stock at the option of Lenfest, and (iii) to remove ETC’s right to redeem the Series B Preferred Stock. ETC also agreed to discuss with AMEX the inclusion of weighted-average anti-dilution protection for the Series B Preferred Stock and Series C Preferred Stock, and, if AMEX permits inclusion of such anti-dilution protection for the Series B Preferred Stock and the Series C Preferred Stock, to amend the terms of the Series B Preferred Stock and Series C Preferred Stock accordingly.

On March 11, 2008, the Company entered into Amendment No. 1 to Convertible Note and Warrant Purchase Agreement (the “Purchase Agreement Amendment”) and First Amendment to Senior Subordinated Convertible Note (the “Note Amendment”) with Lenfest with respect to that certain Convertible Note and Warrant Purchase Agreement, dated as of February 18, 2003, by and between ETC and Lenfest (the “Convertible Note and Warrant Purchase Agreement”). Under the terms of the Purchase Agreement Amendment, ETC and Lenfest agreed to amend the financial covenants set forth in the Convertible Note and Warrant Purchase Agreement so that they are the same as the financial covenants contained in ETC’s credit agreement with PNC. Under the terms of the Note Amendment, the maturity date of the convertible promissory note in the principal amount of \$10,000,000 issued by ETC to Lenfest pursuant to the

Convertible Note and Warrant Purchase Agreement was extended from February 18, 2009 to March 1, 2010. The effective date of the Purchase Agreement Amendment and the Note Amendment is February 19, 2008.

We will need to obtain additional sources of capital in order to continue growing and operating our business. Because we have established businesses in many markets, own 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, although there is no assuredness that we will be successful in this endeavor.

Lenfest Letter Agreement

On May 20, 2008, Lenfest agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC shall not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of the American Stock Exchange, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

Lenfest Acquisition Proposal

On February 20, 2008, ETC received a proposal from an affiliate of Lenfest to purchase all of the publicly traded shares of the common stock of the Company not owned by Lenfest at the time the acquisition is consummated. The Board of Directors of the Company has formed a committee (the "Transaction Committee") comprised of independent directors to evaluate the proposal. The Transaction Committee has engaged a financial advisor to assist the Transaction Committee in evaluating the proposal. The Transaction Committee is evaluating the proposal and will make a recommendation with respect to the proposal to the Company's Board of Directors.

We face the following challenges and business goals in order to make fiscal 2009 a successful year:

- Complete the technology development of ATFS.
- Book at least one significant pilot training contract for the NASTAR Center.
- Finalize production of the two TacModules for the U.S. Government.
- Begin validation of the ATFS technology.
- Book at least one significant international contract for aeromedical equipment.
- Maintain higher order booking rates for our Control Systems Group products.
- Develop alternate sources for acrylic tubes used in our hyperbaric monoplace chamber.
- Complete Core 4 software enhancements in our ADMS line.
- Finalize our only outstanding major litigation case either through settlement, mediation or by judicial determination.

Our plans to meet our goals include the following:

- Market ATFS technology to the U.S. military.
- Search for additional research contracts to utilize NASTAR resources.
- Reduce our costs of manufacture for all product offerings in our Control Systems Group divisions.

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 consider our business activities to be divided into two segments: the Training Services Group (TSG) and the Control Systems Group (CSG). The TSG includes aircrew training products and services, disaster management training product and services and entertainment products. The CSG includes sterilizer, environmental and hyperbaric products and services. We sell utilizing two business approaches: integrated training services and products. Some of our products are customized, using our proprietary software based on specifications provided by our customers. Some of our products take more than one year to manufacture and deliver to the customer. In the TSG segment, we offer integrated training services to both commercial and government military defense agencies and training devices to government military defense agencies both in the United States and internationally. We sell our entertainment products to amusement parks, zoos and museums. We sell our disaster management simulation training and products to fire and emergency training schools and state and local governments. In the CSG segment, we sell our sterilizers to pharmaceutical and medical device manufacturers. We sell our environmental testing systems primarily to commercial automobile manufacturers and heating, ventilation and air conditioning (HVAC) manufacturers. We sell our hyperbaric products to the military (mainly larger chambers) and hospitals and clinics (mainly single occupant monoplace chambers). To a lesser degree, we provide upgrade, maintenance and repair services for our products and for products manufactured by other parties.

We recognize revenue using three methods:

On long-term contracts over \$250,000 in value and over six months in length, the percentage of completion (POC) revenue recognition method is utilized. Under this method a percentage is calculated based on costs incurred from inception to date on a contract as compared to the estimated total costs required to fulfill the contract. This percentage is then multiplied by the contract value to determine the amount of revenue to be recognized in any given accounting period. Revenue recognized on uncompleted long-term contracts in excess of amounts billed to customers is reflected as a current asset on the balance sheet under the caption "costs and estimated earnings in excess of billings on uncompleted long-term contracts". Amounts billed to customers (milestone payments) in excess of revenue recognized are reflected as a current liability on the balance sheet under the caption "billings in excess of costs and estimated earnings on uncompleted long-term contracts." At any time during performance if it is estimated that a contract at completion will result in a loss, the entire amount of the estimated loss is accrued. The effect of revisions in cost and profit estimates for long-term contracts is reflected in the accounting period in which we learn the facts which require us to revise our 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, both at inception and throughout the performance period.

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

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

We have operating subsidiaries in the United Kingdom and Poland, maintain regional offices in the Middle East, Asia and Canada, and use the services of approximately 100 independent sales agents and organizations throughout the world. ETC International Corporation is a holding company established for federal income tax purposes and is not an operating subsidiary.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us 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 our 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. We believe that our critical accounting policies include those described below. For a detailed discussion on the application of these and other accounting policies, see Note 3 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 over six months in length, the percentage of completion (POC) revenue recognition method is utilized. If we do not accurately estimate the total cost required to fulfill the contract, or if we are unsuccessful in the ultimate collection of any 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 our results of operations and financial position.

Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based on payment history and the customer's current creditworthiness. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based on historical experience and any specific customer collection issues that have been identified. Most of our collection issues are related to contract disputes, not customer creditworthiness. While our credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Additionally, as a result of the concentration of international receivables, we cannot predict the effect, if any, that geopolitical disputes and financial constraints will have on the ultimate collection of our 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, for amounts in excess of contract value, is appropriate if it is probable that the claim will result in an increase in the contract value and if the company can reliably estimate the amount of potential additional contract revenue (claim revenue). However, revenue recorded on a contract claim cannot exceed the incurred contract costs related to that claim. Claims are subject to negotiation, arbitration and audit by the customer or governmental agency.

Results of Operations

We have historically experienced significant variability in our quarterly revenue, earnings and other operating results, and our performance may fluctuate significantly in the future.

Fiscal 2008 versus Fiscal 2007

(amounts in thousands)
Summary Table of Results

	Year ended February 29, 2008	Year ended February 23, 2007* (restated)	Variance s	Variance %
			()	= Unfavorable
Sales:				
Domestic	\$ 13,478	\$ 6,012	\$ 7,466	124.2%
US Government	1,828	586	1,242	211.9%
International	7,424	10,821	(3,397)	(31.4)%
Total Sales	22,730	17,419	5,311	30.5%
Gross Profit	4,246	2,071	2,175	105.0%
Selling, general and administrative	11,518	9,434	(2,084)	(22.1)%
Claim settlement costs	3,638	3,004	(634)	(21.1)%
Impairment expense	455	—	(455)	N/A
Research and development	678	569	(109)	(19.2)%
Operating loss	(12,043)	(10,936)	(1,107)	(10.1)%
Interest expense, net	1,582	1,151	(431)	(37.4)%
Other expense (income), net	236	(58)	(294)	(506.9)%
Income taxes	37	(77)	(114)	(148.1)%
Minority interest	(3)	(8)	(5)	(62.5)%
Net loss	\$ (13,895)	\$ (11,944)	\$ (1,951)	(16.3)%
Net loss per common share	\$ (1.61)	\$ (1.35)	\$ (0.26)	(19.3)%

* restated for reserve of claim receivable. See Note 1 — Subsequent Events in the accompanying notes to the Consolidated Financial Statements.

Net Loss.

ETC had a net loss of \$13,895,000 or \$(1.61) per share (diluted) in fiscal 2008 versus a net loss of \$11,944,000 or \$(1.35) per share (diluted) in fiscal 2007, an increase in net loss of \$1,951,000 or 16.3%. Operating loss in fiscal 2008 was \$12,043,000 versus an operating loss of \$10,936,000 in fiscal 2007, an increase in operating loss of \$1,107,000 or 10.1%. The increase in operating loss resulted primarily from increased selling, general and administrative, claim settlement and impairment costs which were only partially offset by the higher sales level and resulting increased gross profit. Net loss in fiscal 2008 included higher interest and other expenses as compared to fiscal 2007.

Sales.

For the fiscal year ended February 29, 2008, total sales were \$22,730,000, an increase of \$5,311,000 or 30.5% from fiscal 2007. The increase primarily reflected favorable domestic performance and to a lesser extent increased U.S. Government sales which were only partially offset by reduced international sales. Overall, all product lines reflected favorable performance except pilot training systems and simulation.

Geographically, domestic sales were \$13,478,000, up \$7,466,000, or 124.2%, from fiscal 2007, and represented 59.3% of total sales, up from 34.5% in fiscal 2007, reflecting favorable performance in all product categories except aircrew training systems and simulation. Percentage increases ranged from approximately 45% for sterilizers and parts and service to approximately 70% for environmental and hyperbaric. U.S. Government sales increased \$1,242,000 or 211.9% from the prior fiscal year reflecting contracted research work for two TacModules. U.S. Government sales represented 8.0% of total sales, up from 3.4% in fiscal 2007. International

sales, including those in the Company's foreign subsidiaries, were \$7,424,000, down \$3,397,000 or 31.4%, from the prior fiscal period and represented 32.7% of total sales, down from 62.1% in fiscal 2007, primarily representing decreases in ETC Southampton. All product categories except service and replacement parts evidenced decreases, most significantly in dollar volume aircrew training systems (down \$1,899,000 or 24.5%) and sterilizers (down \$1,138,000 or 82.8%). Aircrew training systems in the prior period benefited from a gyro-lab sale in Japan while sterilizers in the prior period benefited from two large contract sales in Australia.

In fiscal 2008, one customer represented 10% or more of total sales, as General Motors generated \$3,898,000, or 17.2% of total sales. International sales totaling at least \$500,000 per country were made to customers in Indonesia, Thailand, Turkey, Japan and Saudi Arabia. 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. Of the February 29, 2008 backlog of \$38,281,000, three product lines represented at least 10% of the total backlog: aircrew training systems (\$24,676,000 or 64.5%), environmental products (\$4,266,000 or 11.1%) and sterilizer products (\$4,128,000 or 10.8%). Two international customers in the aircrew training systems line represented \$19,548,000 or 79.2%, of the total aircrew training systems backlog.

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 revenue in any period.

Domestic Sales.

Overall, domestic sales in fiscal 2008 were \$13,478,000 as compared to \$6,012,000 in fiscal 2007, an increase of \$7,466,000 or 124.2%, reflecting favorable performance in all product categories except aircrew training systems and simulation. Percentage increases ranged from approximately 45% for sterilizers and parts and service to approximately 70% for environmental and hyperbaric. Favorable domestic sales performance generally represented favorable domestic market conditions in our Control Systems Group lines of business. Domestic sales represented 59.3% of our total sales in fiscal 2008, up from 34.5% in fiscal 2007. Sales to the U.S. Government in fiscal 2008 were \$1,828,000 as compared \$586,000 in fiscal 2007, representing an increase of \$1,242,000 or 211.9%, reflecting contracted research work for two TacModules. U.S. Government sales represented 8.0% of total sales, up from 3.4% in fiscal 2007.

International Sales.

International sales in fiscal 2008, including those in our foreign subsidiaries, were \$7,424,000 as compared to \$10,821,000 in fiscal 2007, a decrease of \$3,397,000 or 31.4%, and represented 32.7% of total sales as compared to 62.1% in fiscal 2007, primarily representing decreases in ETC Southampton. All product categories except service and spares evidenced decreases, most significantly in dollar volume aircrew training systems (down \$1,899,000 or 24.5%) and sterilizers (down \$1,138,000 or 82.8%). Aircrew training systems in the prior period benefited from a gyro-lab sale in Japan while sterilizers in the prior period benefited from two large contract sales in Australia.

Throughout our history, most of the sales for ATS have been made to international customers. In fiscal 2008, international sales totaling at least ten percent of total international sales were made to a customer in Indonesia (\$1,302,000) and a customer in Thailand (\$1,135,000). 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.

Fiscal Year	(\$000 except for %)				Total	
	Training Services Group		Control Systems Group			
	\$	%	\$	%	\$	%
2008	7,844	34.5%	14,886	65.5%	22,730	100.0%
2007	9,293	53.3%	8,126	46.7%	17,419	100.0%

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: Training Services Group (TSG) and Control Systems Group (CSG). Product categories included in TSG are pilot training and flight simulators, disaster management systems and entertainment applications. CSG includes sterilizers, environmental control devices, hyperbaric chambers along with parts and service support.

Sales of our TSG products were \$7,844,000 in fiscal 2008, a decrease of \$1,449,000, or 15.6% from fiscal 2007. Sales of these products accounted for 34.5% of our sales versus 53.3% in fiscal 2007. Sales in our other segment, the CSG increased \$6,760,000 to \$14,886,000, an increase of 83.2%, and constituted 65.5% of our total sales compared to 46.7% in fiscal 2007.

Gross Profit.

Gross profit for fiscal 2008 increased by \$2,175,000 or 105.0% from fiscal 2007, reflecting the favorable sales performance and resulting gross profit. Additionally, a favorable product and contract mix resulted in an increase in the gross profit rate as a percent of sales to 18.7% for fiscal 2008 versus 11.9% for fiscal 2007. Significantly favorable margin rates were seen in hyperbaric, aircrew training systems and sterilizers.

Selling and Administrative Expenses.

Selling and administrative expenses increased \$2,084,000, or 22.1%, from fiscal 2007. The increase primarily reflected higher legal expenses resulting from the U.S. Navy claim and additional bad debt expense related to the Company's litigation.

Claim Settlement Costs

Claim settlement costs in fiscal 2008 were up \$634,000, or 21.1% from fiscal 2007. The expenses in both fiscal periods were directly related to the claim settlement with the U.S. Navy. (See Note 1 to the Consolidated Financial Statements, Settlement with U.S. Navy.)

Impairment Expense

Impairment expense reflected the write down of the remaining goodwill associated with the Company's purchase of ETC-PZL in 1998. Based on an evaluation of the net undiscounted cash flows expected from ETC-PZL in fiscal 2009, it was determined that the asset representing the net book value over purchase price for this subsidiary would not be recovered.

Research and Development Expenses.

Research and development expenses increased \$109,000, or 19.2%, in fiscal 2008 as compared to fiscal 2007. This increase reflected reduced reimbursement for government grants in our Turkish subsidiary under government research awards. Most of our research efforts, which were and continue to be significant costs of our business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates.

Operating Loss.

Operating loss was \$12,043,000 in fiscal 2008 compared to an operating loss of \$10,936,000 in fiscal 2007, an increase in loss of \$1,107,000 or 10.1%. Increases in selling, general and administrative expenses, claim settlement and impairment costs were only partially offset by favorable gross profit.

On a segment basis, TSG had an operating loss of \$3,929,000, a decrease of \$62,000, or 1.6%, over fiscal 2007, while the CSG had an operating loss of \$5,551,000 in fiscal 2008, a decrease in operating loss of \$177,000, or 3.2%, from fiscal 2007. These segment operating results were offset, in part, by unallocated corporate expenses of \$2,085,000 which were up \$868,000, or 41.6%, from fiscal 2007.

Interest Expense.

Interest expense (net of interest income) increased \$431,000, or 37.4%, in fiscal 2008 from fiscal 2007. The current period reflected higher interest expense on higher borrowings and increased non-cash charges for amortization of debt discount on the Company's subordinated debt.

Other Expense, net.

Other expense, net, increased \$294,000 for fiscal 2008 versus fiscal 2007 reflecting foreign exchange loss in our Polish subsidiary, ETC-PZL coupled with higher letter of credit, license and bank fees.

Provision for Income Taxes.

Income tax expense in fiscal 2008 resulted from expense timing differences in ETC-PZL as, although ETC-PZL had a book loss for reporting purposes, it reported a profit for tax purposes. Although ETC Southampton reported a pre-tax loss during fiscal 2008, no offsetting income tax benefit and corresponding deferred tax asset was recorded, 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. We will recognize these benefits only as reassessment demonstrates that they are realizable. Realization is entirely dependent upon future earnings in specific tax jurisdictions.

Income tax benefit in fiscal 2007 represented tax loss carryforwards in ETC-PZL.

Reflecting the Company's significant losses in the current and prior fiscal years, the Company has approximately \$31.8 million of federal and approximately \$37.8 million of state net loss carry forwards available to offset future income tax liabilities, beginning to expire 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, we have 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 our income tax expense. In addition, the Company may be subject to limitation on the use of its net operating losses based on the potential ownership change that may have occurred as defined by Section 382 of the Internal Revenue Code. The Company is currently evaluating the need to undertake an ownership change study in order to conclude if a further limitation is required.

Liquidity and Capital Resources

During fiscal 2008, we used \$3,486,000 of cash for operating activities versus a usage of \$6,997,000 for fiscal 2007. The improvement primarily reflected significantly favorable cash generated from increases in customer deposits and billings in excess of costs and estimated earnings on long-term contracts which was partially offset by the operating loss and a decrease in the allowances for accounts receivable and inventory.

The Company's investing activities used \$4,287,000 in fiscal 2008 and consisted primarily of costs for the continued construction activities and the manufacturing of demonstration simulators for our NASTAR Center coupled with higher software enhancements for our Advanced Tactical Fighter Systems technology.

The Company's financing activities generated \$7,629,000 of cash during fiscal 2008. This primarily reflected the proceeds from the borrowings under the PNC line of credit described below. Additionally, although the Company received \$3,300,000 from the issuance of preferred stock to H.F. Lenfest, these funds were restricted solely for use to partially fund the payment under the settlement with the U.S. Navy.

Bank Credit and Facility

On July 31, 2007, the Company entered into a revolving credit agreement (the "Credit Agreement") in order to refinance its indebtedness with PNC in the aggregate amount of up to \$15,000,000 (the "Credit Agreement"). This Credit Agreement is a replacement of a credit facility originally entered into with PNC in February 2003.

Borrowings are to be used for ETC's working capital or other general business purposes and for issuances of letters of credit. Amounts borrowed under the Credit Agreement may be borrowed, repaid and reborrowed from time to time until June 30, 2009. Borrowings made pursuant to the Credit Agreement will bear interest at either the prime rate (as described in the Note) minus 1.00% or the London Interbank Offered Rate (as described in the Note) plus 0.90%. Additionally, ETC is obligated to pay a fee of 0.125% per annum for unused available funds.

For the purpose of reducing the risk associated with variable interest rates, ETC has entered into an interest rate swap agreement (Swap Agreement) with PNC which provides for a fixed rate through June 30, 2009, the maturity date of the Swap Agreement, for the borrowings during the first quarter of fiscal 2008. If the Swap Agreement is terminated prior to maturity, an additional payment to PNC or a credit to the Company might be due, based on the relative market rates at the time of termination. The Swap Agreement transaction has been accounted for under FAS No. 133 — "Accounting for Derivative Instruments and Hedging Activities". At February 28, 2008, ETC recorded a Comprehensive Loss of \$228,000 reflecting the reduced value of the interest rate hedge in the accompanying Consolidated Balance Sheets.

The Credit Agreement contains affirmative and negative covenants for transactions of this type, including limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business and transactions with affiliates. Under the Credit Agreement, the Company must maintain a minimum Consolidated Tangible Net Worth of \$9,000,000 at the end of each fiscal quarter. At February 29, 2008, the Company failed to meet the Consolidated Tangible Net Worth financial covenant. Additionally, under the Credit Agreement, the Company's events of default include the obligations of Lenfest as guarantor of the line of credit. Lenfest failed to deliver certain financial statements to the bank within the required time as specified in the Credit Agreement, which also was an event of default under the Agreement. On May 29, 2008 the Company received a waiver from PNC Bank, effective for the period ended February 29, 2008. The waiver does not extend beyond February 29, 2008. The Company has also agreed that Lenfest shall deliver certain additional financial statements on or before October 31, 2008, and failure to do so shall constitute an event of default. Management believes that the Bank will not exercise their rights under the default provisions as contained in the Credit Agreement. Lenfest is a guarantor of the Company's borrowings under the Credit Agreement. If the Bank exercises its right to call the Loan the Lenfest Guarantee will become enforceable. As noted earlier, Lenfest is a guarantor of the Company's borrowings under the Credit Agreement and has agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC may not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of AMEX, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

ETC's obligations under the Credit Agreement are secured by a personal guarantee from Lenfest under a Restated Guaranty, dated July 31, 2007, made by Lenfest in favor of PNC. ETC will pay Lenfest an annual cash fee of 1% of the loan commitment for his guarantee.

In connection with entering into the Credit Agreement, ETC entered into an Amended and Restated Reimbursement Agreement with PNC (the "Reimbursement Agreement"), and an Amended and Restated Subordination and Intercreditor Agreement with PNC and Lenfest (the "Subordination Agreement"). The Reimbursement Agreement governs letters of credit issued pursuant to the Credit Agreement. Under the Subordination Agreement, Lenfest agreed to continue to subordinate his rights in connection with a convertible promissory note executed by ETC in favor of Lenfest in the original aggregate principal amount of \$10,000,000, dated February 18, 2003, to the rights of PNC in connection with the Line of Credit.

As a stipulation for Lenfest's guarantee, the Company repaid \$4,000,000 owed to Lenfest under several unsecured promissory notes. ETC utilized \$4,000,000 of the facility to repay these balances due Lenfest and \$1,000,000 to fund operations. Additionally, the Company has utilized approximately \$5,077,000 of the line of credit to collateralize its letters of credit. At February 29, 2008, the Company had \$746,000 available under the line of credit.

Equity Line

On April 7, 2006, ETC entered into a Preferred Stock Purchase Agreement (the "Lenfest Equity Agreement") with Lenfest. The Lenfest Equity Agreement permitted us to unilaterally draw down up to \$15 million in exchange for shares of our Series B Preferred Stock. The Series B Preferred Stock provides for a dividend equal to six percent per annum. After three years, the Series B Preferred Stock will be convertible, at Lenfest's request, into ETC common shares at a conversion price (the "Conversion Price") which will be set on the day of each draw down. The Conversion Price was equal to the closing price of our common stock on the trading day immediately preceding the day in which the draw down occurs, subject to a floor price of \$4.95 per common share. Drawdowns were not permitted on any day when the Conversion Price was less than this floor price. On the sixth anniversary of the Lenfest Equity Agreement, any issued and outstanding Series B Preferred Stock will be mandatorily converted into ETC common stock at each set Conversion Price. The Lenfest Equity Agreement also allows us to redeem any outstanding Series B Preferred Stock any time within its six-year term of the Lenfest Equity Agreement. Any issued and outstanding Series B Preferred Stock will vote with the ETC common stock on an as converted basis. The Lenfest Equity Agreement was terminated on July 31, 2007 upon execution of the credit agreement with PNC Bank on July 31, 2007 (see above).

In connection with the execution of the Lenfest Equity Agreement, in April 2006 we drew down \$3 million by issuing 3,000 shares of Series B Preferred Stock with a Conversion Price equal to \$4.95 per share. Additionally, on July 31, 2006, we drew down an additional \$3 million by issuing 3,000 shares of Series B Preferred Stock at a conversion price equal to \$6.68 per common share. In each instance, the proceeds were used for general corporate purposes.

By way of a letter dated March 29, 2007, Lenfest agreed to allow ETC to defer until April 6, 2012, or earlier if demanded, the payment of accruing dividends on Series B Preferred Stock issued under the Lenfest Equity Agreement.

Subordinated Convertible Debt

In connection with the financing provided by PNC on February 19, 2003, we entered into a Convertible Note and Warrant Purchase Agreement with Lenfest (the "Subordinated Note"), pursuant to which we issued to 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 our common stock. Upon the occurrence of certain events, we will be obligated to issue additional warrants to Lenfest. The Subordinated Note accrues interest at the rate of 10% per annum (Lenfest reduced the rate to 8% on a temporary basis for the period December 1, 2004 through November 30, 2007) and matures on February 18, 2009. At our option, the quarterly interest payments may be deferred and added to the outstanding principal. (Starting with the payment which was due on December 1, 2006, Lenfest has agreed to defer payment of interest until February 18, 2009 or until such time as we receive written demand notice. He has also agreed to waive paying interest on deferred interest payments.) The Subordinated Note entitles Lenfest to convert all or a portion of the outstanding principal of, and accrued and unpaid interest on, the Subordinated Note into shares of common stock at a conversion price of \$6.05 per share.

Our obligations to Lenfest under the Subordinated Note are secured by a second lien on all of our assets including all of our real property.

On March 11, 2008, the Company entered into Amendment No. 1 to Convertible Note and Warrant Purchase Agreement (the "Purchase Agreement Amendment") and First Amendment to Senior Subordinated Convertible Note (the "Note Amendment") with Lenfest with respect to that certain Convertible Note and Warrant Purchase Agreement, dated as of February 18, 2003, by and between ETC and Lenfest (the "Convertible Note and Warrant Purchase Agreement"). Under the terms of the Purchase Agreement Amendment, ETC and Lenfest agreed to amend the financial covenants set forth in the Convertible Note and Warrant Purchase Agreement so that they are the same as the financial covenants contained in ETC's credit agreement with PNC. Under the terms of the Note Amendment, the maturity date of the convertible promissory note in the principal amount of \$10,000,000 issued by ETC to Lenfest pursuant to the Convertible Note and Warrant Purchase Agreement was extended from February 18, 2009 to March 1, 2010. The effective date of the Purchase Agreement Amendment and the Note Amendment is February 19, 2008.

Preferred Stock

On August 23, 2007, the Company entered into the Series C Preferred Stock Purchase Agreement (the "Series C Purchase Agreement") with Lenfest, pursuant to which, among other things, ETC issued and sold 3,300 shares of its newly-created class of Series C Preferred Stock to Lenfest for \$3,300,000. The proceeds from the issuance of the Series C Preferred Stock were restricted solely for use to partially fund a settlement with the U.S. Navy. The proceeds are presented in the accompanying Consolidated Balance Sheets as Restricted Cash.

The Series C Preferred Stock is convertible by Lenfest at any time into shares of ETC's common stock at a conversion price of \$3.03 per share based on the closing price for ETC's common stock on August 22, 2007, the trading day immediately prior to the issuance. The Series C Preferred Stock votes with ETC's common stock on an as-converted basis and is fully convertible into 1,089,108 shares of ETC common stock. The Series C Preferred Stock automatically converts into ETC common shares on the fifth anniversary of the Acquisition. It carries an annual dividend rate of ten percent (10%).

ETC granted Lenfest certain demand and "piggy back" registration rights pursuant to a Registration Rights Agreement with respect to the shares of common stock issuable upon conversion of the Series C Preferred Stock.

In connection with Lenfest's investment in the Series C Preferred Stock, ETC agreed to amend the terms of ETC's Series B Preferred to (i) increase the annual dividend rate to 10%, (ii) provide for immediate conversion into common stock at the option of Lenfest, and (iii) to remove ETC's right to redeem the Series B Preferred Stock.

As allowed in the Series C Purchase Agreement, the Company is accruing dividends for the outstanding Series C Preferred Stock but has deferred payment of these dividends until a subsequent date, up to and including August 23, 2012.

In connection with the restatement of the Company's previously issued financial statements for the year ended February 23, 2007, the Company has reclassified the Series B and C Preferred Stock (the "instruments") from equity to mezzanine. The reclassification is due to the preferential redemption feature of the instruments, which provides that a change in ownership would result in a forced liquidation. A forced liquidation is considered outside the control of the Company. Therefore, the preferential treatment upon an act outside the control of the Company precluded equity treatment under the Securities and Exchange Commission Accounting Series Release ("ASR") 268 and Topic D98. Prior year's financial statements have been adjusted to reflect this change.

Liquidity

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. 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.

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.

Lenfest Letter Agreement

On May 20, 2008, Lenfest agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC shall not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of the American Stock Exchange, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

Lenfest Acquisition Proposal

On February 20, 2008, ETC received a proposal from an affiliate of Lenfest to purchase all of the publicly traded shares of the common stock of the Company not owned by Lenfest at the time the acquisition is consummated. The Board of Directors of the Company has formed a committee (the "Transaction Committee") comprised of independent directors to evaluate the proposal. The Transaction Committee has engaged a financial advisor to assist the Transaction Committee in evaluating the proposal. The Transaction Committee is evaluating the proposal and will make a recommendation with respect to the proposal to the Company's Board of Directors.

We believe that existing cash balances at February 29, 2008, cash generated from operating activities and future availability under the PNC line of credit and the commitment from Lenfest to fund ETC's operations will be adequate to meet our future obligations through at least June 30, 2009.

The following table presents our contractual cash flow commitments on long-term debt and operating leases. See Notes 8 and 9 to the Consolidated Financial Statements for additional information on our long-term debt and operating leases.

The following table lists the long-term debt and other long-term obligations of the Company as of February 29, 2008.

	Payments Due by Period (in thousands)				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term debt, including current maturities	\$ 18,201	\$ 9	\$ 18,192	\$ —	\$ —
Operating leases	487	131	356	—	—
Total	\$ 18,688	\$ 140	\$ 18,548	\$ —	\$ —

Long-term debt is reported net of unamortized discount of \$634,000 on the Company's subordinated debt.

Sales Backlog

Our sales backlog at February 29, 2008 and February 23, 2007, for work to be performed and revenue to be recognized under written agreements after such dates, was \$38,281,000 and \$13,564,000, respectively. In addition, our training, maintenance and upgrade contracts backlog at February 29, 2008 and February 23, 2007, for work to be performed and revenue to be recognized after such dates under written agreements was \$1,028,000 and \$1,276,000, respectively. Of the February 29, 2008 backlog, three product lines represented at least 10 percent of the total backlog: aircrew training systems (\$24,676,000, 64.5%), environmental products (\$4,266,000, 11.1%) and sterilizer products (\$4,128,000, 10.8%). Two international customers in the aircrew training systems line represented \$19,548,000, 79.2%, of the total aircrew training systems backlog.

We expect to complete approximately 70% of the February 29, 2008 backlog prior to February 27, 2009, the end of our 2009 fiscal year. Of the February 23, 2007 backlog, we completed approximately 69% by February 29, 2008.

Our order flow does not follow any seasonal pattern as we receive orders in each fiscal quarter of our fiscal year.

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements during the fiscal year ended February 29, 2008 that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our investors.

Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133 (“SFAS 161”). SFAS 161 requires enhanced disclosures related to derivative and hedging activities, and thereby seeks to improve the transparency of financial reporting. Under SFAS 161, entities are required to provide enhanced disclosures relating to a) how and why an entity uses derivative instruments; b) how derivatives instruments and related hedge items are accounted for under SFAS 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”), and its related interpretations; and c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This statement shall be effective for the Company beginning November 29, 2008. The Company is currently evaluating the potential impact of the adoption of SFAS 161 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), “Business Combinations” (“SFAS 141R”). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures its financial statements, the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. This statement is effective for the Company beginning November 29, 2008.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements — an amendment of Accounting Research Bulletin No. 51” (“SFAS 160”). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of the consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent’s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also established disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for the Company beginning November 29, 2008. The Company is currently evaluating the potential impact of the adoption of SFAS 141R on its consolidated financial statements.

Equity Compensation Plan Information

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u> (a)	<u>Weighted-average exercise price of outstanding options, warrants and rights</u> (b)	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u> (c)
Equity compensation plans approved by security holders	367,487	\$ 6.70	1,203,323
Equity compensation plans not approved by security holders	—	N/A	202,663
Total	<u>367,487</u>	<u>\$ 6.70</u>	<u>1,405,986</u>

The following plans have not been approved by our shareholders:

Employee Stock Purchase Plan

We have 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. We make a matching contribution equal to 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 (the "Company") as of February 29, 2008 and February 23, 2007 and the related consolidated statements of operations, changes in stockholders' deficiency, and cash flows for the fifty three weeks ended February 29, 2008 and fifty two weeks ended February 23, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 audits to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 financial position of Environmental Tectonics Corporation and Subsidiaries as of February 29, 2008 and February 23, 2007, and the consolidated results of their operations and their cash flows for the each of the fifty three weeks ended February 29, 2008 and fifty two weeks ended February 23, 2007 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 29, 2008 and February 23, 2007 and for the fifty three weeks ended February 29, 2008 and fifty two weeks ended February 23, 2007. In our opinion, this schedule presents fairly, in all material respects, the information required to be set forth herein.

/s/ Friedman LLP

East Hanover, New Jersey

May 29, 2008

Environmental Tectonics Corporation
Consolidated Balance Sheets
(in thousands, except share information)

	February 29, 2008	February 23, 2007 (restated)
ASSETS		
Cash and cash equivalents	\$ 1,871	\$ 2,215
Restricted cash	4,526	20
Accounts receivable, net of allowance for bad debt of \$746 and \$3,372	3,231	2,094
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	3,422	2,816
Inventories	6,773	4,739
Deferred tax asset	43	71
Prepaid expenses and other current assets	790	213
Total current assets	<u>20,656</u>	<u>12,168</u>
Property, plant and equipment, at cost, net	15,208	4,054
Construction in progress	141	8,460
Software development costs, net of accumulated amortization of \$12,161 and \$10,949 in 2008 and 2007	1,614	2,158
Goodwill	—	455
Other assets	6	30
Total assets	<u>\$ 37,625</u>	<u>\$ 27,325</u>
LIABILITIES		
Current portion of long-term debt	\$ 9	\$ —
Accounts payable — trade	3,060	2,254
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	6,491	1,400
Customer deposits	2,989	794
Accrued claim settlement costs	2,275	—
Accrued interest and dividends	2,287	668
Other accrued liabilities	1,803	1,539
Total current liabilities	<u>18,914</u>	<u>6,655</u>
Long-term obligations, less current portion:		
Credit facility payable to bank	8,810	—
Subordinated convertible debt	9,366	8,830
Other long-term debt	16	—
	<u>18,192</u>	<u>8,830</u>
Total liabilities	<u>37,106</u>	<u>15,485</u>
Commitments and contingencies	—	—
Minority interest	50	53
Cumulative convertible participating preferred stock, Series B, \$.05 par value, 15,000 shares authorized; 6,000 shares issued and outstanding at February 29, 2008 and February 23, 2007	6,000	6,000
Cumulative convertible participating preferred stock, Series C, \$.05 par value, 3,300 shares authorized, issued and outstanding at February 29, 2008	3,300	—
STOCKHOLDERS' DEFICIENCY		
Common stock, \$.05 par value, 20,000,000 shares authorized; 9,035,355 and 9,028,459 shares issued and outstanding at February 29, 2008 and February 23, 2007	451	451
Additional paid-in capital	16,139	16,662
Accumulated other comprehensive loss	(121)	(149)
Accumulated deficit	(25,300)	(11,177)
Total stockholders' (deficiency) equity	<u>(8,831)</u>	<u>5,787</u>
Total liabilities and stockholders' deficiency	<u>\$ 37,625</u>	<u>\$ 27,325</u>

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

Environmental Tectonics Corporation
Consolidated Statements of Operations
(amounts in thousands, except share information)

	<u>53 Weeks Ended</u> <u>February 29, 2008</u>	<u>52 Weeks Ended</u> <u>February 23, 2007</u> <u>(restated)</u>
Net sales	\$ 22,730	\$ 17,419
Cost of goods sold	<u>18,484</u>	<u>15,348</u>
Gross profit	<u>4,246</u>	<u>2,071</u>
Operating expenses:		
Selling and administrative, including stock compensation expense of \$114 and \$324	11,518	9,434
Claim settlement costs	3,638	3,004
Impairment charge	455	—
Research and development	<u>678</u>	<u>569</u>
	<u>16,289</u>	<u>13,007</u>
Operating loss	<u>(12,043)</u>	<u>(10,936)</u>
Other expenses:		
Interest expense, net	1,582	1,151
Other expense (income), net	<u>236</u>	<u>(58)</u>
	<u>1,818</u>	<u>1,093</u>
Loss before provision for (benefit from) income taxes and minority interest	(13,861)	(12,029)
Provision for (benefit from) income taxes	<u>37</u>	<u>(77)</u>
Loss before minority interest	(13,898)	(11,952)
(Income) loss attributable to minority interest	<u>(3)</u>	<u>8</u>
Net loss	<u>\$ (13,895)</u>	<u>\$ (11,944)</u>
Preferred stock dividends	(661)	(259)
Loss applicable to common shareholders	<u>\$ (14,556)</u>	<u>\$ (12,203)</u>
Per share information:		
Loss per common share applicable to common shareholders:		
Basic and diluted	<u>\$ (1.61)</u>	<u>\$ (1.35)</u>
Weighted average common shares:		
Basic and diluted	<u>9,030,000</u>	<u>9,030,000</u>

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

Environmental Tectonics Corporation
Consolidated Statements of Changes in Stockholders' Deficiency
(amounts in thousands, except share information)

For the 53 weeks ended February 29, 2008 and the 52 weeks ended February 23, 2007

	Common Stock		Additional Paid-in Capital	Accumulated other comprehensive loss	Accumulated deficit	Total stockholders' deficiency
	Shares	Amount				
Balance, February 24, 2006	9,024,804	\$ 451	\$ 16,584	\$ (249)	\$ 767	\$ 17,553
Net loss for the year (restated)					(11,944)	(11,944)
Foreign currency translation adjustment				100		100
Total comprehensive loss						(11,844)
Stock compensation expense			324			324
Issuance of stock under employee Stock Purchase Plan and Board of Director's compensation	3,655	—	13	—	—	13
Accumulated preferred stock dividends	—	—	(259)	—	—	(259)
Balance, February 23, 2007 (restated)	9,028,459	451	16,662	(149)	(11,177)	5,787
Net loss for the year					(13,895)	(13,895)
Interest hedge valuation					(228)	(228)
Foreign currency translation adjustment				28		28
Total comprehensive loss						(14,095)
Stock compensation expense			114			114
Issuance of stock under employee Stock Purchase Plan and Board of Director's compensation	6,896	—	24	—	—	24
Accumulated preferred stock dividends	—	—	(661)	—	—	(661)
Balance, February 29, 2008	9,035,355	\$ 451	\$ 16,139	\$ (121)	\$ (25,300)	\$ (8,831)

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

Environmental Tectonics Corporation
Consolidated Statements of Cash Flows
(amounts in thousands)

	53 Weeks Ended February 29, 2008	52 Weeks Ended February 23, 2007 (restated)
Cash flows from operating activities:		
Net loss	\$ (13,895)	\$ (11,944)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities		
Depreciation and amortization	1,996	1,857
Accretion of debt discount	536	454
(Decrease) increase in allowance for accounts receivable and inventory	687	2,366
(Income) attributable to minority interest	(3)	(8)
Impairment charge	455	—
Stock compensation expense	138	324
Deferred income taxes (benefit)	28	(71)
Changes in operating assets and liabilities:		
(Increase) decrease in assets:		
Accounts receivable	(1,601)	1,520
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	(606)	664
Inventories	(2,257)	(2,806)
Prepaid expenses and other current assets	(577)	351
Other assets	24	19
Increase (decrease) in liabilities:		
Accounts payable	806	143
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	5,091	282
Customer deposits	2,195	(83)
Accrued income taxes	—	43
Accrued claim settlement costs	2,275	—
Accrued interest and dividends	958	454
Other accrued liabilities	264	(562)
Net cash used in operating activities	<u>(3,486)</u>	<u>(6,997)</u>
Cash flows from investing activities:		
Acquisition of equipment	(3,618)	(308)
Software development costs	(669)	(155)
Net cash used in investing activities	<u>(4,287)</u>	<u>(463)</u>
Cash flows from financing activities:		
Borrowings under credit facility	8,810	—
Issuance of notes payable, Lenfest	4,000	3,000
Repayments of notes payable, Lenfest	(4,000)	(3,000)
Other debt obligations	25	—
Issuance of preferred stock	3,300	6,000
Increase in restricted cash	(4,506)	(4)
Issuance of common stock/warrants	—	13
Net cash provided by financing activities	<u>7,629</u>	<u>6,009</u>
Effect of other comprehensive income	<u>(200)</u>	<u>100</u>
Net (decrease) increase in cash and cash equivalents	(344)	(1,351)
Cash and cash equivalents at beginning of year	<u>2,215</u>	<u>3,566</u>
Cash and cash equivalents at end of year	<u>\$ 1,871</u>	<u>\$ 2,215</u>
Supplemental schedule of cash flow information:		
Interest paid	\$ 230	\$ 616
Income taxes paid	—	—

Supplemental information on non-cash operating, investing and financing activities:

In the year ended February 29, 2008, the Company reclassified \$8,460,000 from Construction in Progress to Property, Plant and Equipment. In the year ended February 23, 2007, the Company reclassified \$8,460,000 from Inventory to Construction in Progress. During the years ended February 23, 2007,

\$382,000 was reclassified from Inventory to Capitalized Software.

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

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements

1. Restatement of Previously Issued Financial Statements

Environmental Tectonics Corporation (“ETC” or the “Company”) has restated its previously issued financial statements for the fiscal year ended February 23, 2007 and the 13 and 39 week-periods ended November 24, 2006.

Settlement with U.S. Navy

History of the Claim Receivable

In May 2003, the Company filed a certified claim with the Department of the Navy (the “Government”) seeking costs totaling in excess of \$5.0 million in connection with a contract for submarine rescue decompression chambers.

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 the Company may receive. However, revenue recorded on a contract claim cannot exceed the incurred contract costs related to that claim. Since 2004, the Company had a claim receivable recorded for \$3,004,000. The Company’s Form 10-K as originally filed for February 23, 2007 included this claim receivable. This claim receivable was subsequently deemed to be impaired and reserved in full (see below).

Litigation of the Certified Claim

On July 22, 2004, the Navy’s contracting officer issued a final decision denying the claim in full. In July 2005, the Company converted this claim into a complaint which the Company filed in the United States Court of Federal Claims. On June 14, 2007, the Government amended its filings to add counterclaims pursuant to the anti-fraud provisions of the Contract Disputes Act, the False Claims Act, and the forfeiture statute.

Settlement of Litigation and Subsequent Funding

On June 27, 2007, the Company and the Government filed a Joint Motion to Dismiss with prejudice all of the Company’s claims against the Government, which was granted on June 28, 2007. Additionally, the Company agreed to pay to the Government \$3.55 million to reimburse the Government for estimated work to complete the chambers and for litigation expenses (\$3.3 million recorded in the first quarter of fiscal 2008 and \$250,000 recorded in the second quarter of fiscal 2008) and transfer the submarine rescue decompression chambers to the Navy. As of May 14, 2008, the Company had made all payments required under this settlement agreement and had transferred the chambers to the Government.

To partially fund the settlement, on August 23, 2007 the Company entered into the Series C Preferred Stock Purchase Agreement with Lenfest, pursuant to which, among other things, ETC issued and sold 3,300 shares of its newly-created class of Series C Cumulative Convertible Participating Preferred Stock (the “Series C Preferred Stock”) to Lenfest for \$3,300,000. The proceeds from the issuance of the Series C Preferred Stock were restricted solely for use to partially fund the settlement with the Government.

Audit Committee Review and Regulatory Compliance Matters

In July 2007 the Company’s Audit Committee retained independent counsel to review the Government claim issue. While this review was being conducted, the Company could not file its Quarterly Reports on Form 10-Q (“Quarterly Reports”), although preliminary financial results were released and filed on Form 8-K’s for each of the fiscal quarters ended May 25, 2007, August 24, 2007 and November 23, 2007. Since the Company could not file its Quarterly Reports, the Company was notified by the American Stock Exchange (“AMEX”) that it was not in compliance with AMEX’s continued listing standards and in August 2007 the Company submitted a plan to regain compliance. On January 30, 2008, the Company was notified by AMEX that, due to continuing non-compliance with listing standards, they were initiating delisting proceedings. The Company appealed that decision and, on April 9, 2008 representatives of the Company participated in an appeal hearing. As a result of that hearing, on April 16, 2008 the Company was granted a stay of delisting proceedings until May 29, 2008.

As a result of the allegations made by the Department of Justice in connection with the Navy matter, on October 12, 2007, pursuant to the Federal Acquisition Regulations, the Government placed the Company on suspension, which barred the Company from soliciting contract work with any Government agency. On December 12, 2007, the Company executed an Administrative Agreement, which included a program of compliance reviews, audits and reports, and the Government lifted the suspension.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Change in Independent Registered Public Accounting Firm

Following the independent counsel's review, the Company's auditors, Grant Thornton LLP, resigned from the Company and rescinded their audit opinion for the fiscal years 2003 through 2007. On January 30, 2008, the Company's Audit Committee engaged Friedman LLP as the Company's registered public accounting firm.

Restatement of Previously Filed Financial Statements

Settlement with U.S. Navy

In November 2007, the independent counsel completed its review. Subsequently, the Company's Audit Committee, in conjunction with management, concluded that as of November 2006 the claim receivable of \$3,004,000 had been impaired.

On April 24, 2008, the Company announced that it was restating results for the 13 and 39 week-periods ended November 24, 2006 and the fiscal year ended February 23, 2007. This restatement reflected the formal investigation which concluded that the carrying value of the \$3,004,000 claim receivable had been impaired during the third quarter of fiscal 2007. This impairment resulted from certain allegations made by the Government during that period which resulted in the counterclaim which was filed by the Government against the Company in June 2007.

The restatement for the 13 and 39 week-periods ended November 24, 2006 and the fiscal year ended February 23, 2007 involves one change, namely the recording of a reserve against a claim receivable for the full amount of the carrying value of \$3,004,000 of the claim receivable. The effect of this adjustment results in a corresponding reduction in accounts receivable, an increase in net loss and a reduction in stockholder's equity.

Preferred Stock

In connection with the restatement of the Company's previously issued financial statements for the year ended February 23, 2007, the Company has reclassified the Series B and C Preferred Stock (the "instruments") from equity to mezzanine. The reclassification is due to the preferential redemption feature of the instruments, which provides that a change in ownership would result in a forced liquidation. A forced liquidation is considered outside the control of the Company. Therefore, the preferential treatment upon an act outside the control of the Company precluded equity treatment under the Securities and Exchange Commission Accounting Series Release ("ASR") 268 and Topic D98. Prior year's financial statements have been adjusted to reflect this change.

Due to the Company's accumulated deficit, all dividends accruing for the Series B and Series C Preferred Stock have been recorded in the accompanying financial statements as a reduction in additional paid-in capital.

For the discussion of the restatement adjustments, see Note 1 — Restatement of Previously Issued Financial Statements in the accompanying Notes to the Consolidated Financial Statements. All amounts referenced in this Annual Report for the 13 and 39 week-periods ended November 24, 2006 and the fiscal year ended February 23, 2007 reflect the amounts on a restated basis.

Additional Matters Regarding H.F. Lenfest

Lenfest Acquisition Proposal

On February 20, 2008, ETC received a proposal from an affiliate of Lenfest to purchase all of the publicly traded shares of the common stock of the Company not owned by Lenfest at the time the acquisition is consummated. The Board of Directors of the Company has formed a committee (the "Transaction Committee") comprised of independent directors to evaluate the proposal. The Transaction Committee has engaged a financial advisor to assist the Transaction Committee in evaluating the proposal. The Transaction Committee is evaluating the proposal and will make a recommendation with respect to the proposal to the Company's Board of Directors.

Lenfest Letter Agreement

On May 20, 2008, Lenfest agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC may not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of AMEX, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

Failure to Meet Financial Covenants under Credit Agreement

On July 31, 2007, the Company entered into a revolving credit agreement (the "Credit Agreement") in order to refinance its indebtedness with PNC Bank, National Association ("PNC") in the aggregate amount of up to \$15,000,000. This Credit Agreement is a replacement of a credit facility originally entered into with PNC in February 2003.

The Credit Agreement contains affirmative and negative covenants for transactions of this type, including limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business and transactions with affiliates. Under the Credit Agreement, the Company must maintain a minimum Consolidated Tangible Net Worth of \$9,000,000 at the end of each fiscal quarter. At February 29, 2008, the Company failed to meet the Consolidated Tangible Net Worth financial covenant. Additionally, under the Credit Agreement, the Company's events of default include the obligations of Lenfest as guarantor of the line of credit. Lenfest failed to deliver certain financial statements to the bank within the required time as specified in the Credit Agreement, which also was an event of default under the Agreement. On May 29, 2008 the Company received a waiver from PNC Bank, effective for the period ended February 29, 2008. The waiver does not extend beyond February 29, 2008. The Company has also agreed that Lenfest shall deliver certain additional financial statements on or before October 31, 2008, and failure to do so shall constitute an event of default. Management believes that the Bank will not exercise their rights under the default provisions as contained in the Credit Agreement. Lenfest is a guarantor of the Company's borrowings under the Credit Agreement. If the Bank exercises its right to call the Loan the Lenfest Guarantee will become enforceable. As noted earlier, Lenfest is a guarantor of the

Company's borrowings under the Credit Agreement and has agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC may not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of AMEX, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

The following financial schedules reflect the impact of these restatements.

Restated Statements of Operations amounts:

The table below sets forth the effect of the adjustment on the Condensed Consolidated Statement of Operations for the 13 week period ended November 24, 2006.

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

	As Originally Reported	Claim Receivable Impairment	As Restated
Net sales	\$ 4,718	\$ —	\$ 4,718
Cost of goods sold	3,688	—	3,688
Gross profit	<u>1,030</u>	<u>—</u>	<u>1,030</u>
Operating expenses:			
Selling and administrative	2,568		2,568
Claim settlement costs	—	3,004	3,004
Research and development	43	—	43
	<u>2,611</u>	<u>3,004</u>	<u>5,615</u>
Operating loss	<u>(1,581)</u>	<u>(3,004)</u>	<u>(4,585)</u>
Other expenses:			
Interest expense	291	—	291
Other income, net	(43)	—	(43)
	<u>248</u>	<u>—</u>	<u>248</u>
Loss before income taxes	(1,829)	(3,004)	(4,833)
Provision for income taxes	4	—	4
Loss before minority interest	(1,833)	(3,004)	(4,837)
Income attributable to minority interest	33	—	33
Net loss	<u>\$ (1,866)</u>	<u>\$ (3,004)</u>	<u>\$ (4,870)</u>
Preferred stock dividend	(90)	—	(90)
Loss applicable to common shareholders	<u>\$ (1,956)</u>	<u>\$ (3,004)</u>	<u>\$ (4,960)</u>
Per share information:			
Basic and diluted loss per share applicable to common shareholders	<u>\$ (0.22)</u>	<u>\$ (0.33)</u>	<u>\$ (0.55)</u>
Basic and diluted weighted average number of common shares	<u>9,027,000</u>	<u>9,027,000</u>	<u>9,027,000</u>

Environmental Tectonics Corporation
Notes to the Condensed Consolidated Financial Statements, continued

The table below sets forth the effect of the adjustment on the Condensed Consolidated Statement of Operations for the 39 week period ended November 24, 2006

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

	As Originally Reported	Claim Receivable Impairment	As Restated
Net sales	\$ 13,622	\$ —	\$ 13,622
Cost of goods sold	11,084	—	11,084
Gross profit	<u>2,538</u>	<u>—</u>	<u>2,538</u>
Operating expenses:			
Selling and administrative	7,204		7,204
Claim settlement costs	—	3,004	3,004
Research and development	529	—	529
	<u>7,733</u>	<u>3,004</u>	<u>10,737</u>
Operating loss	<u>(5,195)</u>	<u>(3,004)</u>	<u>(8,199)</u>
Other expenses:			
Interest expense	857	—	857
Other income, net	(36)	—	(36)
	<u>821</u>	<u>—</u>	<u>821</u>
Loss before income taxes	(6,016)	(3,004)	(9,020)
Provision for income taxes	<u>13</u>	<u>—</u>	<u>13</u>
Loss before minority interest	(6,029)	(3,004)	(9,033)
Income attributable to minority interest	<u>16</u>	<u>—</u>	<u>16</u>
Net loss	<u>\$ (6,045)</u>	<u>\$ (3,004)</u>	<u>\$ (9,049)</u>
Preferred stock dividend	<u>(169)</u>	<u>—</u>	<u>(169)</u>
Loss applicable to common shareholders	<u>\$ (6,214)</u>	<u>\$ (3,004)</u>	<u>\$ (9,218)</u>
Per share information:			
Basic and diluted loss per share applicable to common shareholders	<u>\$ (0.69)</u>	<u>\$ (0.33)</u>	<u>\$ (1.02)</u>
Basic and diluted weighted average number of common shares	<u>9,031,000</u>	<u>9,031,000</u>	<u>9,031,000</u>

Environmental Tectonics Corporation
Notes to the Condensed Consolidated Financial Statements, continued

The table below sets forth the effect of the adjustment on the Consolidated Statement of Operations for the year ended February 23, 2007.

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

	As Originally Reported	Claim Receivable Impairment	As Restated
Net sales	\$ 17,419	\$ —	\$ 17,419
Cost of goods sold	15,348	—	15,348
Gross profit	<u>2,071</u>	<u>—</u>	<u>2,071</u>
Operating expenses:			
Selling and administrative	9,434		9,434
Claim settlement costs	—	3,004	3,004
Research and development	569	—	569
	<u>10,003</u>	<u>3,004</u>	<u>13,007</u>
Operating loss	<u>(7,932)</u>	<u>(3,004)</u>	<u>(10,936)</u>
Other expenses:			
Interest expense	1,151	—	1,151
Other income, net	(58)	—	(58)
	<u>1,093</u>	<u>—</u>	<u>1,093</u>
Loss before income taxes	(9,025)	(3,004)	(12,029)
Benefit from income taxes	(77)	—	(77)
Loss before minority interest	(8,948)	(3,004)	(11,952)
Loss attributable to minority interest	(8)	—	(8)
Net loss	<u>\$ (8,940)</u>	<u>\$ (3,004)</u>	<u>\$ (11,944)</u>
Preferred stock dividend	(259)	—	(259)
Loss applicable to common shareholders	<u>\$ (9,199)</u>	<u>\$ (3,004)</u>	<u>\$ (12,203)</u>
Per share information:			
Basic and diluted loss per share applicable to common shareholders	<u>\$ (1.02)</u>	<u>\$ (0.33)</u>	<u>\$ (1.35)</u>
Basic and diluted weighted average number of common shares	<u>9,030,000</u>	<u>9,030,000</u>	<u>9,030,000</u>

Environmental Tectonics Corporation
Notes to the Condensed Consolidated Financial Statements, continued
Restated Balance Sheets amounts:

The table below sets forth the effect of the adjustment on the Condensed Consolidated Balance Sheet as of November 24, 2006.

(in thousands, except share and per share information)

	As Originally Reported adjusted for	Claim Receivable	As
	Preferred Stock Reclass	Impairment	Restated
Assets			
Current assets:			
Cash	\$ 4,002	\$ —	\$ 4,002
Restricted cash	19	—	19
Accounts receivable, net of allowance for bad debts of \$376 and \$3,380	8,381	(3,004)	5,377
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	4,679	—	4,679
Inventories	12,782	—	12,782
Prepaid expenses and other current assets	428	—	428
Total current assets	30,291	(3,004)	27,287
Property, plant and equipment, at cost, net of accumulated depreciation of \$12,643	4,099	—	4,099
Software development costs, net of accumulated amortization of \$10,773	2,008	—	2,008
Goodwill	455	—	455
Other assets	29	—	29
Total assets	\$ 36,882	\$ (3,004)	\$ 33,878
Liabilities and Stockholders' Equity			
Liabilities			
Current liabilities:			
Notes payable	3,000	—	3,000
Accounts payable — trade	1,818	—	1,818
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	2,035	—	2,035
Customer deposits	1,401	—	1,401
Accrued liabilities	2,134	—	2,134
Total current liabilities	10,388	—	10,388
Long-term obligations:			
Subordinated convertible debt	8,709	—	8,709
Total liabilities	19,097	—	19,097
Commitments and contingencies			
Minority interest	77	—	77
Cumulative convertible participating preferred stock, Series B, \$.05 par value, 15,000 shares authorized; 6,000 shares issued and outstanding	6,000	—	6,000
Stockholders' Equity			
Common stock; \$.05 par value; 20,000,000 shares authorized; 9,026,958 issued and outstanding	451	—	451
Additional paid-in capital	16,455	—	16,455
Accumulated other comprehensive loss	(179)	—	(179)
Accumulated deficit	(5,019)	(3,004)	(8,023)
Total stockholders' equity	11,708	(3,004)	8,704
Total liabilities and stockholders' equity	\$ 36,882	\$ (3,004)	\$ 33,878

Environmental Tectonics Corporation
Notes to the Condensed Consolidated Financial Statements, continued

The table below sets forth the effect of the adjustment on the Consolidated Balance Sheet as of February 23, 2007.

(in thousands, except share and per share information)

	As Originally Reported adjusted for		As
	Preferred Stock Reclass	Claim Receivable Impairment	Restated
Assets			
Current assets:			
Cash	\$ 2,215	\$ —	\$ 2,215
Restricted cash	20	—	20
Accounts receivable, net of allowance for bad debts of \$368 and \$3,372	5,098	(3,004)	2,094
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	2,816	—	2,816
Inventories	4,739	—	4,739
Deferred tax asset	71	—	71
Prepaid expenses and other current assets	213	—	213
Total current assets	15,172	(3,004)	12,168
Property, plant and equipment, at cost, net of accumulated depreciation of \$12,760	4,054	—	4,054
Construction in progress	8,460	—	8,460
Software development costs, net of accumulated amortization of \$10,949	2,158	—	2,158
Goodwill	455	—	455
Other assets	30	—	30
Total assets	<u>\$ 30,329</u>	<u>\$ (3,004)</u>	<u>\$ 27,325</u>
Liabilities and Stockholders' Equity			
Liabilities			
Current liabilities:			
Accounts payable — trade	2,254	—	2,254
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	1,400	—	1,400
Customer deposits	794	—	794
Accrued liabilities	2,207	—	2,207
Total current liabilities	6,655	—	6,655
Long-term obligations:			
Subordinated convertible debt	8,830	—	8,830
Total liabilities	15,485	—	15,485
Commitments and contingencies			
Minority interest	53	—	53
Cumulative convertible participating preferred stock, Series B, \$.05 par value, 15,000 shares authorized; 6,000 shares issued and outstanding	6,000	—	6,000
Stockholders' Equity			
Common stock; \$.05 par value; 20,000,000 shares authorized; 9,028,459 issued and outstanding	451	—	451
Additional paid-in capital	16,662	—	16,662
Accumulated other comprehensive loss	(149)	—	(149)
Accumulated deficit	(8,173)	(3,004)	(11,177)
Total stockholders' equity	8,791	(3,004)	5,787
Total liabilities and stockholders' equity	<u>\$ 30,329</u>	<u>\$ (3,004)</u>	<u>\$ 27,325</u>

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

2. Nature of Business and Liquidity Matters:

Environmental Tectonics Corporation is principally engaged in the design, manufacture and sale of software driven products and services used to recreate 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 (aeromedical, tactical combat and general), disaster management systems and services, entertainment products, sterilizers (steam and gas), environmental testing products and hyperbaric chambers and other products that involve similar manufacturing techniques and engineering technologies. ETC focuses on software enhancements, product extensions, new product development and new marketplace applications. Sales of its products are made principally to U.S. and foreign government agencies and to the entertainment market. We operate in two primary business segments, the Training Services Group (TSG) and the Control Systems Group (CSG).

Training Services Group. This segment includes three primary product groups: aircrew training devices and services, disaster management training and systems, and entertainment products.

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

The Company's fiscal year is the 52-or 53-week annual accounting period ending the last Friday in February. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2008.

The Company has experienced net cash usages from operations of \$3,518,000 and \$6,997,000 for fiscal years 2008 and 2007, respectively.

On May 20, 2008, Lenfest agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC shall not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of the American Stock Exchange, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

On February 20, 2008, ETC received a proposal from an affiliate of Lenfest to purchase all of the publicly traded shares of the common stock of the Company not owned by Lenfest at the time the acquisition is consummated. The Board of Directors of the Company has formed a committee (the "Transaction Committee") comprised of independent directors to evaluate the proposal. The Transaction Committee has engaged a financial advisor to assist the Transaction Committee in evaluating the proposal. The Transaction Committee is evaluating the proposal and will make a recommendation with respect to the proposal to the Company's Board of Directors.

We believe that existing cash balances at February 29, 2008, cash generated from operating activities and future availability under the PNC line of credit and the commitment from Lenfest to fund ETC's operations will be adequate to meet our future obligations through at least June 30, 2009.

3. 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. "ETC SH" refers to the company's corporate headquarters and main production plant located in Southampton, Pennsylvania, USA. All material inter-company accounts and transactions have been eliminated in consolidation.

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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Revenue Recognition:

On long-term contracts, with a contract value over \$250,000 and a minimum completion period of six months, the percentage-of-completion (“POC”) 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 an asset. Amounts billed to customers in excess of revenue recognized on uncompleted long-term contracts are reflected as a 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 the 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 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, 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. Revenue on contracts under \$250,000, or to be completed in less than six months, and where post-shipment services (such as installation and customer acceptance) are required, is recognized following customer acceptance. 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 the Company may receive. 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.

Cash:

Cash 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 proceeds from the issuance of Series C Preferred Stock to fund the settlement with the U.S. Navy. Additionally, the Company had monies on deposit in Turkey securing a performance guarantee in Turkey.

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, records a reserve to reflect the net realizable value of the inventory.

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. Buildings and building additions are depreciated over 40 years; machinery and equipment, 3 to 20 years; office furniture and equipment, 10 years; and building improvements, 5 to 10 years. 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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

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. Goodwill of \$24,000 was recorded in fiscal 2001 for the Company's purchase of 99% of ETC Europe. The Company did not record any amortization expense in fiscal years 2008 and 2007. The net value of goodwill as of February 23, 2007 was \$455,000. Based on an evaluation of the net undiscounted cash flows expected from ETC-PZL in fiscal 2009, it was determined that the asset representing the net book value over purchase price for this subsidiary would not be recovered. Therefore, the entire amount of Goodwill, \$455,000, remaining from this purchase was charged to operations in fiscal 2008. This expense is included in the Consolidated Statement of Operations as an Impairment charge of \$455,000 for the 52 weeks ended February 29, 2008. There was no impairment charge for fiscal 2007.

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 \$774,000 and \$537,000 respectively, for the fiscal years ended February 29, 2008 and February 23, 2007. Related software amortization totaled \$1,213,000 and \$1,231,000, respectively, for fiscal 2008 and 2007.

Research and Development:

Research and development expenses are charged to operations as incurred. During fiscal 2008 and 2007, the Company incurred research and development costs of approximately \$678,000 and \$569,000, respectively.

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 SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", 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.

Share-Based Compensation:

The Company adopted Statement of Financial Accounting Standard ("SFAS") No. 123(R) effective February 25, 2006. SFAS No. 123(R) requires the Company to recognize expense related to the fair value of stock-based compensation awards, including employee stock options. Prior to the adoption of SFAS No. 123(R), the Company accounted for stock options using the intrinsic value method of APB Opinion No. 25, and it did not recognize compensation expense in its income statement for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company also provided certain pro forma disclosures for stock option awards as if the fair value-based approach of SFAS No. 123(R) had been applied.

The Company has elected to use the modified prospective transition method as permitted by SFAS No. 123(R) and therefore has not restated its financial results for prior periods. Under this transition method, the Company applied the provisions of SFAS No. 123(R) to new awards and to awards modified, repurchased or cancelled after February 24, 2006. Additionally, for unvested awards granted prior to the effective date of the Company's adoption of SFAS No. 123(R), the Company recognizes compensation expense in

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

the same manner as was used in its income statement or for pro-forma disclosures prior to the effective date of its adoption of SFAS No. 123(R).

Advertising Costs:

The Company expenses advertising costs, which include trade shows, as incurred. Advertising expense was \$310,000 and \$351,000 in fiscal 2008 and 2007, 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.

Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board ("FASB") issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133 ("SFAS 161"). SFAS 161 requires enhanced disclosures related to derivative and hedging activities, and thereby seeks to improve the transparency of financial reporting. Under SFAS 161, entities are required to provide enhanced disclosures relating to a) how and why an entity uses derivative instruments; b) how derivatives instruments and related hedge items are accounted for under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), and its related interpretations; and c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This statement shall be effective for the Company beginning November 29, 2008. The Company is currently evaluating the potential impact of the adoption of SFAS 161 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures its financial statements, the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. This statement is effective for the Company beginning November 29, 2008.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of the consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also established disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for the Company beginning November 29, 2008. The Company is currently evaluating the potential impact of the adoption of SFAS 141R on its consolidated financial statements.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

4. Accounts Receivable:

The components of accounts receivable at February 29, 2008 and February 23, 2007 are as follows:

	(in thousands)	
	February 29, 2008	February 23, 2007
U.S. government receivables billed and unbilled contract costs subject to negotiation	\$ 315	\$ 3,135
U.S. commercial receivables billed	2,573	1,525
International receivables billed	1,089	806
	3,977	5,466
Less allowance for doubtful accounts	(746)	(3,372)
	\$ 3,231	\$ 2,094

Unbilled contract costs subject to negotiation as of February 23, 2007, 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 fully reserved, which was subsequently disposed after settlement (See Note 1 — Restatement of Previously Issued Financial Statements).

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Notes to the Consolidated Financial Statements, continued

5. Costs and Estimated Earnings on Uncompleted Contracts:

Unbilled costs

The following is a summary of long-term contracts in progress at February 29, 2008 and February 23, 2007

	(in thousands):	
	<u>February 29, 2008</u>	<u>February 23, 2007</u>
Cost incurred on uncompleted long-term contracts	\$ 44,451	\$ 40,395
Estimated earnings	12,071	14,953
	<u>56,522</u>	<u>55,348</u>
Less billings to date	(59,591)	(53,932)
	<u>\$ (3,069)</u>	<u>\$ 1,416</u>

Included in accompanying balance sheets under the following captions:

	<u>February 29, 2008</u>	<u>February 23, 2007</u>
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	\$ 3,422	\$ 2,816
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(6,491)	(1,400)
	<u>\$ (3,069)</u>	<u>\$ 1,416</u>

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 2008 and 2007.

6. Inventories:

Inventories consist of the following:

	(in thousands)	
	<u>February 29, 2008</u>	<u>February 23, 2007</u>
Raw material	\$ 90	\$ 95
Work in process	5,916	3,820
Finished goods	767	824
Total inventory	<u>\$ 6,773</u>	<u>\$ 4,739</u>

Inventory is presented above net of an allowance for obsolescence of \$1,222,000 (Raw material \$90,000, Work in process \$571,000 and Finished goods \$561,000) and \$991,000 (Raw material \$95,000, Work in process \$326,000 and Finished goods \$570,000) in fiscal 2008 and 2007, respectively.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

7. Property, Plant and Equipment:

The following is a summary of property, plant and equipment, at cost, and estimated useful lives at February 29, 2008 and February 23, 2007:

	February 29, 2008	February 23, 2007
	(in thousands)	
Land	\$ 100	\$ 100
Buildings and building additions	3,851	3,763
Machinery and equipment	21,034	10,024
Office furniture and equipment	1,194	1,379
Building improvements	2,466	1,548
	<u>28,645</u>	<u>16,814</u>
Less accumulated depreciation	(13,437)	(12,760)
Property, plant and equipment, net	<u>\$ 15,208</u>	<u>\$ 4,054</u>

Depreciation expense for the fiscal years ended February 29, 2008 and February 23, 2007 was \$783,000 and \$624,000, respectively. The Company had recorded as Construction in Progress \$8,460,000 in costs for building improvements and equipment associated with its NASTAR Center, as of February 23, 2007. During fiscal 2008, the NASTAR Center became operational and these assets were reclassified to property, plant and equipment. At February 29, 2008, the Company had recorded \$141,000 as Construction in Progress for tube manufacturing for hyperbaric chambers.

8. Long-Term Obligations and Credit Arrangements:

Lenfest Letter Agreement

On May 20, 2008, Lenfest agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC shall not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of the American Stock Exchange, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

Bank Credit and Facility

On July 31, 2007, the Company entered into a revolving credit agreement (the "Credit Agreement") in order to refinance its indebtedness with PNC Bank, National Association ("PNC") in the aggregate amount of up to \$15,000,000. This Credit Agreement is a replacement of a credit facility originally entered into with PNC in February 2003.

Borrowings are to be used for ETC's working capital or other general business purposes and for issuances of letters of credit. Amounts borrowed under the Credit Agreement may be borrowed, repaid and reborrowed from time to time until June 30, 2009. Borrowings made pursuant to the Credit Agreement will bear interest at either the prime rate (as described in the Note) minus 1.00% or the London Interbank Offered Rate (as described in the Note) plus 0.90%. Additionally, ETC is obligated to pay a fee of 0.125% per annum for unused available funds.

For the purpose of reducing the risk associated with variable interest rates, ETC has entered into an interest rate swap agreement (Swap Agreement) with PNC which provides for a fixed rate through June 30, 2009, the maturity date of the Swap Agreement, for the borrowings during the first quarter of fiscal 2008. If the Swap Agreement is terminated prior to maturity, an additional payment to PNC or a credit to the Company might be due, based on the relative market rates at the time of termination. The Swap Agreement transaction has been accounted for under FAS No. 133 — "Accounting for Derivative and Instruments and Hedging Activities". At February 28, 2008, ETC recorded a Comprehensive Loss of \$228,000 reflecting the reduced value of the interest rate hedge in the accompanying Consolidated Balance Sheets.

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Notes to the Consolidated Financial Statements, continued

The Credit Agreement contains affirmative and negative covenants for transactions of this type, including limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business and transactions with affiliates. Under the Credit Agreement, the Company must maintain a minimum Consolidated Tangible Net Worth of \$9,000,000 at the end of each fiscal quarter. At February 29, 2008, the Company failed to meet the Consolidated Tangible Net Worth financial covenant. Additionally, under the Credit Agreement, the Company's events of default include the obligations of Lenfest as guarantor of the line of credit. Lenfest failed to deliver certain financial statements to the bank within the required time as specified in the Credit Agreement, which also was an event of default under the Agreement. On May 29, 2008 the Company received a waiver from PNC Bank, effective for the period ended February 29, 2008. The waiver does not extend beyond February 29, 2008. The Company has also agreed that Lenfest shall deliver certain additional financial statements on or before October 31, 2008, and failure to do so shall constitute an event of default. Management believes that the Bank will not exercise their rights under the default provisions as contained in the Credit Agreement. Lenfest is a guarantor of the Company's borrowings under the Credit Agreement. If the Bank exercises its right to call the Loan the Lenfest Guarantee will become enforceable. As noted earlier, Lenfest is a guarantor of the Company's borrowings under the Credit Agreement and has agreed to fund all requests by ETC for funds to support its operations through June 30, 2009, on terms and conditions to be mutually agreed upon by Lenfest and ETC, provided that ETC may not request more than \$10 million in the aggregate. All agreements will be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of AMEX, if required. ETC's objective will be to either replace or supplant any financing provided by Lenfest with third party commitments on a best efforts basis.

ETC's obligations under the Credit Agreement are secured by a personal guarantee from Lenfest under a Restated Guaranty, dated July 31, 2007, made by Lenfest in favor of PNC. ETC will pay Lenfest an annual cash fee of 1% of the loan commitment for his guarantee.

In connection with entering into the Credit Agreement, ETC entered into an Amended and Restated Reimbursement Agreement with PNC (the "Reimbursement Agreement"), and an Amended and Restated Subordination and Intercreditor Agreement with PNC and Lenfest (the "Subordination Agreement"). The Reimbursement Agreement governs letters of credit issued pursuant to the Credit Agreement. Under the Subordination Agreement, Lenfest agreed to continue to subordinate his rights in connection with a convertible promissory note executed by ETC in favor of Lenfest in the original aggregate principal amount of \$10,000,000, dated February 18, 2003, to the rights of PNC in connection with the Line of Credit.

As a stipulation for Lenfest's guarantee, the Company repaid \$4,000,000 owed to Lenfest under unsecured promissory notes. ETC utilized \$4,000,000 of the facility to repay these balances due Lenfest and \$1,000,000 to fund operations. Additionally, the Company has utilized approximately \$5,077,000 of the line of credit to collateralize its letters of credit. At February 29, 2008, the Company had \$746,000 available under the line of credit.

Long-term obligations at February 29, 2008 and February 23, 2007 consist of the following:

	(in thousands)	
	February 29, 2008	February 23, 2007
Note payable to bank	\$ 8,810	\$ —
Automobile loan	25	—
Subordinated convertible debt, net of unamortized discount of \$634 and \$1,170 at February 29, 2008 and February 23, 2007, respectively	9,366	8,830
	<u>\$ 18,201</u>	<u>\$ 8,830</u>

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

2009	\$ 9
2010	18,185
2011	7
2012 and thereafter	—
Total future obligations	<u>\$ 18,201</u>

The interest rate in the Company's subordinated debt agreement is 10% per annum. However, Lenfest reduced the interest rate to 8% per annum for the period December 1, 2004 through November 30, 2008.

Equity Line

On April 7, 2006, the Company entered into a Preferred Stock Purchase Agreement (the "Lenfest Equity Agreement") with Lenfest. The Lenfest Equity Agreement permitted ETC to unilaterally draw down up to \$15 million in exchange for shares of the Company's Series B Cumulative Convertible Preferred Stock ("Series B Preferred Stock"). The Preferred Stock provides for a dividend equal to 6% per annum. On August 23, 2007, the dividend was amended to 10% per annum, effective from August 23, 2007. The Preferred Stock is convertible, at Lenfest's request, into ETC common shares at a conversion price (the "Conversion Price") which was set on the day of each draw down. The Conversion Price will be equal to the closing price of the Company's common stock on the trading day immediately preceding the day in which the draw down occurs, subject to a floor price of \$4.95 per common share. Drawdowns were not permitted on any day when the Conversion Price would be less than this floor price. On the sixth anniversary of the Lenfest Equity Agreement, any issued and outstanding Preferred Stock will be mandatorily converted into

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

ETC common stock at each set Conversion Price. The Preferred Stock will vote with the ETC common stock on an as converted basis.

In connection with the execution of the Lenfest Equity Agreement, the Company drew down \$3 million by issuing 3,000 shares of Preferred Stock with a Conversion Price equal to \$4.95 per share. Additionally, on July 31, 2006, the Company drew down an additional \$3 million by issuing 3,000 shares of Preferred Stock at a conversion price equal to \$6.68 per common share. The Lenfest Equity Agreement was terminated on July 31, 2007 upon execution of the credit agreement with PNC Bank.

By way of a letter dated March 29, 2007, Lenfest agreed to allow the Company to defer until April 6, 2012, or earlier if demanded, the payment of accruing dividends on the Series B Preferred Stock issued under the Lenfest Equity Agreement.

Preferred Stock

On August 23, 2007, the Company entered into the Series C Preferred Stock Purchase Agreement (the "Series C Purchase Agreement") with Lenfest, pursuant to which, among other things, ETC issued and sold 3,300 shares of its newly-created class of Series C Preferred Stock to Lenfest for \$3,300,000. The proceeds from the issuance of the Series C Preferred Stock were restricted solely for use to partially fund a settlement with the U.S. Navy. The proceeds are presented in the accompanying Consolidated Balance Sheets as Restricted Cash.

The Series C Preferred Stock is convertible by Lenfest at any time into shares of ETC's common stock at a conversion price of \$3.03 per share based on the closing price for ETC's common stock on August 22, 2007, the trading day immediately prior to the issuance. The Series C Preferred Stock votes with ETC's common stock on an as-converted basis and is fully convertible into 1,089,108 shares of ETC common stock. The Series C Preferred Stock automatically converts into ETC common shares on the fifth anniversary of the Acquisition. It carries an annual dividend rate of ten percent (10%).

ETC granted Lenfest certain demand and "piggy back" registration rights pursuant to a Registration Rights Agreement with respect to the shares of common stock issuable upon conversion of the Series C Preferred Stock.

In connection with Lenfest's investment in the Series C Preferred Stock, ETC agreed to amend the terms of ETC's Series B Preferred Stock to (i) increase the annual dividend rate to 10%, (ii) provide for immediate conversion into common stock at the option of Lenfest, and (iii) to remove ETC's right to redeem the Series B Preferred Stock.

As allowed in the Series C Purchase Agreement, the Company is accruing dividends for the outstanding Preferred Stock but has deferred payment of these dividends until a subsequent date, up to and including August 23, 2012.

In connection with the restatement of the Company's previously issued financial statements for the year ended February 23, 2007, the Company has reclassified the Series B and C Preferred Stock (the "instruments") from equity to mezzanine. The reclassification is due to the preferential redemption feature of the instruments, which provides that a change in ownership would result in a forced liquidation. A forced liquidation is considered outside the control of the Company. Therefore, the preferential treatment upon an act outside the control of the Company precluded equity treatment under the Securities and Exchange Commission Accounting Series Release ("ASR") 268 and Topic D98. Prior year's financial statements have been adjusted to reflect this change.

Due to the Company's accumulated deficit, all dividends accruing for the Series B and Series C Preferred Stock have been recorded in the accompanying financial statements as a reduction in additional paid-in capital.

Subordinated Convertible Debt

In connection with the financing provided by PNC on February 19, 2003, the Company entered into a Convertible Note and Warrant Purchase Agreement with Lenfest, pursuant to which the Company issued to 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 Lenfest. The Subordinated Note accrues interest at the rate of 10% per annum (Lenfest reduced the rate to 8% per annum for the period December 1, 2004 through November 30, 2007) 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 Subordinated Note entitles Lenfest to convert all or a portion of the outstanding principal of, and accrued and unpaid interest on, the note into shares of ETC common stock at a conversion price of \$6.05 per share. The warrants may be exercised into shares of ETC 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 ETC common stock for the 25 consecutive trading days immediately preceding the date of exercise.

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Notes to the Consolidated Financial Statements, continued

The obligations of the Company to Lenfest under the Subordinated Note 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 promissory note executed in favor of Lenfest and the value of the associated warrants issued in connection with the 2003 Refinancing. 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 \$536,000 and \$454,000 in fiscal 2008 and fiscal 2007, respectively.

Unsecured Promissory Notes

In addition to the subordinated convertible debt, on November 16, 2006, the Company executed an Unsecured Promissory Note (the "Lenfest Note") in favor of Lenfest in the aggregate principal amount of \$3,000,000. Pursuant to the terms of the Lenfest Note, ETC was entitled to borrow up to \$3,000,000, in increments of \$1,000,000, prior to the maturity date of October 6, 2007. As of May 25, 2007, ETC owed \$2,000,000 under the Lenfest Note. In June 2007, the Company drew down the remaining \$1million available under the Lenfest Note. On June 28, 2007, the Company borrowed and executed an additional Unsecured Promissory Note in favor of Lenfest in the aggregate principal amount of \$1,000,000. These promissory notes were repaid in July 2007 in connection with the Bank Credit and Facility (see above).

The following table summarizes the subordinated convertible debt as of February 29, 2008:

	(in thousands)
Face Value	\$ 10,000
Less value of conversion feature	(1,400)
Less value of warrants	(1,209)
	<u>7,391</u>
Accretion 2008	536
Accretion 2007	454
Accretion prior years	985
Carrying value at February 29, 2008	<u>\$ 9,366</u>

The following table lists the long-term debt and other long-term obligations of the Company as of February 29, 2008.

	Payments Due by Period (in thousands)				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term debt, including current maturities	\$ 18,201	\$ 9	\$ 18,192	\$ —	\$ —
Operating leases	487	131	356	—	—
Total	<u>\$ 18,688</u>	<u>\$ 140</u>	<u>\$ 18,548</u>	<u>\$ —</u>	<u>\$ —</u>

Long-term debt is reported net of unamortized discount of \$634,000 on the Company's subordinated debt.

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Notes to the Consolidated Financial Statements, continued

9. 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 non-cancelable operating leases having a remaining term expiring after one fiscal year as of February 29, 2008 are \$131,000 in 2009; \$131,000 in 2010; \$131,000 in 2011; and \$94,000 in 2012 and thereafter. Total rental expense for all operating leases for the fiscal years ended February 29, 2008 and February 23, 2007 was \$213,000, and \$177,000, respectively.

10. Income Taxes:

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

	(in thousands)	
	<u>52 Weeks Ended</u> <u>February 29, 2008</u>	<u>52 Weeks Ended</u> <u>February 23, 2007</u>
	\$	\$
Currently (receivable) payable		
Federal	—	—
State	—	—
Foreign (benefits) taxes	37	(6)
	<u>37</u>	<u>(6)</u>
Deferred:		
Federal	—	—
State	—	—
Foreign benefit	—	(71)
	<u>\$ 37</u>	<u>\$ (77)</u>

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

	<u>52 Weeks Ended</u> <u>February 29, 2008</u>	<u>52 Weeks Ended</u> <u>February 23, 2007</u>
Statutory income tax	(34.0)%	(34.0)%
State income tax, net of federal tax benefit	(3.7)	(0.0)
Research and experimentation and other tax credits	(1.0)	(1.6)
Benefit of foreign and foreign-source income or loss	(1.2)	(0.9)
Change in valuation allowance	43.2	35.1
Other, net	(3.6)	0.5
	<u>(0.3)%</u>	<u>(0.9)%</u>

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Notes to the Consolidated Financial Statements, continued

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

	(in thousands)	
	2008	2007
Deferred tax assets:		
Vacation reserve	\$ 69	\$ 66
Inventory reserve	464	317
Receivable reserve	278	137
Warranty reserve	63	63
Compensation and other reserves	58	40
Stock options	97	96
ETC — PZL deferred tax asset	43	82
Net operating loss and credits	13,669	8,536
Other, net	75	74
	<u>14,816</u>	<u>9,411</u>
Valuation Reserve	<u>(13,558)</u>	<u>(8,149)</u>
Total current deferred tax asset	<u>\$ 1,258</u>	<u>\$ 1,262</u>
Deferred tax liabilities:		
Amortization of capitalized software	\$ 727	\$ 886
Depreciation	488	305
Total non-current deferred tax liability	<u>\$ 1,215</u>	<u>\$ 1,191</u>
Net deferred tax asset	<u>\$ 43</u>	<u>\$ 71</u>

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Reflecting the Company's significant losses in the current and prior fiscal years, the Company has approximately \$31.8 million of federal net loss carry forwards available to offset future income tax liabilities, beginning to expire 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. In addition, the Company may be subject to limitation on the use of its net operating losses based on the potential ownership change that may have occurred as defined by Section 382 of the Internal Revenue Code. The Company is currently evaluating the need to undertake an ownership change study in order to conclude if a further limitation is required.

11. 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: Training Services Group (TSG) and the Control Systems Group (CSG). Product categories included in TSG are pilot training and flight simulators, disaster management systems and entertainment applications. CSG includes sterilizers, environmental control devices, hyperbaric chambers along with parts and service support.

The following segment information reflects the accrual basis of accounting.

	(amounts in thousands)		
	Training Services TSG	Control Systems CSG	Total
Fiscal 2008			
Net sales	\$ 7,844	\$ 14,886	\$ 22,730
Interest expense	1,171	411	1,582
Depreciation and amortization	1,380	616	1,996
Operating loss	(3,929)	(5,551)	(9,480)
Income tax benefit	37	—	37
Identifiable assets	7,369	7,669	15,038
Expenditures for segment assets	3,407	287	3,694
Fiscal 2007 (restated)			
Net sales	\$ 9,293	\$ 8,126	\$ 17,419
Interest expense	852	299	1,151
Depreciation and amortization	973	884	1,857
Operating loss	(3,991)	(5,728)	(9,719)
Income tax benefit	(77)	—	(77)
Goodwill	455	—	455
Identifiable assets	7,698	4,109	11,807
Expenditures for segment assets	160	148	308
		<u>2008</u>	<u>2007 (restated)</u>
Reconciliation to consolidated amounts:			
Segment assets		\$ 15,038	\$ 11,807
Corporate assets		22,587	15,518
Total assets		<u>\$ 37,625</u>	<u>\$ 27,325</u>
Segment operating (loss)/income		\$ (9,480)	\$ (9,719)
Less interest expense		(1,582)	(1,151)
Income tax (provision) benefit		(37)	77
Total loss for segments		(11,099)	(10,793)
Corporate home office expense		(2,085)	(1,217)
Impairment charge		(455)	—
Other expenses		(259)	58
Minority interest		3	8
Net loss		<u>\$ (13,895)</u>	<u>\$ (11,944)</u>

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 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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

International sales in fiscal 2008 totaling at least \$500,000 per country were made to customers in Indonesia, Thailand, Turkey, Japan and Saudi Arabia. In fiscal 2007, international sales totaling at least ten percent of total international sales were made to one customer in Japan for \$3,365,000. 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.

In fiscal 2008, one customer represented individually 10% or more of total sales, General Motors, totaling \$3,898,000 or 17.2% (CSG segment) of total sales. In fiscal 2007, approximately 26% of sales totaling \$4,465,000 were made to two customers, one customer in Japan (TSG segment) and one domestic customer (CSG segment).

Included in the segment information for the years ended February 29, 2008 and February 23, 2007 are export sales of \$7,424,000 and \$10,821,000, respectively. Sales to the U.S. government and its agencies aggregated \$1,828,000 and \$586,000 for the years ended February 29, 2008 and February 23, 2007, respectively.

12. Stock Options:

A summary of the status of the Company's Stock Option Plans as of and for the fiscal years ended:

	February 29, 2008		February 23, 2007	
	Shares	Weighted average Exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	371,928	\$ 6.70	247,939	\$ 7.31
Granted	—	—	124,639	5.46
Exercised	—	—	(650)	3.31
Forfeited	—	—	—	—
Outstanding at end of year	<u>371,928</u>	6.70	<u>371,928</u>	6.70
Options exercisable at year end	332,816		310,496	
Weighted average fair value of options granted during the year		\$ —		\$ 6.76

The following information applies to options outstanding at February 29, 2008:

Range of exercise prices	Options outstanding			Options exercisable	
	Number Outstanding at February 23, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at February 23, 2007	Weighted average exercise price
\$5.00 to \$5.12	114,500	6.7 years	\$ 5.08	114,500	\$ 5.08
\$7.24 to \$7.81	<u>257,428</u>	3.8 years	\$ 7.41	<u>218,316</u>	\$ 7.56
Total	<u>371,928</u>			<u>332,816</u>	

The cost for stock option compensation was \$114,000 and \$324,000 for the years ended February 29, 2008 and February 29, 2008, respectively.

As February 29, 2008, the remaining prospective pre-tax cost of unvested stock option employee compensation was \$44,000, which will be expensed on a pro-rata basis going forward.

At February 29, 2008, the Company had two stock-based compensation plans, one for employees and one for non-employee members of the Board of Directors.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Employee Stock Plan:

In August 1999, the Company adopted an Incentive Stock Option Plan to replace the 1988 Incentive Stock Option Plan which expired in August 1999. The plan authorizes a committee of the Board of Directors to grant options for the purchase of up to 1,000,000 shares of common stock to qualifying officers and other key employees. The plan provides that option price shall not be less than 100% (or in the case of a ten percent owner, 110%) of the current market price of the stock on the date of the grant. Depending on specific grants, options may be exercised on a cumulative basis at the rate of either 50% or 25% per year commencing one year after the date of grant and have a maximum term of 10 years. The Plan will terminate on August 1, 2008. At February 29, 2008, there were 712,513 shares available to be granted under the Plan.

Non-employee Director Stock Plan:

In September 2005, the Company adopted subsequent to shareholder approval a stock option plan which allows for the granting to non-employee members of ETC's Board of Directors of options to purchase up to 600,000 shares of common stock. The plan provides that option price shall not be less than 100% of the current market price of the stock on the date of the grant. The amount of each individual award and the vesting period are determined by the Board of Directors or its appointed committee. Granted options have a maximum term of 10 years. The Plan shall remain in effect until terminated by the Board of Directors. At February 29, 2008, there were 520,000 shares available to be granted under the Plan.

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 2007: expected volatility of 45.4% to 53.4%; risk-free interest rate of 4.56% and 4.71%; and an expected life of 10 years. There were no grants of stock options in fiscal 2008.

13. Other Related Party Transactions

ETC purchases industrial products from Industrial Instruments Corp. which is owned by Christine and Charles Walter, the daughter and son-in-law of William F. Mitchell, ETC's President and Chief Executive Officer. During fiscal 2008 and 2007, the Company purchased \$315,000 and \$265,000, respectively, from Industrial Instruments. ETC also rents office space to Industrial Instruments at ETC's corporate headquarters. During both fiscal 2008 and 2007, Industrial Instruments paid to ETC rent in the amounts of \$8,000.

ETC purchases travel accommodations from Jet Set, a company that employs Kathleen Mahon, the daughter of Mr. Mitchell. During fiscal 2008 and 2007, ETC purchased travel through Jet Set totaling \$254,000 and \$217,000, respectively, and Ms. Mahon received approximately \$12,000 from her employer in each fiscal period in commissions on account of such purchases. Ms. Mahon is also engaged by ETC as a consultant to review expense reports submitted by Company employees. During fiscal 2008 and 2007, Ms. Mahon received \$11,000 and \$10,000, respectively in consideration of such services.

ETC also employs William F. Mitchell, Jr., the son of Mr. Mitchell, as its Vice President, Contracts/Purchasing, and David Mitchell, the son of Mr. Mitchell, as its Business Unit Manger for the Sterilizer Division. In fiscal 2008, David Mitchell received \$141,000 in compensation from ETC.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

14. Commitments and Contingencies

Claims and Litigation:

U.S. Navy

In May 2003, the Company filed a certified claim with the Department of the Navy (the "Government") seeking costs totaling in excess of \$5.0 million in connection with a contract for submarine rescue decompression chambers. On July 22, 2004, the Navy's contracting officer issued a final decision denying the claim in full. In July 2005, the Company converted this claim into a complaint which the Company filed in the United States Court of Federal Claims. On June 14, 2007, the Government amended its filings to add counterclaims pursuant to the anti-fraud provisions of the Contract Disputes Act, the False Claims Act, and the forfeiture statute. On June 27, 2007, the Company and the Government filed a Joint Motion to Dismiss with prejudice all of the Company's claims against the Government, which motion was granted on June 28, 2007. Additionally, the Company agreed to pay to the Government \$3.55 million (\$3.3 million recorded in the first quarter of fiscal 2008 and \$250,000 recorded in the second quarter of fiscal 2008) and transfer the submarine rescue decompression chambers to the Navy. In February 2008, the Government approved the settlement. As of May 14, 2008, the Company has made all payments required under this settlement agreement and has delivered the chambers to the Navy.

On October 2, 2007, the Company was suspended by the Department of the Navy from soliciting work for the federal government pursuant to the Federal Acquisition Regulation. Effective December 12, 2007, the Department of the Navy lifted the Company's suspension pursuant to the execution by the Company and the Department of the Navy of an Administrative Agreement. In accordance with the Administrative Agreement, the Company has established and implemented a program of compliance reviews, audits and reports. See Note 1 — Restatement of Previously Issued Financial Statements in the accompanying Notes.

Walt Disney World Co.

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 a 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 ETC (under a guarantee) for, among other things, alleged failures in performance and design in the contract. Disney alleges damages from \$36 million to \$65 million plus punitive damages (collectively, the "2003 Litigation"). In December 2005, EnTCO filed a second lawsuit against Disney, alleging breach of confidentiality and unfair trade practices (the "2005 Litigation"). The 2003 Litigation has been stayed until the 2005 Litigation is ready for trial. We believe that we have valid defenses to the counterclaims asserted by Disney in the 2003 Litigation. We are not able to predict the outcome of the 2003 Litigation. On March 26, 2008, the Court granted summary judgment in favor of Disney and against the Company and dismissed the Company's claim in the 2005 Litigation. On April 7, 2008, the Company filed a motion for reconsideration asking the Court to reconsider its March 2008 decision in the 2005 Litigation. The motion for reconsideration had not been decided as of May 29, 2008.

Other Matters

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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

15. 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 \$144,000 and \$112,000 in fiscal 2008 and fiscal 2007, 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.

16. Quarterly Consolidated Financial Information (Unaudited):

Financial data for the interim periods of fiscal 2008 and 2007 were as follows (amounts in thousands):

Fiscal Year 2008	Quarter ended:			
	May 25, 2007	August 24, 2007	November 23, 2007	February 29, 2008
Net sales	\$ 4,347	\$ 4,247	\$ 6,701	\$ 7,435
Gross profit (loss)	895	543	1,222	1,586
Operating loss	(5,347)	(2,579)	(1,627)	(2,490)
Loss before income taxes	(5,731)	(2,976)	(2,094)	(3,060)
Minority interest	(6)	(6)	4	5
Net loss	(5,725)	(2,970)	(2,098)	(3,102)
Loss per common share:				
Basic	(\$0.64)	(\$0.34)	(\$0.26)	(\$0.37)
Diluted	(\$0.64)	(\$0.34)	(\$0.26)	(\$0.37)

Fiscal Year 2007	Quarter ended:			
	May 26, 2006	August 25, 2006	November 24, 2006 (restated)*	February 23, 2007
Net sales	\$ 4,575	\$ 4,329	\$ 4,718	\$ 3,797
Gross profit (loss)	1,014	494	1,030	(467)
Operating loss	(1,701)	(1,913)	(4,585)	(2,737)
Loss before income taxes	(2,033)	(2,154)	(4,833)	(3,009)
Minority interest	(3)	(16)	33	(23)
Net loss	(2,030)	(2,148)	(4,870)	(2,896)
Loss per common share:				
Basic	(\$0.23)	(\$0.24)	(\$0.55)	(\$0.33)
Diluted	(\$0.23)	(\$0.24)	(\$0.55)	(\$0.33)

* restated for reserve of claim receivable. See Note 1 — Subsequent Events in the accompanying notes.

ENVIRONMENTAL TECTONICS CORPORATION AND SUBSIDIARIES
SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

Column A	Column B	Column C	Column D	Column E
Description	Balance at beginning of period	Charges / (credits) to costs or expenses	Reductions	Balance at end of period
Fiscal year ended February 29, 2008				
Valuation and qualifying accounts related to:				
Accounts receivable	\$ 3,372	\$ 378	\$ 3,004	\$ 746
Inventory	991	808	577	1,222
Property, plant and equipment	12,760	677	—	13,437
Software development costs	10,949	1,213	—	12,162
Fiscal year ended February 23, 2007 (restated)*				
Valuation and qualifying accounts related to:				
Accounts receivable	\$ 965	\$ 3,022	\$ 615	\$ 3,372
Inventory	1,032	446	487	991
Property, plant and equipment	12,134	626	—	12,760
Software development costs	9,718	1,231	—	10,949

* restated for reserve of claim receivable. See Note 1 — Subsequent Events in the accompanying notes.

List of Subsidiaries

Name	Jurisdiction	% Ownership
Entertainment Technology Corporation	PA	100%
ETC International Corporation	Barbados	100%
ETC-PZL Aerospace Industries	Poland	95%
ETC-Europe	Great Britain	99%
ETC-Delaware	Delaware	100%
NASTAR Center Holdings Corporation	Delaware	100%
NASTAR Center LLC	Delaware	100%

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements Form S-8 (File No. 333-131322, effective January 27, 2006, File No. 333-65469, effective October 8, 1998 and File No. 33-44219, effective July 6, 1988) of Environmental Tectonics Corporation and Subsidiaries, of our report, dated May 29, 2008 relating to the consolidated financial statements, which appear in this Form 10-K.

/s/ Friedman LLP
East Hanover, New Jersey
May 29, 2008

CERTIFICATION PURSUANT TO RULE 13A-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934

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 officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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 29, 2008

By: /s/ William F. Mitchell

William F. Mitchell
President and Chief Executive Officer

CERTIFICATION PURSUANT TO RULE 13A-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934

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 officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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 29, 2008

By: /s/ Duane D. Deaner
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 year ended February 23, 2007 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

William F. Mitchell
Chief Executive Officer

/s/ Duane D. Deaner

Duane D. Deaner
Chief Financial Officer

May 29, 2008

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.