

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 26, 2010

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.)

125 James Way
County Line Industrial Park
Southampton, Pennsylvania 18966
(Address of principal executive offices, Zip Code)

Registrant's telephone number, including area code (215) 355-9100
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, par value \$.05 per share

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 has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted, pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes No

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 definition of "accelerated filer", "large 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 28, 2009, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$7,250,000 based upon the closing sale price of the registrant's common stock on the Over the Counter Bulletin Board of \$1.30 on such date. See footnote (1) below.

As of May 10, 2010, there were 9,086,999 shares of the registrant's common stock issued and outstanding.

(1) Index to Exhibits appears after page 36 of this Report.

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.

ENVIRONMENTAL TECTONICS CORPORATION
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED
FEBRUARY 26, 2010
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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

Discussions of some of the matters contained in this Annual Report on Form 10-K for Environmental Tectonics Corporation may constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, and as such, may involve risks and uncertainties. Some of these discussions are contained under the captions “Item 1. Business” and “Item 6. Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We have based these forward-looking statements on our current expectations and projections about future events or future financial performance, which include implementing our business strategy, developing and introducing new technologies, obtaining, maintaining and expanding market acceptance of the technologies we offer, and competition in our markets. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about ETC and its subsidiaries that may cause actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

These forward-looking statements include statements with respect to the Company’s vision, mission, strategies, goals, beliefs, plans, objectives, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business of the Company, including, but not limited to, (i) projections of revenues, costs of materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items and the effects of currency fluctuations, (ii) statements of our plans and objectives of the Company or its management or Board of Directors, including the introduction of new products, or estimates or predictions of actions of customers, suppliers, competitors or regulatory authorities, (iii) statements of future economic performance, (iv) statements of assumptions and other statements about the Company or its business, (v) statements made about the possible outcomes of litigation involving the Company, (vi) statements regarding the Company’s ability to obtain financing to support its operations and other expenses, and (vii) statements preceded by, followed by or that include terminology such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “future,” “predict,” “potential,” “intend,” or “continue,” and similar expressions. These forward-looking statements involve risks and uncertainties which are subject to change based on various important factors. Some of these risks and uncertainties, in whole or in part, are beyond the Company’s control. Factors that might cause or contribute to such a material difference include, but are not limited to, those discussed in this Annual Report on Form 10-K, in the section entitled “Risks Particular to Our Business.” Shareholders are urged to review these risks carefully prior to making an investment in the Company’s common stock.

The Company cautions that the foregoing list of factors that could affect forward-looking statements by ETC 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.

References to fiscal 2010 or the 2010 fiscal year are references to the fifty-two week period ended February 26, 2010. References to fiscal 2009 or the 2009 fiscal year are references to the fifty-two week period ended February 27, 2009.

PART I

Item 1. Business

ETC was incorporated in 1969 in Pennsylvania. For over forty years, we have provided our customers with products, service and support. Innovation, continuous technological improvement and enhancement, and product quality are core values and critical to our success. We are a significant supplier and innovator in the following product areas: (1) software driven products and services used to create and monitor the physiological effects of flight; (2) high performance jet tactical flight simulation; (3) steam and gas sterilization; (4) testing and simulation devices for the automotive industry; (5) hyperbaric and hypobaric chambers; and (6) driving and disaster simulation systems.

We operate in two business segments — Training Services Group (“TSG”) and Control Systems Group (“CSG”). Our core technologies in TSG include the design, manufacture and sale of training services which includes (1) software driven products and services used to create and monitor the physiological effects of flight; (2) high performance jet tactical flight simulation, and; (3) driving and disaster simulation systems, and in CSG include: (1) steam and gas sterilization; (2) testing and simulation devices for the automotive industry, and; (3) hyperbaric and hypobaric chambers. Product categories included in TSG are Aircrew Training Systems (ATS) and flight simulators, disaster management systems and entertainment applications. CSG includes sterilizers, environmental control devices and hyperbaric chambers along with parts and service support. Revenue and other financial information regarding our segments may be found in Note 11 — Business Segment Information of the Notes to the Consolidated Financial Statements in Exhibit 13.

Marketing

We utilize both employees and independent representatives to market our products and services. At February 26, 2010, approximately 30 employees were committed to sales and marketing functions. We have branch offices in England, Turkey, Egypt, Singapore, the United Arab Emirates and Malaysia. Internationally, we contract with numerous independent sales representatives and organizations.

Product Development

Technological improvement and enhancement is an integral part of our philosophy. New ideas and products come from customer feedback and from all levels of our design and engineering staff. Within the TSG segment, product development emphasizes additional functionality and fidelity, enhancing control systems and software graphics and exploring commercial possibilities. Our recent product development efforts are as follows:

Tactical Flight Combat and G-force / Disorientation Trainers

Initially, the Company's high-G (the physiological impact of gravity on humans) pilot training centrifuges were developed for the aeromedical community to provide G-training such as G-loss of consciousness ("G-LOC") for high performance jet pilots. However, we believed that we could incorporate tactical flight simulation into a high-G ground simulator. By 2004 the engineering tools and technology had evolved sufficiently to allow us to begin this integration in earnest. The result of this evolution is our Authentic Tactical Fighting System ("ATFS"), 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. Development of this technology is a core objective of ETC. Additionally we are now migrating elements of this technology to other products, especially our GYROLAB, our four axes motion platform simulator.

Upset Recovery Training

In 2009, our National AeroSpace Training and Research ("NASTAR") Center, in conjunction with Embry Riddle Aeromedical University ("ERAU"), began conducting research under a Federal Aviation Administration ("FAA") funded research project aimed at examining the effectiveness of using centrifuge based simulation for Upset Recovery Training ("URT").

Loss of control in flight is a major cause factor in loss of life and hull damage aircraft accidents. Modern day commercial aviation currently has no requirement for training of pilots to deal with these situations, commonly referred to as "upsets." Twenty years ago 80% of civilian pilots were from a military training background; today this percentage is down to 20%. Realistic training for responding to and recovering from upsets, or URT, requires more than a non-centrifuge-based simulator because non-centrifuge-based simulators do not reproduce the physiological stresses and disorientation that a pilot experiences during an actual upset. We believe our GYROLAB simulator series is an answer to providing pilots with the dynamic environment necessary for effective training.

The FAA-funded research project was focused on comparing the benefits of three different types of URT. The first included only academic lectures. The second type included academic lecture and computer based training using Microsoft Flight Simulator training software. The third type included academic lecture plus instruction in our GYROLAB GL-2000, a centrifuge type motion based simulator. The research involved training an equal number of ERAU's flight students under each approach and then comparing their upset recovery skills in an actual flight in ERAU's American Champion Aircraft Decathlon airplane. Additionally, each student received identical classroom instruction at ERAU.

As of the filing date of this Annual Report on Form 10-K, the test flights have been completed and the results are under evaluation.

Advanced Disaster Management Simulator ("ADMS")

During fiscal 2010, our simulation division continued development of its software-driven disaster scenario products. ETC-PZL, our subsidiary in Poland, performed extensive effort on the ADMS software platform while engineers in our Orlando, Florida, 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 fiscal 2010, we completed a contract for the New York City Office of Emergency Management to supply a multi-station ADMS COMMAND, our most advanced training system. This system included 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 New York City's Citywide Incident Management System Training Program. During fiscal 2010, we also continued work on a contract with the Pennsylvania Southeast Region Counter-Terrorism Task Force to provide an ADMS-TEAM training system.

Internationally, in recent years we expanded our presence with sales to Düsseldorf, Germany and Hong Kong. During fiscal 2010, we delivered a multiple ADMS-COMMAND to a national training institute in the Middle East. This simulator included several team training systems, customized scenarios, regionalized environments, and models of appropriate vehicles, equipment, responders, and citizens. The system was delivered in Arabic with specific evaluation, scoring, and record keeping components to train and assess individuals and teams according to the country's national standards. A two-year service, support, and scenario expansion package was

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also included. The ADMS-COMMAND systems will be used to train emergency responders in command and control. Trainees will exercise in dynamic scenarios in realistic virtual environments. Fires, hazardous material releases, and victims' health status react dynamically to mitigation efforts, offering real-world incident conditions and realistic experiences for trainees.

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

Within the CSG segment, product development includes:

Sterilizer Division

Sectional sterilizers: This recent innovation involves the fabrication and installation of Bulk Size Sterilizers in "Sections." Research facilities, many of which are located in older buildings, face serious problems when attempting to replace large, "bulk size" sterilizers installed many years ago. These locations are simply no longer accessible without demolition of existing walls, which is expensive and disruptive. We have engineered the unique capability of manufacturing, delivering, and installing these large size sterilizers in modular segments, or "Sections." The sections travel through narrow corridors and doorways, into old, narrow elevators, and around corners to the final destination. The sections are then rigged into the existing footprint and welded together on-site (no flanges or gaskets) to American Society of Mechanical Engineers ("ASME") Code.

Green projects: During fiscal 2010, we were awarded a large "green" project from a domestic customer that is intended to dramatically reduce their consumption of water by reusing cooling water. This project virtually eliminates all wastewater from the current sterilizers. The project calls for us to retrofit the customer's older sterilizers (which were manufactured by another supplier) with state of the art control systems and vacuum systems while also adding a chilled water loop for cooling the older sterilizers. The project will result in significant monetary savings for the customer due to reduced energy consumption and maintenance expense, while improving process reliability. The largest benefit will be the reduction of tens of thousands of gallons of wastewater each year. Additionally, this project will extend the useful life of their sterilizers at a fraction what it would cost to replace the systems.

Hyperbaric Division

With respect to Electronic Medical Records (EMR), our engineering staff has addressed this part of the federal government's plan to modernize the nation's healthcare system by developing O.S.C.A.R.[™] (Operating System for Control And Recordkeeping). O.S.C.A.R. is a computer-based pressure vessel control device designed for single compartment (i.e., monoplace) hyperbaric chambers. The technology in O.S.C.A.R. has the potential to provide comprehensive EMR of the Hyperbaric Oxygen Therapy treatment (HBOT) each patient receives. Prior to introducing this device into the market, we must obtain, and are in the process of trying to obtain, pre-market approval from the U.S. Food and Drug Administration.

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 includes our NASTAR Center.

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 we have historically had little 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. We do maintain designs, drawings, molds, tools, safety stock, alternate vendors, and other techniques to eliminate or mitigate the effects of the loss of a single source vendor.

To support our backlog, we have formed Team ETC, a vendor teaming arrangement which includes approximately 30 of our most valuable vendors. Formation of this consortium expands our design and manufacturing capabilities to support large, multiple year contracts.

Intellectual Property

We own or have rights to certain intellectual property used in our business (i.e., patents or patent applications, trade secrets, copyrights, trademarks and trade names). While we consider patents, trademarks and copyrights to be valuable assets, we do not believe that our competitive position is dependent solely on patent, trademark or copyright protection, or that any business segment or our operations as a whole is dependent on any individual patent, trademark or copyright. We believe that it is unlikely that we could lose any intellectual property rights that are material to our business.

Customers

Throughout most of our history, in any given fiscal year a substantial portion of our revenues reflect significant contracts with a small number of customers. These customers tend to vary between fiscal years. For the most part we do not depend upon repeat orders from these same customers, although many of these accounts are long time customers and over time tend to order additional or replacement products, upgrades or devices. We sell our Aircrew Training Systems principally to U.S. and foreign governmental agencies. Our ADMS products are sold domestically primarily to municipalities and quasi-governmental agencies and internationally to training schools and academies. Most of our CSG products (sterilizers, environmental systems and hyperbaric monoplace chambers) are sold domestically to commercial customers.

In fiscal 2010, sales to two customers represented in total \$10,536,000, or 24.6%, of total sales. International sales totaling at least \$500,000 per country, listed in order of magnitude, were made to customers in Saudi Arabia, Korea, Malaysia and Turkey. Additionally, three customers represented a total of \$85,724,000, or 88.4%, of ETC's total backlog of \$96,964,000.

We do not have any relationship with these customers other than as customers. We are continuing to conduct business with these customers in fiscal 2011.

Foreign and Domestic Operations and Export Sales

The following schedule presents sales information by geographic area (amounts in thousands except percentages):

Geographic area:	Fiscal year ended February 26, 2010		Fiscal year ended February 27, 2009	
	Sales	%	Sales	%
Domestic	\$ 12,870	30.5%	\$ 14,442	39.4%
US Government	7,711	18.2%	3,096	8.4%
International	21,690	51.3%	19,149	52.2%
Total	\$ 42,271	100.0%	\$ 36,687	100.0%

During the fiscal years ended February 26, 2010 and February 27, 2009, \$7,711,000 (18.2%) and \$3,096,000 (8.4%), respectively, of our 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 26, 2010 and February 27, 2009, \$21,690,000 (51.3%) and \$19,149,000 (52.2%), respectively, of our revenues were attributable to export sales, including sales of our ETC-PZL subsidiary. Depending on the geographic location of the customer, payments under international contracts are normally secured by irrevocable letters of credit primarily.

During the fiscal years ended February 26, 2010 and February 27, 2009, \$12,870,000 (30.5%) and \$14,442,000 (39.4%), respectively, of our revenues were attributable to domestic sales to customers other than the U.S. Government.

We do not believe that the distribution of our sales between Domestic, U.S. Government and International 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 ("POC") basis. Contracts under POC accounted for \$29,066,000 or 68.8% of our total revenues during fiscal 2010.

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.

Product Warranties and Service

We provide warranties against defects in materials and workmanship in our products. Warranty periods for our products range from 90 days to two years. We maintain a general provision for estimated expenses of providing service under these warranties. Non-warranty service is billed to the customer as performed. The assumptions we use to estimate warranty accruals are evaluated periodically in light of actual experience and management's estimates of future claims, and, when appropriate, the accruals are adjusted. Our determination of the appropriate level of warranty accrual is subjective and based on estimates, and actual experience may be different than our accruals.

Manufacturing Facilities

Our manufacturing facility is located on a five-acre site in Southampton, Pennsylvania, a northern suburb of Philadelphia. We have approximately 64,000 square feet devoted to manufacturing, assembly and testing. We are an ISO 9001-2000 certified manufacturer. Over the last year we instituted the Lean Manufacturing process with the intent of streamlining project execution and reducing costs and we intend to continue to optimize the process in the foreseeable future.

Green Initiative

We have adopted a "green" initiative to save energy. Some of the applications we have initiated include:

- Our ATFS-400 regenerative braking technology recovers 80% of the energy used to power the centrifuge.
- We are currently replacing all the CRT computer monitors (90 watts) with more energy efficient LCD monitors (45 watts).
- We are undergoing a full "energy audit" in an effort to reduce consumption.
- We are investigating switching to LED lighting and the feasibility of a Solar Farm on our roof.

Operationally, we continue to emphasize the following:

- Expand our recycling effort so as to reduce waste sent to landfills.
- Use our printers less and email more. When printing we strive to use recycled or FSC certified paper. (Products carrying the FSC label are independently certified to assure consumers that they come from forests that are managed to meet the social, economic and ecological needs of present and future generations.) Also, we have added the following disclaimer to the bottom of our emails: "Please consider the environment before printing this email".

Sales Backlog

Below is a breakdown of the Company's February 26, 2010 sales backlog (amounts in thousands except percentages):

Geographic area:	Business segment:		Total	%
	TSG	CSG		
Domestic	\$ 210	\$ 3,772	\$ 3,982	4.1%
US Government	49,111	48	49,159	51.0
International	36,244	7,579	43,823	44.9
Total	\$ 85,565	\$ 11,399	\$ 96,964	100.0%
% of total	88.2%	11.8%	100.0%	

Our sales backlog at February 26, 2010, for work to be performed and revenue to be recognized under written agreements after such dates, was \$96,964,000. Of the February 26, 2010 sales backlog, one product line represented at least 10% of the total backlog: aircrew training systems (\$81,707,000, 84.3%). Additionally, three customers represented a total of \$85,724,000, or 88.4%, of the total backlog.

We expect to complete approximately 50% of the February 26, 2010 sales backlog prior to February 25, 2011, the end of our 2011 fiscal year. Of the February 27, 2009 sales backlog, we completed approximately 54% by February 26, 2010.

Of significance is the continued mix shift in fiscal year-end backlog to U.S. Governmental contracts. At February 26, 2010 this category constituted 51.0% of the total backlog and at February 26, 2009, U.S. Government contracts constituted 46.9% of the total backlog. It is also important to note that almost the entire U.S. Government backlog at February 26, 2010 reflected contracts awarded under funding allocated to the Base Realignment and Closure Act (BRAC). It should not be assumed that significant U.S. Government contracts of this magnitude would necessarily be awarded in the future.

Competition

Competition in our diverse product groups reflects our product applications (military versus commercial), market (defense purchases, capital goods for testing and production, etc.), customer (governmental versus commercial), and geographic area (domestic versus international). 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 larger 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 capability, reliability, product performance, past performance and price. Competition for our aeromedical products has increased in recent years.

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 did not incur during fiscal 2010, nor do we anticipate incurring during fiscal 2011, 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. We believe that we are currently in compliance with federal, state and local statutes, rules and regulations concerning the discharge of materials into the environment.

Governmental policy makers, industry representatives and scientists continue to discuss global climate change and potential legislation to reduce greenhouse gases. Due to the high level of uncertainty regarding the character and timing of any legislation or regulations that may be adopted, management is unable to evaluate the potential economic impact of any such measures at this time. Additional regulation in this area could result in incurring additional capital spending and higher operating expenses.

Compliance with Export Controls

Depending on the product, customer, location and the application or use, some of our aeromedical products require an export license from the U.S. Commerce or State Department. Certain international letters of credit for contracts which include controlled equipment may also include the requirement for us to obtain export licenses before applying for payments. We have an Export License Compliance Program which covers all key aspects of the International Traffic in Arms Regulations ("ITAR"), as issued by the U.S. Department of Defense Trade Controls, a division of the U.S. Department of State. Although most export licenses are readily obtainable in a reasonable timeframe, depending on the equipment and customer, some of our international contracts for aeromedical equipment include the issuance of an export license as a force majeure (a natural and unavoidable catastrophe that disrupts the expected course of events) exception for any contract penalties or liquidated damages.

Employees

On February 26, 2010, we had 273 full-time employees (compared to 240 a year ago), of which five were employed in executive positions, 120 were engineers, engineering designers, or drafts people, 56 were administrative (sales, sales support, accounting and general administrative) and clerical personnel, and 92 were engaged principally in production, operations and field support. A total of 186 employees were stationed in our Southampton, Pennsylvania corporate headquarters.

Available Information

Our Internet address is www.etcusa.com. The content on our website is available for informational purposes only. You should not rely upon such content for investment purposes and such content is not incorporated by reference into this Form 10-K.

We make available free of charge, on our Internet website under the heading "Investor Relations," our Annual Report on Form 10-K, Proxy Statement, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. We also make available on or through our website copies of our key corporate governance documents, including our Charters for the Audit Committee, Compensation Committee, and the Nominating and Governance Committee of the Board of Directors and our Codes of Ethics and Conduct. Stockholders may request free copies of these documents from our Investor Relations Department by writing to Environmental Tectonics Corporation, Investor Relations, 125 James Way, Southampton, PA 19866, by calling (215) 355-9100, or by sending an email request to invest@etcusa.com.

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 26, 2010. These risks and uncertainties include the following items, which do not represent a comprehensive list of all the risks and uncertainties associated with our business.

Our common stock is currently quoted on the Over the Counter — Bulletin Board which may limit purchase and sale of our common stock.

Our common stock is quoted on the Over-the-Counter Bulletin Board (“OTC-BB”). Certain investors have policies and regulations that may not allow investment in our common stock because it is listed on the OTC-BB. This may limit trading volume and affect the price of our common stock.

In general, the market price of securities of thinly traded public companies has historically faced significant volatility. Our common stock does not experience a significant average daily trading volume. Accordingly, if one stockholder either elects to purchase or sell a block of our common stock, it may have a significant effect on the current trading price. 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. Factors that have influenced the trading prices for our common stock include, but are not limited to, the following:

- actual or anticipated operating results;
- market conditions in the industries in which we compete;
- announcements by competitors;
- results of litigation;
- regulatory actions; and
- general economic conditions.

Any of the above factors would likely affect the market price of our common stock.

During the current fiscal year, our core business, aircrew training simulators, was awarded three large multi-year contracts, two with the U.S. Department of Defense and one with a major international defense agency. Purchases such as these are infrequent and inconsistent. The U.S. Defense contracts were awarded under funds appropriated under the Base Realignment and Closure Act (BRAC). This Act had a specific focus and purpose and funds allocation. Although possible, it should not be assumed that additional awards will be obtained under this Act nor that additional funding under this Act will be available. If we are unsuccessful in obtaining additional contracts under BRAC funding our financial performance could be significantly negatively impacted.

As of February 26, 2010, \$48.3 million of our backlog was for two contracts awarded under BRAC funds. Additionally, \$37.5 million represented one large international contract. We currently have a major outstanding proposal for another U.S. defense purchase which is also covered under BRAC funds. Given the political and economic environment, and the extremely competitive nature of these contracts, there is no assurance that we will be successful in obtaining this or any major U.S. Defense contract. We have spent significant funds over the prior years to develop advanced technologies to support the defense simulator industry and our cost of software, plant assets and operating expenses is relatively high in comparison to our revenue base. Also, the cost of preparing these complicated proposals is significant. (Depending on the size and nature of the proposal, preparation costs including pre-engineering costs can exceed \$500,000.) Consequently, our financial performance is highly dependent upon obtaining these contracts.

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

On May 29, 2008, a Request for Arbitration was filed against the Company with the Secretariat of the International Court of Arbitration by Mends International Ltd. (“Mends”). Mends’ Request for Arbitration arose out of a February 3, 1999 contract between the Company and Mends wherein Mends purchased aeromedical equipment for sale to the Nigerian Air Force. Mends asserted a claim for breach of contract and demanded \$797,486, plus interest and costs. On September 16, 2008, Mends filed an Amended Request for Arbitration, adding tort claims for conversion and breach of fiduciary duty and seeking punitive damages. In response, the Company asserted a counterclaim seeking damages for other disputes with Mends that have arisen under the contract that Mends has put at issue in this arbitration. On April 27, 2009 the Company participated in an arbitration hearing in the United Kingdom on this matter. As of the filing date of this Annual Report on Form 10-K, a decision had not been determined in this matter, although one is anticipated in the near future. The Company is contesting this arbitration case vigorously; however, in conformity with accounting principles generally accepted in the United States, the Company has recorded a reserve in this matter.

Our sources of revenues are not consistent; they tend to be concentrated within a few contracts with a few customers and in a particular mix. It cannot be assumed that any of these contracts, customers or mix will recur in future years.

In any given fiscal year, a substantial portion of our revenues is typically derived from a small number of contracts and customers. In fiscal 2010, sales to two customers each represented 10% or more of total sales, totaling \$10,536,000 or 24.6% of our total sales. In fiscal 2009, one customer contributed \$7,327,000 or 20.0% of total sales. Of the February 26, 2010 sales backlog, one product line represented at least 10% of the total backlog: aircrew training systems (\$81,707,000, 84.3%). Additionally, three customers represented a total of \$85,724,000, or 88.4%, of the total backlog. At February 27, 2009 one customer accounted for 44.1% of our sales backlog.

Of significance is the continued mix shift in fiscal year-end backlog to U.S. Governmental contracts. At February 26, 2010 this category constituted 51.0% of the total backlog and at February 26, 2009, U.S. Government contracts constituted 46.9% of the total backlog. It is also important to note that almost the entire U.S. Government backlog at February 26, 2010 reflected contracts awarded under funding allocated to the Base Realignment and Closure Act (BRAC). It should not be assumed that significant U.S. Government contracts of this magnitude would necessarily be awarded in the future.

Our debt is concentrated and directly dependent upon either direct arrangements or under guarantee arrangements with H. F. Lenfest.

In addition to cash flow from operations, a significant portion of our cash needs are supplied under direct arrangements or bank agreements guaranteed personally by H.F. Lenfest, a major shareholder and member of our Board of Directors. Mr. Lenfest has supplanted or provided funding in multiple arrangements and at multiple times since 2003. Should these personal guarantees no longer be available, this event might cause a disruption of available funds under our various financing arrangements.

Additionally, we have a significant amount of indebtedness and Mr. Lenfest's preferred stock. We may not generate sufficient cash flow from operations, or have future additional sources of cash available to us to service our required payments.

Our ability to make debt payments depends on our future performance, which, to a certain extent, is subject to general economic, financial, competitive and other factors, many 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 Bank line of credit and our Line of Credit with Mr. Lenfest will be adequate to meet our future obligations through at least June 1, 2011. However, given that our bank debt is personally guaranteed by Mr. Lenfest and that all of our arrangements and agreements are with him as an individual, there can be no assurance that, should our business not generate sufficient cash flow from operations to enable us to pay our debts or to make necessary capital expenditures, we will be successful in negotiating new financial arrangements with Mr. Lenfest or any other party, or that any refinancing of debt would be available and on commercially reasonable terms.

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

A challenge for our ATFS technology has been marketing this technology to the world's defense agencies. This is a new technology that is contrary to the conventional training belief that tactical flight and combat skills can only be learned in a flying aircraft. Although we made significant progress toward this goal during fiscal 2010 by being awarded a contract by the United States Air Force to provide a high performance training and research human centrifuge, at this point we cannot be certain that we will be able to overcome 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 pace of technological change impacts products in our Training Services Group. Changing technology requires us to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. Technology development is only partially funded through enhancements included in customer orders. 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.

Long term contracts under percentage of completion (“POC”) accounting comprise a significant portion of our fiscal 2010 revenues and our backlog at February 26, 2010. Delays in the delivery of our products may prevent us from invoicing our costs and estimated earnings on uncompleted contracts.

At February 26, 2010, contracts accounted for under the percentage of completion (“POC”) accounting method comprised \$91,143,000 or 94.0% of our total backlog. Additionally, contracts under POC accounted for \$29,066,000 or 68.8% of our total revenues. In conformity with accounting principles generally accepted in the United States for long-term contracts under the POC accounting method, we record, due to timing differences, an asset for our costs and estimated earnings that exceed the amount we are able to bill our customers on uncompleted contracts. At February 26, 2010, this asset totaled \$3,576,000. Although a significant portion of these costs have been billed and collected since the end of our fiscal year, 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 time lag ranging from six to twenty-four months between performance and associated costs for these types of projects and billing and collection of all contract payments. Our failure to meet milestones by delivering and integrating our products in a timely manner may impact our ability to collect final payments on these contracts, which could severely impact our cash flow.

For an explanation of percentage of completion accounting, see the section “Critical Accounting Policies” in Management’s Discussion and Analysis of Financial Condition and Results of Operations and Note 2 — Summary of Significant Accounting Policies of the notes to our consolidated financial statements in the Annual Report to Stockholders attached hereto as Exhibit 13 and incorporated herein by reference.

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 a multitude of suppliers and subcontractors. Some of the parts we purchase are highly specialized. Planning production, optimizing inventory levels, and meeting delivery schedules all require high coordination and at times may have conflicting goals. Most of our large aircrew training simulators and our software 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-reimbursement contracts may commit us to unfavorable terms.

Historically, we have provided our products and services primarily through fixed-price contracts. 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 contract losses. 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 a contract. A further risk associated with fixed-price contracts is the difficulty of estimating sales and costs that are related to performance in accordance with contract specifications. Our failure to anticipate technical problems, estimate costs accurately or control costs during performance of a fixed-price contract may reduce our profitability and may cause us to incur a loss on the project.

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 may 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 instruments or that these types of instruments, if available, will be affordable in the future.

Under the terms of our commercial contracts, we typically must satisfy 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.

As a U.S. Government contractor, we are subject to a number of procurement rules and regulations.

Government contractors must comply with specific procurement regulations and other requirements. These regulations and requirements, although customary in government contracts, increase our performance and compliance costs. In addition, current U.S. Government budgetary constraints could lead to changes in the procurement environment. If such changes occur, our costs of complying with procurement requirements could increase and reduce our margins.

Failure to comply with these regulations and requirements could result in reductions of the value of contracts, contract modifications or termination, and the assessment of penalties and fines, which could negatively impact our results of operations and financial condition. The termination of a government contract or relationship could also, under certain circumstances, result in our suspension or debarment from future government contracting for a period of time, and this could have a negative impact on our reputation and ability to procure other government contracts in the future. Presently, the Company is not aware of any circumstances which could result in its suspension or debarment from government contracting.

Our business could be adversely affected by a negative audit by the U.S. Government.

As a government contractor, we are subject to routine audits and investigations by U.S. Government agencies such as the Defense Contract Audit Agency (DCAA). These agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. The DCAA also reviews the contractor's adequacy of and compliance with its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed or must be refunded if already reimbursed. If an audit contains a significant adverse finding, we could be subject to penalties and fines and contract termination, which could negatively impact our results of operations and financial condition. The termination of a government contract or relationship could also, under certain circumstances, result in our suspension or debarment from future government contracting for a period of time, and this could have a negative impact on our reputation and ability to procure other government contracts in the future. Presently, the Company is not aware of any circumstances which could result in a significant adverse finding by the DCAA.

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 supply contracts generally are awarded to us through a competitive bidding process in which we may have many qualified competitors. Upon expiration, government supply contracts may be subject, once again, to the competitive bidding process. We cannot assure 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 business, financial condition and results of operations could be materially and adversely affected to the extent that government agencies believe our competitors offer a more attractive combination of technical merit, personnel qualifications, financial capability, experience and price. 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 competitive bidding process, the evaluation process or the award of a contract to a competitor. Other characteristics of the government contract market that may affect our operating results include the complexity of designs, and the difficulty of forecasting costs and schedules when bidding on developmental and highly sophisticated technical work. 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 international business is subject to geo-political and economic factors, regulatory requirements and other risks.

Our international business exposes us to geo-political and economic factors, regulatory requirements and other risks associated with doing business in foreign countries. These risks differ from and potentially may be greater than those associated with our domestic business. In addition, our exposure to such risks may increase if our international business continues to grow as we anticipate.

Our international business is sensitive to changes in the priorities and budgets of international customers, which may be driven by changes in threat environments and potentially volatile worldwide economic conditions, regional and local economic and political factors, as well as U.S. foreign policy. Our international sales are subject to U.S. laws, regulations and policies, which sometimes include the Foreign Corrupt Practices Act, the International Traffic in Arms Regulations (ITAR), and other export laws and regulations. They are also subject to local government laws, regulations and procurement policies and practices which may differ from U.S. Government regulations, including regulations relating to import-export control, investments, exchange controls and repatriation of earnings, as well as to varying currency, geo-political and economic risks. Our international contracts may include requirements on specific in-country purchases, manufacturing agreements or financial support obligations, known as offsets, and provide for penalties if we fail to meet such requirements. We also are exposed to risks associated with using foreign representatives and consultants for international sales and operations and teaming with international subcontractors, partners and suppliers in connection with international programs. As a result of these factors, we could experience award and funding delays on international programs and could incur losses on such programs which could negatively impact our results of operations and financial condition.

Legislative actions resulting in higher compliance costs are likely to adversely affect our future consolidated results of operations, financial position and cash flows.

Compliance with laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, and new regulations enacted by the Securities and Exchange Commission (the “SEC”), are resulting in increased compliance costs. We, like all other public companies, are incurring expenses and diverting employees’ time in an effort to comply with Section 404 of the Sarbanes-Oxley Act of 2002. We are a smaller reporting company, and have completed the process of documenting our systems of internal control and have evaluated our systems of internal control. Beginning with the year ended December 31, 2007, we have been required to assess continuously our compliance with Section 404 of the Sarbanes-Oxley Act of 2002. We expect to continue to devote the necessary resources, including internal and external resources, to support our assessment. In the future, if we identify one or more material weaknesses, or our independent registered public accounting firm is unable to attest that our report is fairly stated or to express an opinion on the effectiveness of our internal controls over financial reporting, this could result in a loss of investor confidence in our financial reports, have an adverse effect on our stock price and/or subject us to sanctions or investigation by regulatory authorities. Compliance with these evolving standards will result in increased general and administrative expenses and may cause a diversion of our time and attention from revenue-generating activities to compliance activities.

Changes in healthcare policy could increase our costs and impact sales of and reimbursement for our tests.

Several proposals to reform the system of health care delivery in the U.S. are currently being considered by the federal and many state governments. Some of the reforms call for a government sponsored health plan. A number of states are also contemplating significant reform of their healthcare policies. A proposal for additional government-funded health care could subject expenditures for health care to governmental budget constraints and limits on spending. We cannot predict what healthcare policy reforms, if any, will be adopted or the effect that such adoption may have on our taxes, fees and other costs, which could impact our business, financial condition and results of operations.

The Company is subject to environmental laws and potential exposure to environmental liabilities.

We are subject to various international, federal, state and local environmental laws and regulations that govern our operations, including the handling and disposal of non-hazardous and hazardous wastes, the recycling and treatment of electrical and electronic equipment, and emissions and discharges into the environment. Failure to comply with such laws and regulations could result in costs for corrective action, penalties or the imposition of other liabilities. We are also subject to laws and regulations that impose liability and clean-up responsibility for releases of hazardous substances into the environment. Based on currently available information, although there can be no assurance, we believe that such costs and liabilities have not had and will not have a material adverse impact on our consolidated results of operations.

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

Our revenues and earnings tend to 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;
- our ability to finance our operations;
- the number of bid and proposal efforts undertaken;
- delays in sales bookings 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.

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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 1, 2010, our directors and executive officers own and could vote an aggregate of approximately 73.7% 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 significant control over the direction of our business and affairs.

We depend on the recruitment and retention of qualified personnel, and our failure to attract and retain such personnel could seriously harm our business.

Due to the specialized nature of our business, our future performance is highly dependent upon the continued services of our key engineering personnel and executive officers, the development of additional management personnel and the hiring of new qualified engineering, manufacturing, marketing, sales and management personnel for our operations. Competition for qualified personnel is intense, and we may not be successful in attracting or retaining qualified personnel. The loss of key employees, our inability to attract new qualified employees or adequately train employees, or the delay in hiring key personnel, could seriously harm our business, results of operations and financial condition.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own our executive offices and principal production facility (an approximately 92,000 square foot steel and masonry building) located on a five-acre site in the County Line Industrial Park, Southampton, Pennsylvania. Approximately 64,000 square feet of the building is devoted to manufacturing, our NASTAR training center occupies approximately 22,000 square feet, and approximately 6,000 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.

The NASTAR Center includes aerospace training and research equipment including:

- ATFS-400 Authentic Tactical Flight Simulator
- GYROLAB GL-2000 Advanced Spatial Disorientation Trainer
- Hypobaric Chamber
- Ejection Seat Trainer
- Night Vision and Night Vision Goggle Training System

Item 3. Legal Proceedings

Mends International, Ltd.

On May 29, 2008, a Request for Arbitration was filed against the Company with the Secretariat of the International Court of Arbitration by Mends International Ltd. (“Mends”). Mends’ Request for Arbitration arose out of a February 3, 1999 contract between the Company and Mends wherein Mends purchased aeromedical equipment for sale to the Nigerian Air Force. Mends asserted a claim for breach of contract and demanded \$797,486, plus interest and costs. On September 16, 2008, Mends filed an Amended Request for Arbitration, adding tort claims for conversion and breach of fiduciary duty and seeking punitive damages. In response, the Company asserted a counterclaim seeking damages for other disputes with Mends that have arisen under the contract that Mends has put at issue in this arbitration. On April 27, 2009 the Company participated in an arbitration hearing in the United Kingdom on this matter. As of the filing date of this Annual Report on Form 10-K, a decision had not been determined in this matter, although one is anticipated in the near future. The Company is contesting this arbitration case; however, the Company has recorded a reserve in this matter.

Administrative Agreement with U.S. Navy

In 2007, the Company entered into a settlement agreement with the Department of the Navy to resolve litigation filed by the Company in May 2003 in connection with a contract for submarine rescue decompression chambers. As of May 14, 2008, the Company had made all payments required under this settlement agreement and had transferred the chambers to the Department of the Navy. From October 2, 2007 through December 12, 2007, the Company was suspended by the Department of the Navy from soliciting work for the federal government pursuant to the Federal Acquisition Regulation. However, 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.

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.

PART II

Item 4. Market for the Registrant's Common Stock and Related Security Holder Matters and Issuer Purchases of Equity Securities

Our common stock is currently traded on the Over the Counter Bulletin Board under the symbol "ETCC." As of May 16, 2010, the Company had 277 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 2010		
First Quarter	\$ 2.84	\$ 0.73
Second Quarter	1.68	1.05
Third Quarter	2.69	1.20
Fourth Quarter	3.55	2.26
Fiscal 2009		
First Quarter	\$ 2.95	\$ 1.54
Second Quarter	2.82	1.35
Third Quarter	2.30	1.10
Fourth Quarter	1.92	0.55

On May 16, 2010, the closing price of our common stock was \$2.75. We have never paid any cash dividends on our common stock and do not anticipate that any cash dividends on our common stock will be declared or paid in the foreseeable future.

Refinancing Transaction

Lenfest Financing Transaction

On April 24, 2009, the Company entered into a transaction (the "Lenfest Financing Transaction"), which was approved by the shareholders on July 2, 2009, with H.F. Lenfest, a member of ETC's Board of Directors and a significant shareholder of and investor in ETC ("Lenfest"), that provided for the following: (i) a \$7,500,000 credit facility provided by Lenfest to ETC; (ii) exchange of the Subordinated Note held by Lenfest, together with all accrued interest and warrants issuable under the Subordinated Note, and all Series B Preferred Stock and Series C Preferred Stock held by Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock, of the Company; and (iii) the guarantee by Lenfest of all of ETC's obligations to PNC Bank, National Association ("PNC Bank") in connection with an increase of the Company's existing \$15,000,000 revolving line of credit with PNC Bank (the "2007 PNC Credit Facility") to \$20,000,000, and in connection with this guarantee, the pledge by Lenfest to PNC Bank of \$10,000,000 in marketable securities.

For additional information regarding the Lenfest Financing Transaction, please refer to Note 7 — Long-Term Obligations and Credit Arrangements in the accompanying Notes to the Consolidated Financial Statements.

Item 5. Selected Financial Data

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

Item 6. 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 7. 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 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 8T. Controls and Procedures

Evaluation of Disclosure Control and Procedures

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. 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 were functioning effectively and provide reasonable assurance that the information required to be disclosed by the Company in its periodic reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, and 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.

Changes in Internal Control over Financial Reporting.

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 likely to materially affect, our internal control over financial reporting.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding 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.

PART III**Item 9. Directors and Executive Officers of the Registrant**

The following table sets forth certain information with respect to our directors and executive officers:

Name	Age	Served as Director or Officer Since (1)	Positions and Offices
William F. Mitchell (2)	68	1969	Chairman of the Board, Chief Executive Officer, President and Director
George K. Anderson, M.D. (3)	64	2003	Director
H.F. Lenfest (4)	80	2003	Director
Stephen F. Ryan (5)	74	2009	Director
George A. Sawyer (6)	78	2009	Director
Duane D. Deaner (7)	62	1996	Chief Financial Officer
James D. Cashel (8)	47	2009	General Counsel and Corporate Secretary

- (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) 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.
- (4) 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. Since 1989, Mr. Lenfest has served on the Board of Directors for TelVue Corporation, a broadcast technology company. Mr. Lenfest is a graduate of Washington and Lee University and Columbia Law School.
- (5) Mr. Ryan retired in 2001 as the Chairman, President, CEO and a Director from Selas Corporation of America (now known as IntriCon Corporation). Selas was a diversified international firm engaged in the design, development, engineering and manufacturing of industrial products, such as the furnace section of continuous annealing and galvanizing lines in steel production for automotive steel, glass production furnace lines, cable winch devices for below the chassis spare tire lift holders for the automotive industry, parts for hearing aid devices and transistors for electric surge guards for computers and electronics. Mr. Ryan also currently serves as a Director of Bolt Technology Corporation, a public company which is traded

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- on NASDAQ. Bolt is a manufacturer and seller of seismic air guns, cables, hydrophones and other devices engaged in the offshore oil and gas exploration market. Mr. Ryan received a Bachelor of Business Administration degree from Iona College and MBA degree from the University of Connecticut. He is a member of the New York State Society of Certified Public Accountants (NYSSCPA) and the American Institute of CPAs (AICPA).
- (6) Mr. Sawyer is a founding partner of J.F. Lehman & Company and currently serves as Executive Advisor. From 1993 to 1995, he served as President and Chief Executive Officer of Sperry Marine, Inc. Prior thereto, Mr. Sawyer held a number of prominent positions in private industry and in the United States government, including serving as President of John J. McMullen Associates, President and Chief Operating Officer of TRE Corporation, Executive Vice President and Director of General Dynamics Corporation, Vice President of International Operations for Bechtel Corporation and Assistant Secretary of the Navy for Shipbuilding and Logistics. He graduated Phi Beta Kappa from Yale University and completed graduate studies in nuclear engineering at the Knolls Atomic Power Laboratories. He is also the co-inventor of the Consolidated Nuclear Steam Generator II and served in the US Navy for ten years as a nuclear submariner. Mr. Sawyer currently serves as a Director of Atlantic Marine Holding Company, Black Light Power Inc. and CHI Systems, Inc.
- (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 a Masters of Business Administration degree from Temple University and a Bachelors of Arts degree in Mathematics from Millersville University in Pennsylvania.
- (8) Mr. Cashel was appointed General Counsel and Corporate Secretary in July 2009. From December 2008 to July 2009, Mr. Cashel was General Counsel at ETC. From 1996 through 2008, Mr. Cashel was in private law practice. From May 1998 through December 2008, Mr. Cashel practiced law at Montgomery, McCracken, Walker and Rhoads, LLP, having served as a partner from 2003 through 2008. Mr. Cashel, who is also a registered patent attorney, received a Bachelor of Science degree in Chemical Engineering from Drexel University in 1987, and from 1987 through 1994 he was employed in various engineering positions. Mr. Cashel currently serves on the Board of Directors for the Delaware Valley Association of Corporate Counsel and a Drexel University College of Engineering advisory board.

Board of Directors

Our Board of Directors consists of five members, one of whom (Mr. Mitchell) is also a member of management. Each Board member brings a diverse combination of background, education and interests to the Board's oversight responsibility. In evaluating a nominee for Board membership, the Nominating and Governance Committee considers a number of factors including education and background, relevant experience, industry affiliations, personal interests and diversity (racial, gender, viewpoint, etc.) with a goal towards fostering Board heterogeneity.

We have structured our Board to address the diverse nature of our businesses. Mr. Mitchell has been instrumental in introducing new technologies since the Company's inception and possesses detailed knowledge of the technology of each of our businesses. Mr. Anderson, a former jet pilot with the U.S. Air Force, is a medical doctor with extensive experience in hyperbaric medicine and the aeromedical impact of flight. He is a key supporter of our Authentic Tactical Fighter Systems and a subject matter expert for our hyperbaric monoplace business. Mr. Lenfest, an attorney, spent 25 years managing and growing a company, is an investor with a long term horizon, and appreciates the longer development and marketing cycle required to introduce new technologies to an industry. Mr. Ryan is a retired certified public accountant who also was the CEO of a manufacturing company for thirteen years with long-term projects. He is cognizant of the financial aspects affecting the chief executive's role particularly related to the management of long-term "turn-key" projects. Mr. Sawyer spent numerous years on both sides of procurement with the U.S. Navy and can offer valuable insight to proposal review and the management of complex government contracts.

Our Board serves a specific role in risk oversight. Management reports to the full Board summarizing the important financial, operational and legal performance and issues of the recent period provide the basis for discussions on risk factors facing the organization. Our Audit Committee is assigned responsibility for financial risk. Our Nominating and Governance Committee addresses compliance risk. And our Compensation Committee evaluates compensation philosophy and policy with particular focus on their effect on enterprise risk.

Mr. Mitchell serves the dual function as President, CEO and Chairman of the Board. We feel this is appropriate given the nature of our business. Our Company's core strength is our ability to design, develop and integrate new technologies in our product lines. In our main market, pilot training systems, each new aircraft introduces a quantum leap forward in performance and application. To continue to successfully market our simulators, we must understand the important new features and be able to recreate their effects in a ground based training device. Mr. Mitchell has significant technical education, experience and training, and an in-depth working knowledge of the Company's technology, and as a result he is able to educate the Board members on the applications of our technologies. As the chief spokesperson for our core technology, ATFS, he can provide valuable insight to the Board as to the evolution

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of and acceptance for this new and unique training method. ETC is a technology-driven Company and as such we feel the Board leader should possess this background.

We do not have a lead independent director.

Howard W. Kelley resigned from the Board effective July 2, 2009.

Committees of the Board of Directors

During the fiscal year ended February 26, 2010, the Board of Directors held four meetings. All members of the Board of Directors attended all of the Board meetings.

We have three standing Board Committees: Audit, Compensation and Nominating and Governance. Each committee has a charter which can be found on the Company’s website at www.etcusa.com. The members and chairpersons of each committee during fiscal 2010 are identified in the following table and each committee, its function and the numbers of meetings held by each committee during fiscal 2010 are described below.

Name of Director	Independent	Audit	Compensation	Nominating and Governance
Stephen F. Ryan	Yes	Chair	X	X
Dr. George K. Anderson	Yes	X	X	Chair
George A. Sawyer	Yes	X	Chair	X
Number of Meetings Held in Fiscal Year		7	1	1

Director Independence

Our stock is quoted on the OTC BB inter-dealer quotation system, which does not have director independence requirements. The Company, however, according to the Company’s Audit Committee Charter, requires that a minimum of three directors qualify as “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. Sawyer and Ryan, and Dr. Anderson are our independent directors. Independent directors constitute a majority of our Board of Directors.

The Company has an Audit Committee Charter which is posted on our website, which is located at www.etcusa.com. At February 26, 2010, we had an Audit Committee consisting of Messrs. Ryan (Chairman) and Sawyer and Dr. Anderson. Mr. Ryan has been designated as the Audit Committee Financial Expert as defined by the rules of the Securities and Exchange Commission. Among other responsibilities, the Audit Committee meets (in person 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. Sawyer (Chairman) and Ryan and Anderson also served on our Compensation Committee at February 26, 2010. The Compensation Committee is charged with the following responsibilities:

- Establish CEO and executive officers compensation
- Develop the compensation philosophy which shall include the strict adherence to the company’s Code of Ethics and Code of Conduct
- Assist with the preparation of and review the Compensation Discussion and Analysis (“CD&A”)
- Oversee equity compensation grant policy
- Retain and terminate outside experts if needed
- Evaluate related shareholder proposals

Messrs. Anderson (Chairman) and Ryan and Sawyer also served on our Nominating and Governance Committee at February 26, 2010. 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 a Code of Ethics, which applies to our chief executive officer, chief financial officer, controller and other senior financial officers. We also have a Company Code of Conduct that applies to our directors, officers and all employees. The Code of Ethics and the Company Code of Conduct are posted on our website, which is located at www.etcusa.com.

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. Unless extended, this agreement is effective through December 2010.

Compliance With Section 16(a) of the Exchange Act

Section 16(a) of the Exchange Act 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. 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, Messrs. Mitchell and Anderson had one late filing each. We believe that our greater than ten percent beneficial owners complied with all applicable filing requirements.

Compensation Committee Interlocks and Insider Participation

During fiscal 2010, the members of our Compensation Committee were Mr. George A. Sawyer (Chairman), Dr. George K. Anderson and Mr. Stephen F. Ryan. None of our executive officers served as (i) a member of the compensation committee (or other committee of the board of directors performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served on our Compensation Committee, (ii) a director of another entity, one of whose executive officers served on our Compensation Committee or (iii) a member of a compensation committee (or other committee of the board of directors performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served as one of our directors. No member of our Compensation Committee has ever been our employee. The issuance of options to members of our Compensation Committee is discussed herein under the heading "Director Compensation".

Item 10. 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 currently composed of George A. Sawyer who serves as the Committee Chairman, Dr. George K. Anderson, and Stephen F. Ryan, each of whom is independent under the relevant rules of the Securities and Exchange Commission.

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 Committee Charter is available on ETC's corporate website (<http://www.etcusa.com>). In April 2009, the Compensation Committee incorporated into its charter a policy statement which defined its specific responsibilities and established a set of generic evaluation criteria for developing and rewarding goals and objectives for the CEO and executive officers.

Stated broadly, we seek to provide competitive compensation for our executive officers that attracts and retains qualified executives, rewards individual and company achievement and aligns the financial interest of our executives with those of our stockholders. We use a combination of base salary, annual cash incentives, long-term equity incentives, perquisites and benefits programs to achieve these objectives. We emphasize performance-based incentive compensation programs for our executives, because we believe that these types of programs reward our executives when our financial and operational goals are achieved.

Compensation Philosophy and Objectives

The primary focus of our executive compensation program is to improve our performance in the short and long term. 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. We seek to maximize the possibilities for enhancing shareholder value by closely aligning compensation for ETC's executive officers with the profitability of ETC. 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.

Primary Components of Executive Compensation

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

We set base salaries for our executive officers based upon their respective positions and corresponding responsibilities and authorities. Executive salaries are reviewed on an annual basis consistent with our fiscal reporting period. We compare our base salaries to market benchmarks for each particular position.

The Compensation Committee specifically evaluates on an annual basis the CEO's performance in relation to the individual goals and performance criteria in place for the period and in relation to overall Company performance. Based on this review, they establish an appropriate base compensation level for the next fiscal year. They also review and approve the CEO's recommendations for executive officer compensation.

Short-term Incentive Compensation

We use short-term incentives to focus executive officers on our quarterly and annual performance plan and to reward them for achieving pre-established performance goals and strategic objectives. These short-term incentives, along with the long-term incentives, put a significant portion of each executive officer's pay at risk, so that these incentives are only earned when we achieve key performance goals and strategic objectives.

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During fiscal 2010 our CEO and each of our other named executives participated in a short term incentive compensation plan. Each executive was given a set of individual and common goals which applied for a specific period. These goals included financial objectives tied into our annual budget, individual goals related to operating or financing objectives, and goals related to personal development. Depending on their performance under the plan, each executive could earn a quarterly or annual compensation payment up to a total of 75% of base salary for our CEO and up to 50% of base salary for the other named executives. Starting with fiscal 2011, our short term incentive compensation plans will be evaluated on a fiscal year basis.

Incentive payments related to performance in fiscal 2010 under the various short term incentive plans totaled \$247,500 for our CEO (Mr. Mitchell received this payment subsequent to fiscal year end), \$21,502 for our CFO, and \$22,500 for our Corporate Counsel. (Certain of these payments were made subsequent to fiscal year end.) This program must be re-authorized on an annual basis and is subject to cancellation at any time.

Long-Term Incentive Compensation

We provide equity-based, long-term incentives to our executive officers as part of their competitive pay package because we believe that they align the interests of the officers directly with the interests of our stockholders. We also believe that long-term incentive compensation is an important retention tool.

On October 26, 2009, pursuant to the Company's 2009 Employee, Director and Consultant Stock Plan, the Board of Directors authorized the grant of stock options for 33,000 shares of common stock to our Chief Executive Officer, 11,500 options to our Chief Financial Officer, and 15,500 options to our General Counsel and Corporate Secretary.

Executive Benefits and Perquisites

As salaried employees, our executive officers participate in all our standard Company benefit programs. Our health and welfare plans include medical, dental, life, short-term disability and other coverages. The health and related benefits provided to executive officers are offered through broad based plans applicable to all regular full-time ETC employees. Our executive officers are also eligible to participate in the ETC Retirement Savings Plan, a qualified 401(k) plan that provides all of the executive officers with the opportunity to contribute compensation, up to the limits imposed by the Internal Revenue Code, on a pre-tax or after-tax basis. We match 100% of the first 4% of salary contributed, and this match vests in equal shares over a period of the five subsequent years. This Retirement Savings Plan is the same plan offered to all regular full-time ETC employees.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Annual Report.

Employment Agreements with Executive Officers

As of February 26, 2010, we have entered into employment agreements with certain employees, including the executive officers listed in the Summary Compensation Table.

Chief Executive Officer Employment Agreement

On July 24, 2006, ETC entered into an employment agreement with William F. Mitchell (the "CEO Plan") pursuant to which Mr. Mitchell is employed as the President and Chief Executive Officer. Mr. Mitchell also serves as the Chairman of the Board of ETC. Under Mr. Mitchell's employment agreement, he is entitled to receive a base salary (currently \$330,000), which is subject to increase annually based on a review of his performance by ETC's Compensation Committee. 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 was originally three years, and it has been extended for another three years (through July 24, 2012). If ETC does not renew the employment agreement for any 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 (other than a change of control in connection with an acquisition by Lenfest), each as defined in the employment agreement.

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ETC has also entered into employment agreements (the “Employment Agreement(s)”) with Duane D. Deaner, our CFO, and James D. Cashel, our General Counsel and Corporate Secretary (the “Executives”). Under the Employment Agreements, the Executives each receive a base salary which is subject to increase annually based on a review of their performance. Additionally, the Executives are entitled to bonuses based on specific annual objectives tailored to their individual areas of responsibility. The term of the Employment Agreements is through November 1, 2011. If ETC does not renew them for additional two-year periods, each Executive is entitled to terminate their employment agreement and to receive certain benefits including, without limitation, two years of base salary, bonuses and participation in various benefit plans. The employment agreements also provide the Executives with two years of base salary, bonuses, and participation in various benefit plans of ETC if the Executive’s employment is terminated due to a disability, by ETC without cause, or if the Executive terminates their employment with ETC for good reason as defined in the 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 26, 2010 and February 27, 2009.

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	2010	\$ 243,000	(2)	—	\$86,000(3)	—	—	\$ 66,000(4)	\$ 395,000
	2009	\$225,000						\$ 68,000(5)	\$ 293,000
Duane D. Deaner (6) Chief Financial Officer	2010	\$ 115,000	\$ 22,000(7)	—	\$ 30,000(8)	—	—	\$ 2,000(9)	\$ 169,000
	2009	\$ 102,000	\$15,000					\$ 2,000(10)	\$ 119,000
James D. Cashel (11) General Counsel, Corporate Secretary	2010	\$ 143,000	(12)	—	\$ 41,000(13)	—	—	\$ 3,000(14)	\$ 187,000

- (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 are summarized above under “Primary Components of Executive Compensation-Chief Executive Officer Employment Agreement.”
- (2) Mr. Mitchell received a bonus of \$247,500 subsequent to fiscal year end.
- (3) On October 26, 2009 Mr. Mitchell was awarded stock options for 33,000 shares of the Company’s common stock pursuant to the Company’s 2009 Employee, Director and Consultant Stock Plan.
- (4) Consists of \$60,000 paid to Mr. Mitchell in connection with ETC’s use of Mr. Mitchell’s properties, \$2,000 in automobile allowance payments for Mr. Mitchell’s company car, and \$4,000 in contributions on behalf of Mr. Mitchell pursuant to ETC’s Retirement Savings Plan.
- (5) Consists of \$60,000 paid to Mr. Mitchell in connection with ETC’s use of Mr. Mitchell’s properties, \$2,000 in automobile allowance payments for Mr. Mitchell’s company car, \$3,000 in life insurance premium payments and \$3,000 in contributions on behalf of Mr. Mitchell pursuant to ETC’s Retirement Savings Plan.

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- (6) ETC is 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 are summarized above under “Primary Components of Executive Compensation-Employment Agreements with Executive Officers.”
- (7) Subsequent to fiscal year end, Mr. Deaner received an additional \$8,000 in bonus payments related to the Company’s performance in fiscal 2010.
- (8) On October 26, 2009 Mr. Deaner was awarded stock options for 11,500 shares of the Company’s common stock pursuant to the Company’s 2009 Employee, Director and Consultant Stock Plan.
- (9) Consists of ETC’s contribution on behalf of Mr. Deaner’s pursuant to ETC’s Retirement Savings Plan.
- (10) Consists of ETC’s contribution on behalf of Mr. Deaner’s pursuant to ETC’s Retirement Savings Plan.
- (11) ETC is party to an employment agreement with Mr. Cashel, pursuant to which Mr. Cashel serves as General Counsel and Corporate Secretary. The terms and conditions of Mr. Cashel’s employment agreement are summarized above under “Primary Components of Executive Compensation-Employment Agreements with Executive Officers.”
- (12) Subsequent to fiscal year end, Mr. Cashel received a bonus payment of \$22,500 related to the Company’s performance in fiscal 2010.
- (13) On October 26, 2009 Mr. Cashel was awarded stock options for 15,500 shares of the Company’s common stock pursuant to the Company’s 2009 Employee, Director and Consultant Stock Plan.
- (14) Consists of ETC’s contribution on behalf of Mr. Cashel 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 26, 2010.

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	—	33,000	\$ 2.64	12/17/2019
Duane D. Deaner Chief Financial Officer	2,881 6,978 642	— — — 11,500	\$ 7.375 \$ 7.24 \$ 6.07 \$ 2.64	1/03/11 9/15/14 9/21/16 12/17/2019
James D. Cashel General Counsel, Corporate Secretary		15,500	\$ 2.64	12/17/2019

Compensation of Directors

Currently our directors who did not serve as officers are paid a fee of \$5,000 (either in cash or equivalent value of common stock of the Company) per calendar quarter for attending four Board of Directors meetings, four Audit Committee meetings, and two each of Nominating/Governance and Compensation Committee meetings. For additional Board meetings, directors receive \$1,000 per meeting. For additional committee meetings, directors receive either \$1,500 for each in-person meeting or \$250 for each teleconference meeting. Additionally, non-employee directors may be awarded options to purchase common stock of the Company. Pursuant to this plan, in November 2009, each of Mr. Anderson, Mr. Sawyer and Mr. Ryan, our independent directors, were awarded options to purchase 10,000 shares of common stock at an exercise price of \$2.64 per share, which is equal to the closing trading price on the date of grant.

FISCAL 2010 DIRECTOR COMPENSATION TABLE

The following table sets forth the compensation paid by the Company to each of its Directors for the fiscal year ended February 26, 2010.

Name (a)	Fees Earned or Paid in Cash (\$) (b)	Stock Awards (\$) ¹ (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 ²	—	—	—	—	—	—	—
George K. Anderson, M.D. ³	\$ 16,000	—	—	—	—	—	\$ 16,000
H. F. Lenfest ⁴	\$ 5,000	4,000	—	—	—	—	\$ 9,000
George A. Sawyer ⁵	\$ 10,000	—	—	—	—	—	\$ 10,000
Steve Ryan ⁶	\$ 12,667	—	—	—	—	—	\$ 12,667
	—	—	—	—	—	—	—

¹ ETC used the closing price of its common stock on the date of grant as reported on the Over the Counter – Bulletin Board to compute the value of these awards.

² Mr. Mitchell held options to purchase an aggregate of 33,000 shares of our common stock as of February 26, 2010.

³ Dr. Anderson held options to purchase an aggregate of 60,000 shares of our common stock as of February 26, 2010.

⁴ Mr. Lenfest did not hold any options to purchase shares of our common stock as of February 26, 2010.

⁵ Mr. Sawyer held options to purchase an aggregate of 10,000 shares of our common stock as of February 26, 2010.

⁶ Mr. Ryan held options to purchase an aggregate of 10,000 shares of our common stock as of February 26, 2010.

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Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth, as of May 1, 2010, the number of shares and percentage of our common stock owned beneficially by each Director, each nominee for Director and each executive officer named in the Summary Compensation Table, and each person holding, to our knowledge, more than 5% of our outstanding common stock (1). The table also sets forth the holdings of all directors and executive officers as a group.

	Number of shares	Percentage
William F. Mitchell (2) c/o Environmental Tectonics Corporation 125 James Way Southampton, PA 18966	1,093,624(3)	12.0%
George K. Anderson, M.D. (4) 8 Little Harbor Way Annapolis, MD 21403	51,250(5)	1.0%
H.F. Lenfest (4) c/o The Lenfest Group Fire Tower Bridge-Suite 460 300 Barr Harbor Drive West Conshohocken, PA 19428	14,512,176(6)	68.5%
Stephen F. Ryan (4) c/o Environmental Tectonics Corporation 125 James Way Southampton, PA 18966	6,713	*
George A. Sawyer (4) 404 North Union Street Alexandria, VA 22314	1,713	*
T. Todd Martin, III 50 Midtown Park East Mobile, AL 36606	999,592(7)	11.0%
Duane D. Deaner (8) c/o Environmental Tectonics Corporation 125 James Way Southampton, PA 18966	10,501(9)	*
James D. Cashel (10) c/o Environmental Tectonics Corporation 125 James Way Southampton, PA 18966	—	*
All Directors and Executive Officers as a group (7 persons)	15,675,977	73.7%(11)

* 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. The “Percent of Common Stock” is based on a denominator for the applicable Beneficial Owner equal to the sum of: (i) 9,086,999 shares of common stock outstanding, (ii) the shares of common stock, which may be acquired by such Beneficial Owner upon the exercise of options owned by such Beneficial Owner, and (iii) the shares of common stock beneficially owned by Lenfest set forth in footnote 6 below.

(2) Chairman of the Board, President, Chief Executive Officer and Director of the Company.

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- (3) Includes 45,200 shares of common stock held by Mr. Mitchell's wife.
- (4) Director of the Company.
- (5) Includes 50,000 shares of common stock which may be acquired upon the exercise of options that are presently exercisable.
- (6) Includes 11,370,500 shares of common stock issuable upon conversion of 22,741 shares of Series E Preferred Stock, 148,601 shares of common stock issuable upon conversion of 155 shares of Series D Preferred Stock and 594,335 shares of common stock issuable upon conversion of 700,000 common stock warrants.
- (7) Includes 938,692 shares of common stock owned by Advanced Technology Asset Management, LLC, 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.
- (8) Chief Financial Officer of the Company.
- (9) Includes 10,501 shares of common stock which may be acquired upon the exercise of options granted under our Incentive Stock Option Plan that are presently exercisable.
- (10) General Counsel and Corporate Secretary of the Company.
- (11) Includes 50,000 shares of common stock which may be acquired by members of the Board of Directors upon the exercise of options that are presently exercisable. Additionally, includes 11,370,500 shares of common stock issuable upon conversion of 22,741 shares of Series E Preferred Stock, 148,601 shares of common stock issuable upon conversion of 155 shares of Series D Preferred Stock and 594,335 shares of common stock issuable upon conversion of 700,000 common stock warrants. Also includes 10,501 shares of common stock which may be acquired by Duane D. Deaner 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 Item 5 of this Annual Report, both of which are incorporated herein by reference.

Item 12. Certain Relationships and Related Transactions and Director Independence

Background For Discussion Of Transactions Completed in Fiscal 2010

On February 19, 2003, ETC completed a refinancing of its indebtedness with PNC Bank and H.F. Lenfest ("Lenfest") in the aggregate amount of \$29,800,000. Pursuant to the terms of the Convertible Note and Warrant Purchase Agreement, dated February 19, 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 Bank, 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 7, 2006, we entered into a Preferred Stock Purchase Agreement (the "Lenfest Equity Agreement") with Lenfest. The Lenfest Equity Agreement, which was scheduled to terminate 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") at a dividend equal to six percent per annum. Three years after issue the Series B Preferred Stock was 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 was equal to the closing price of our 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. Draw downs 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 would be mandatorily converted into ETC common stock at each set Conversion Price. The Lenfest Equity Agreement also allowed 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 would 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 (discussed below).

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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. The Series B Preferred Stock voted with ETC's common stock on an as-converted basis and was fully convertible into 1,055,163 shares of ETC common stock.

Effective May 9, 2007, the Company entered into a letter agreement with Lenfest pursuant to which 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 its indebtedness with PNC Bank in the aggregate amount of up to \$15,000,000. This refinancing by ETC was an extension of a credit facility originally entered into with PNC Bank in February 2003. ETC's obligations under the Credit Agreement was secured by a personal guarantee from Lenfest under a Restated Guaranty, dated July 31, 2007, made by Lenfest in favor of PNC. ETC agreed to pay Lenfest an annual cash fee of 1% of the loan commitment for his guarantee.

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 Series C Preferred Stock was 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 voted with ETC's common stock on an as-converted basis and was fully convertible into 1,089,108 shares of ETC common stock. The Series C Preferred Stock would automatically convert into ETC common shares on the fifth anniversary of its issuance. It carried a dividend equal to ten percent (10%) per annum.

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 dividend rate to 10% per annum, (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.

The Series B and C Preferred Stock (the "instruments") are recorded in the accompanying financial statements as mezzanine financing. This classification is due to the preferential redemption feature of the instruments, which provided 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.

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. On September 11, 2008, ETC was informed by Lenfest that he was withdrawing this proposal.

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 similar to the financial covenants contained in ETC's credit agreement with PNC Bank, 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 would be subject to any required approvals including the approval of ETC's shareholders and in accordance with the rules and regulations of the NYSE AMEX LLC (formerly the American Stock Exchange), if required.

Transactions Completed in Fiscal 2010

Effective April 24, 2009, we entered into a transaction (the "Lenfest Financing Transaction") with Lenfest that provided for the following upon the satisfaction of certain conditions, including the receipt of the approval of the Company's shareholders to certain components of the transaction (as more fully described below, the "Shareholder Approvals"): (i) a \$7,500,000 credit facility to be

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provided by Lenfest to ETC; (ii) exchange of the Subordinated Note (as defined below) held by Lenfest, together with all accrued interest and warrants issuable under the Subordinated Note, and all Series B Preferred Stock and Series C Preferred Stock held by Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock, of the Company, the terms of which are described below; and (iii) the guarantee by Lenfest of all of ETC's obligations to PNC Bank in connection with an increase of the existing \$15,000,000 revolving line of credit with PNC Bank (the "2007 PNC Credit Facility") to \$20,000,000, and in connection with this guarantee, the pledge by Lenfest to PNC Bank of \$10,000,000 in marketable securities.

Lenfest Credit Facility

As part of the Lenfest Financing Transaction, the Company established a credit facility in the maximum amount of \$7,500,000 with Lenfest (the "Lenfest Credit Facility"). The Lenfest Credit Facility is to be used to finance certain government projects that ETC was and is seeking to be awarded (the "Projects"). The terms of the Lenfest Credit Facility are set forth in a Secured Credit Facility and Warrant Purchase Agreement between the Company and Lenfest, dated as of April 24, 2009 (the "Lenfest Credit Agreement"). In connection with the Lenfest Credit Agreement, the Company has executed, and will in the future execute, promissory notes in favor of Lenfest, in the aggregate principal amount of up to \$7,500,000 (the "Lenfest Credit Facility Note"). Each Lenfest Credit Facility Note issued prior to ETC obtaining the Shareholder Approvals accrues interest at the rate of 15% per annum, payable in cash or, at the option of Lenfest, in shares of a new class of preferred stock, Series D Preferred Stock, of the Company, the terms of which are described below. The interest rate on the Lenfest Credit Facility Notes will decrease to 10% per annum retroactive to the date of the issuance of each note if the Company obtains the Shareholder Approvals. All Lenfest Credit Facility Notes issued after ETC obtains the Shareholder Approvals shall accrue interest at the rate of 10% per annum, payable in cash or, at the option of Lenfest, shares of Series D Preferred Stock.

In connection with the execution of the Lenfest Credit Agreement on April 24, 2009, the Company was initially entitled to drawdown \$1,000,000 under the Lenfest Credit Agreement prior to obtaining the Shareholder Approvals and satisfying certain other conditions (the "Initial \$1 Million Loan"). The Initial \$1 Million Loan had a maturity date of five (5) business days following the Shareholder Approval Date (as defined below) (the "Initial \$1 Million Loan Early Maturity Date"), unless the Company received the Shareholder Approvals, in which event the maturity date would be extended until three years from its date of issuance. Each additional Lenfest Credit Facility Note, none of which would be issued unless the Company received the Shareholder Approvals, shall mature on the earlier of (i) three years from its date of issuance or (ii) December 31, 2012.

As set forth in the Form 8-K of the Company filed on February 26, 2009, Lenfest made a loan to ETC in the principal amount of \$2,000,000 on February 20, 2009 (the "\$2 Million Loan"), which amount is considered advanced under the Lenfest Credit Facility. The \$2 Million Loan was to be used by ETC solely to support ETC's proposal on one of the Projects. The terms of the \$2 Million Loan are set forth in a Secured Promissory Note, dated February 20, 2009, by ETC in favor of Lenfest (the "\$2 Million Note"). The \$2 Million Note will mature on the earlier of (i) three days following the date ETC is informed by the United States government or otherwise learns that it has been denied or will not be awarded the Project, (ii) August 20, 2009 if ETC has not obtained the Shareholder Approvals on or before the Shareholder Approval Date (the "\$2 Million Loan Early Maturity Date") or (iii) three years following the date of issuance of the \$2 Million Note. The proceeds from this \$2 million loan are included in restricted cash in ETC's balance sheets as of February 27, 2009. On September 1, 2009 the Company repaid the \$2 million loan in full.

Additional advances on the Lenfest Credit Facility after the Initial \$1 Million Loan and the \$2 Million Loan are subject to the satisfaction of certain conditions, in addition to the condition that the Shareholder Approvals have been obtained, including the award of one or more of the Projects to ETC and that at least one such Project remains in effect, the satisfaction of the other Financing Transaction Conditions described below and the determination by Lenfest, in his sole discretion, that ETC's prospects in the long-term for reaching consistent cash flow and positive operations are continuing to improve. ETC can make requests under the Lenfest Credit Facility up to December 31, 2010.

The Company paid to Lenfest an origination fee of 1% of the committed (but not advanced as of yet) amount of the Lenfest Credit Facility. The origination fee was paid in 55 shares of new Series D Preferred Stock of the Company, which has a stated value of \$1,000 per share.

In connection with each Lenfest Credit Facility Note issued by ETC, ETC agreed to issue to Lenfest a warrant to purchase a number of shares of ETC common stock equal to (i) 10% of the principal amount of the Lenfest Credit Facility Note divided by (ii) closing price of ETC common stock for the day immediately preceding the date of issuance of this warrant. The exercise price for the warrants would be equal to such closing price. The warrants would be exercisable for seven years following issuance.

With respect to the warrant to be issued in connection with the \$1 Million Loan, if it was drawn down but not repaid in full on or before the Initial \$1 Million Loan Early Maturity Date or if ETC did not obtain the Shareholder Approvals by July 2, 2009 (which

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date would be extended up to August 13, 2009 if the Securities and Exchange Commission provided comments to the Proxy Statement to be filed in connection with the transactions described herein) (the “Shareholder Approval Date”), then Lenfest will be entitled to purchase under such warrant a number of shares of ETC Common Stock equal to \$500,000 divided by the closing price of ETC’s common stock for the day immediately preceding the date of issuance of the warrant, at an exercise price equal to 50% of the initial exercise price.

In addition, in connection with the \$2 Million Loan, ETC issued to Lenfest a warrant (the “\$2 Million Loan Warrant”) to purchase 143,885 shares of ETC common stock, at an exercise price per share equal to \$1.39, which was equal to the average price of ETC common stock for the 120 trading days immediately preceding the date of this warrant. If the \$2 Million Loan was not repaid in full on or before the \$2 Million Loan Early Maturity Date or if ETC did not obtain the Shareholder Approvals by the Shareholder Approval Date, then Lenfest would be entitled to purchase an additional 575,539 shares of ETC stock for a total of 719,424 shares of ETC common stock under such warrant and the exercise price per share of such warrant would be decreased by 50% to \$0.69 for all shares. The \$2 Million Loan Warrant was amended and restated on April 24, 2009 to confirm its definition of the Shareholder Approval Date with the definition set forth in the Lenfest Credit Agreement.

The Lenfest Credit Agreement contained customary 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. The Lenfest Credit Agreement also contained financial covenants that were similar in scope to the financial covenants set forth in the proposed Amended and Restated PNC Credit Agreement (as defined below).

The Lenfest Credit Facility Notes provided for customary events of default with corresponding grace periods, including the failure to pay any principal or interest when due, failure to comply with covenants, material misrepresentations, certain bankruptcy, insolvency or receivership events, imposition of judgments and the liquidation of ETC.

The obligations of the Company to Lenfest under the Lenfest Credit Facility are secured by (i) the grant of a security interest in all personal property of the Company and certain subsidiaries of the Company and (ii) the Company’s grant of a mortgage on all of the Company’s real property in favor of Lenfest.

Exchange of Existing Instruments for Series E Preferred Stock

As part of the Lenfest Financing Transaction, the Subordinated Note in the original principal amount of \$10,000,000 issued by ETC to Lenfest on February 18, 2003, together with all accrued interest and warrants issuable pursuant to the terms of the Subordinated Note, and all Series B Preferred Stock and Series C Preferred Stock of the Company held by Lenfest, together with all accrued dividends thereon, was exchanged (the “Series E Exchange”) for shares of a newly-created class of Series E Convertible Preferred Stock of the Company (the “Series E Preferred Stock”). The Series E Exchange was conditioned upon ETC’s receipt of the Shareholder Approvals. Accordingly, the Company was not able to complete the Series E Exchange unless the Company obtains the Shareholder Approvals.

The Series E Preferred Stock provides for a dividend equal to 10% per annum. The dividend will be payable on the liquidation of ETC, on the conversion of the Series E Preferred Stock or following declaration by the Board of Directors of ETC. Upon liquidation, dissolution or winding up of ETC, the Series E Preferred Stock will have the right to receive the original investment amount plus accrued dividends. To the extent of any remaining funds or assets, the Series E Preferred Stock will participate on an as-converted basis in additional distributions. The Series E Preferred Stock will rank *pari passu* with the Series D Preferred Stock. Assuming that ETC’s shareholders approve the Lenfest Financing Transaction, the Series E Preferred Stock will vote with the ETC common stock on an as converted basis on all matters that require the vote of ETC’s shareholders.

The Series E Preferred Stock is convertible, at Lenfest’s request, into shares of ETC common stock at a conversion price equal to \$2.00 per common share.

The Series E Preferred Stock contains anti-dilution protection for issuances of ETC’s common stock or securities convertible into ETC’s common stock at prices below the conversion price of the Series E Preferred Stock.

ETC has granted Lenfest 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 E Preferred Stock.

The Series E Preferred Stock is classified in the Company’s balance sheet as permanent equity.

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Increased PNC Bank Credit Facility and Issuance of New Guarantee

On April 24, 2009, PNC Bank agreed to increase the amount of financing available under the 2007 PNC Credit Facility from \$15,000,000 to \$20,000,000 subject to the condition that Lenfest continues to personally guaranty all of ETC's obligations to PNC Bank (the "Lenfest Guaranty") and that Lenfest pledges \$10,000,000 in marketable securities as collateral security for his guaranty (the "Lenfest Pledge"). Lenfest's obligation to provide the Lenfest Guaranty and the Lenfest Pledge is conditioned upon the Company's receipt of the Shareholder Approvals.

The terms of PNC Bank's agreement to increase the amount of financing under the 2007 PNC Credit Facility are set forth in a letter agreement, dated April 24, 2009, between ETC and PNC Bank (the "PNC Letter Agreement"). If the Shareholder Approvals are obtained, ETC and PNC Bank agreed to enter into the Amended and Restated Credit Agreement (the "Amended and Restated PNC Credit Agreement") and the Second Amended and Restated Reimbursement Agreement for Letters of Credit (the "Amended and Restated Reimbursement Agreement") in the forms attached to the PNC Letter Agreement. The promissory note executed by ETC in favor of PNC Bank in connection with the 2007 PNC Credit Facility would also be cancelled and replaced with the Amended and Restated Promissory Note in the principal amount of \$20,000,000 in the form attached to the PNC Letter Agreement (the "Amended and Restated PNC Note"). Lenfest would execute and deliver to PNC Bank the following agreements, the forms of which are attached to the PNC Letter Agreement: (i) an Amended and Restated Guaranty Agreement, which would replace the Restated Guaranty executed by Lenfest in connection with the 2007 PNC Credit Facility (the "Amended and Restated Guaranty"), (ii) a Pledge Agreement, pursuant to which Lenfest shall make the Lenfest Pledge, and (iii) a Notification and Control Agreement. Such agreements, together with the Amended and Restated PNC Credit Agreement, the Amended and Restated Reimbursement Agreement and the Amended and Restated PNC Note are collectively referred to herein as the "2009 PNC Financing Documents".

In the event that the Shareholder Approvals were not obtained or ETC and Lenfest fail to enter into the 2009 PNC Financing Documents on or before August 6, 2009, PNC Bank would no longer be obligated to enter into such agreements and increase the amount of financing available to ETC to \$20,000,000.

Borrowings under the Amended and Restated PNC Credit Agreement are available for working capital or other general business purposes and for issuances of letters of credit. Amounts borrowed under the Amended and Restated PNC Credit Agreement may be borrowed, repaid and reborrowed from time to time until June 30, 2010. Borrowings made under the Amended and Restated PNC Credit Agreement will bear interest at the London Interbank Offered Rate (as described in the Amended and Restated PNC Note) plus 2.50%. Additionally, ETC will be obligated to pay a fee of 0.125% per annum for unused available funds.

The Amended and Restated PNC Credit Agreement contains affirmative and negative covenants that are customary 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 Amended and Restated PNC Credit Agreement, the Company must maintain a minimum Consolidated Tangible Net Worth (which, as defined, is total assets excluding intangibles less liabilities excluding the Subordinated Note) of \$3,500,000 for each fiscal quarter. Under the Amended and Restated PNC Credit Agreement, the Company must also maintain a minimum EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of (a) \$300,000 for the fiscal quarter ended May 31, 2009, (b) \$1,200,000 for the fiscal quarter ended August 31, 2009, (c) \$1,000,000 for the fiscal quarter ended November 30, 2009, (d) \$900,000 for the fiscal quarter ended February 28, 2010 and (e) \$1,300,000 for the fiscal quarter ending March 1, 2010 and thereafter.

The Amended and Restated Reimbursement Agreement governs letters of credit issued pursuant to the Amended and Restated PNC Credit Agreement.

All of ETC's indebtedness to Lenfest shall be subordinated to the indebtedness under the 2009 PNC Financing Documents pursuant to the terms of the Second Amended and Restated Subordination and Intercreditor Agreement, dated April 24, 2009, by and among the Company, Lenfest and PNC Bank.

Financing Transaction Conditions

Additional advances under the Lenfest Line of Credit, the Series E Exchange and Lenfest's execution of the Lenfest Guaranty are subject to certain conditions (the "Financing Transaction Conditions"). These conditions include (i) shareholder approval of an increase in the number of authorized shares of the Company from 20,000,000 to 50,000,000, (ii) shareholder approval of the Series E Exchange, and (iii) shareholder approval of the restoration of Lenfest's voting rights with respect to all preferred and common shares owned by Lenfest currently or issuable to Lenfest as part of the Lenfest Financing Transaction (collectively, the "Shareholder Approvals"). These conditions also include the amendment of existing employment agreements between ETC and certain ETC employees to amend certain change in control provisions. Pursuant to a Shareholders Voting Agreement, dated April 24, 2009, William F. Mitchell, Sr. has agreed to vote all of his shares of ETC common stock in favor of the Shareholder Approvals.

Shareholder Approvals

ETC obtained the Shareholder Approvals on July 2, 2009. As a result, the 2009 PNC Financing Documents were entered into, and ETC paid to Lenfest an origination fee equal to 1% of the Lenfest Pledge and annual interest equal to 2% of the Lenfest Pledge, each payable in shares of Series D Preferred Stock. In consideration of Lenfest entering into the Amended and Restated Guaranty, ETC issued to Lenfest warrants to purchase shares of ETC common stock equal to 10% of the amount of the \$5,000,000 increase in funding available under the Amended and Restated PNC Credit Agreement. The warrants will be exercisable for seven years following issuance at an exercise price per share equal to the closing price of ETC's common stock on the day prior to issuance.

Series D Preferred Stock

ETC has created a new class of Series D Preferred Stock. The Series D Preferred Stock was issued for payment of the origination fee and interest on the Lenfest Credit Facility Notes as described above. The Series D Preferred Stock provides for a dividend equal to 10% per annum. The dividend will be paid on the liquidation of ETC, on the conversion of the Series D Preferred Stock or following declaration by the Board of Directors of ETC. Upon liquidation, dissolution or winding up of ETC, the Series D Preferred Stock will have the right to receive the original investment amount plus accrued dividends. To the extent of any remaining funds or assets, the Series D Preferred Stock will participate on an as-converted basis in additional distributions. The Series D Preferred Stock ranks *pari passu* with the Series E Preferred Stock. The Series D Preferred Stock votes with the ETC common stock on an as converted basis on all matters that require the vote of ETC's shareholders.

The Series D Preferred Stock is convertible, at Lenfest's request, into ETC common shares at a conversion price equal to the fair market value of ETC's common stock on the date of issuance.

The Series D Preferred Stock contains anti-dilution protection for issuances of ETC's common stock or securities convertible into ETC's common stock at prices below the conversion price of the Series D Preferred Stock.

ETC has granted Lenfest 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 D Preferred Stock.

The Series D Preferred Stock is classified in the Company's balance sheet as permanent equity.

First Amendment to Amended and Restated PNC Credit Agreement

On October 1, 2009, the Amended and Restated PNC Credit Agreement was amended to extend the maturity date to June 30, 2011. Additionally, the affirmative covenants were adjusted. The Consolidated Tangible Net Worth covenant was modified to reflect the impact on the Company's balance sheet of the Lenfest Financing Transaction. Effective with each fiscal quarter ending after October 1, 2009, the Company must maintain a minimum Consolidated Tangible Net Worth of at least \$10,000,000. The Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) covenant was changed to a minimum of \$1,200,000 for the fiscal quarter ended August 28, 2009, and \$1,000,000 for the fiscal quarter ended November 27, 2009. Beginning with the first fiscal quarter ending after December 1, 2009, and for each fiscal quarter ending thereafter, the Company must maintain a minimum aggregate EBITDA of \$4,000,000 for the fiscal quarter then ending and the three preceding fiscal quarters.

Dedicated Line of Credit Agreement with PNC Bank

On November 16, 2009, the Company and PNC Bank entered into a Letter Agreement, Reimbursement Agreement, Pledge Agreement, and Amendment to Subordination Agreement (collectively, the "Dedicated Line of Credit Agreement"), pursuant to which the Company has received a committed line of credit in the amount of \$5,422,405 (the "Line of Credit") which the Company used to satisfy performance bond and repayment guarantee requirements in a contract with an existing customer. Use of this dedicated line of credit is restricted to funding contract requirements under this specific contract.

As security for this line of credit, ETC and H.F. Lenfest were each required to provide PNC Bank with the equivalent of \$2,711,000 in the form of cash or other financial instruments. To meet this requirement, ETC has deposited cash in this amount in a restricted bank account with PNC Bank. H.F. Lenfest has guaranteed the Company's obligations under the Dedicated Line of Credit Agreement, and has pledged to PNC Bank \$2,711,000 in certificated securities. On March 30, 2010 ETC placed additional cash funds with PNC Bank, and subsequent to fiscal year end Lenfest's guarantee was terminated and his securities were returned.

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, Sr., ETC's President and Chief Executive Officer. During fiscal 2010 the Company purchased \$626,000 from Industrial Instruments. ETC also rents office space to Industrial Instruments at ETC's corporate headquarters. During fiscal 2010, Industrial Instruments paid to ETC rent in the amounts of \$5,000.

ETC purchases travel accommodations from Jet Set, a company that employs Kathleen Mahon, the daughter of Mr. Mitchell, Sr. During fiscal 2010, ETC purchased travel through Jet Set totaling \$317,000, and Ms. Mahon received approximately \$9,000 from her employer 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 2010, Ms. Mahon received \$17,000 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 2010, William F. Mitchell, Jr., received \$134,000 and David Mitchell received \$132,000 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.

Item 13. Principal Accountant 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 is vested in 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.

The following table presents fees for professional audit services rendered by the Company's independent registered public accounting firm, Friedman, LLP for professional services rendered. 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 26, 2010 and February 27, 2009.

	<u>FY 2010</u>	<u>FY 2009</u>
Audit fees	\$ 182,512	\$ 240,780
Audit related fees (1)	20,472	19,048
Audit and audit related fees	202,984	259,828
Tax fees (2)	12,925	24,212
Total fees	<u>\$215,909</u>	<u>\$ 284,040</u>

(1) Audit related fees consist of fees related to review of the Lenfest transaction (fiscal 2009) and employee benefit plan audits.

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

PART IV

Item 14. Exhibits and Financial Statement Schedules.

(a) Exhibits:

<u>Number</u>	<u>Item</u>
3.1(i)(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)(2)	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(i)(3)	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.
3.1(i)(4)	Statement with respect to shares of Series D Convertible Preferred Stock, and incorporated herein by reference.
3.1(ii)	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.
3.1(i)(5)	Statement with respect to shares of Series E Convertible Preferred Stock was filed on July 6, 2009 as Exhibit 3.1 to Registrant's Form 8-K and incorporated herein by reference.
3.1(i)(6)	Amendment to Articles of Incorporation of the Company was filed on July 6, 2009 as Exhibit 3.2 to Registrant's Form 8-K and 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.
4.5	Secured Promissory Note by the Registrant in favor of H.F. Lenfest, dated as of February 20, 2009, was filed on February 26, 2009 as Exhibit 10.2 to Form 8-K and is incorporated by reference.
4.6	Common Stock Warrant issued by the Registrant in favor of H.F. Lenfest, dated as of February 20, 2009, was filed on February 26, 2009 as Exhibit 10.3 to Form 8-K and is incorporated by reference.
4.7	Amended and Restated Warrant, dated as of April 24, 2009, between Registrant and Lenfest, was filed on April 27, 2009 as Exhibit 10.1 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	Registrant's 2009 Employee, Director and Consultant Stock Plan was filed on September 4, 2009 on Form S-8 and is incorporated herein by reference. *
10.5	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.
10.6	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.



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<u>Number</u>	<u>Item</u>
10.7	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.
10.8	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.
10.9	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.
10.10	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. *
10.11	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.
10.12	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.
10.13	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.
10.14	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.*
10.15	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.*
10.16	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.
10.17	Agreement between Registrant and H.F. Lenfest, dated as of May 9, 2007 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.
10.18	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.
10.19	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
10.20	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.
10.22	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.
10.22	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.
10.23	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.
10.24	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.
10.25	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.
10.26	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.
10.27	Letter Agreement between Registrant and H.F. Lenfest, dated as of May 20, 2008 was filed on May 29, 2008 as Exhibit 10.32 to Form 10-K and is incorporated by reference.

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Number	Item
10.28	First Amendment to Loan Documents between Registrant and PNC Bank, National Association, was filed on October 7, 2008 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.29	Security Agreement by the Registrant in favor of H.F. Lenfest, dated as of February 20, 2009, was filed on February 26, 2009 as Exhibit 10.2 to Form 8-K and is incorporated by reference.
10.30	Secured Credit Facility and Warrant Purchase Agreement, dated April 24, 2009, between Registrant and H.F. Lenfest, was filed on April 27, 2009 as Exhibit 10.1 to Form 8-K and is incorporated by reference.
10.31	Letter Agreement, dated April 24, 2009, between Registrant and PNC Bank, with the Amended and Restated PNC Credit Agreement, the Amended and Restated PNC Note, the Amended and Restated Guaranty Agreement, the Pledge Agreement and the Notification and Control Agreement (each as defined in such letter agreement) attached thereto as exhibits, was filed on April 27, 2009 as Exhibit 10.3 to Form 8-K and is incorporated by reference.
10.32	Second Amended and Restated Subordination Agreement, dated April 24, 2009, among PNC Bank, Lenfest and Registrant, was filed on April 27, 2009 as Exhibit 10.4 to Form 8-K and is incorporated by reference.
10.33	Amended and Restated Open-End Mortgage and Security Agreement, dated as of April 24, 2009, by Registrant in favor of Lenfest was filed on May 12, 2009 as Exhibit 10.32 to Form 10-K and is incorporated by reference.
10.34	Letter Agreement by and between the Registrant and H.F. Lenfest was filed on July 6, 2009 as Exhibit 10.1 to Form 10-K and is incorporated by reference.
10.35	First Amendment to Executive Employment Agreement dated as of June 9, 2009, by and between the Registrant and Duane D. Deaner was filed on July 6, 2009 as Exhibit 10.2 to Form 10-K and is incorporated by reference.
10.36	First Amendment to 2007 PNC Credit Facility, between Registrant and PNC Bank, dated October 1, 2009, was filed on October 7, 2009 as Exhibit 1.1 to Form 10-K and is incorporated by reference.
10.37	Letter Agreement between the Registrant and PNC Bank, dated as of November 16, 2009 was filed on November 20, 2009 as Exhibit 1.1 to Form 8-K and is incorporated by reference.
10.38	Reimbursement Agreement between the Registrant and PNC Bank, dated as of November 16, 2009 was filed on November 20, 2009 as Exhibit 1.2 to Form 8-K and is incorporated by reference.
10.39	Pledge Agreement between the Registrant and PNC Bank, dated as of November 16, 2009 was filed on November 20, 2009 as Exhibit 1.3 to Form 8-K and is incorporated by reference.
10.40	Amendment to Subordination Agreement between the Registrant, H.F. Lenfest and PNC Bank, dated as of November 16, 2009, was filed on November 20, 2009 as Exhibit 1.4 to Form 8-K and is incorporated by reference.
10.41	Stock Repurchase Agreement between the Registrant and H.F. Lenfest, dated March 10, 2010, was filed on March 16, 2010, as Exhibit 10.1 to Form 8-K and is incorporated by reference.
13	Portions of Registrant's 2010 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.
21	Subsidiaries of the Registrant (Filed herewith).
23	Consent of Friedman LLP dated May 27, 2010. (Filed herewith)
31.1	Certification dated May 27, 2010 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 27, 2010 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 27, 2010 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)

* 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 27, 2010
<u>/s/ Duane D. Deaner</u> Duane D. Deaner	Chief Financial Officer (Principal Financial and Accounting Officer)	May 27, 2010
<u>/s/ H.F. Lenfest</u> H.F. Lenfest	Director	May 27, 2010
<u>/s/ George K. Anderson</u> George K. Anderson, M.D.	Director	May 27, 2010
<u>/s/ Stephen F. Ryan</u> Stephen F. Ryan	Director	May 27, 2010
<u>/s/ George A. Sawyer</u> George A. Sawyer	Director	May 27, 2010

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Item</u>
13	Portions of Registrant's 2010 Annual Report to Shareholders which are incorporated by reference into this Form 10-K.
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32	Certification dated May 27, 2010 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.

**PORTIONS OF
ENVIRONMENTAL TECTONICS CORPORATION
2010
ANNUAL REPORT TO STOCKHOLDERS**

FINANCIAL REVIEW**(amounts in thousands, except share and per share information)**

	Fiscal year ended:	
	February 26, 2010	February 27, 2009
Net sales	\$ 42,271	\$ 36,687
Gross profit	18,824	11,858
Operating profit (loss)	6,600	(346)
Net income (loss)	6,453	(1,974)
Income (loss) per common share:		
Basic	\$ 0.50	\$ (0.32)
Diluted	\$ 0.30	\$ (0.32)
Working capital	\$ 15,326	\$ 4,684
Long-term obligations	9,820	22,072
Total assets	51,729	37,278
Total stockholders' equity (deficiency)	\$ 17,414	\$ (11,710)
Weighted average common shares:		
Basic	9,069,000	9,037,000
Diluted	21,235,000	9,037,000

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.

Dividends on the Company's Preferred Stock as declared are accrued according to the terms of the Preferred Stock and paid in cash.

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

FORWARD-LOOKING STATEMENTS

Discussions of some of the matters contained in this Annual Report on Form 10-K for Environmental Tectonics Corporation may constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, and as such, may involve risks and uncertainties. Some of these discussions are contained under the captions "Item 1. Business" and "Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations." We have based these forward-looking statements on our current expectations and projections about future events or future financial performance, which include implementing our business strategy, developing and introducing new technologies, obtaining, maintaining and expanding market acceptance of the technologies we offer, and competition in our markets. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about ETC and its subsidiaries that may cause actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

These forward-looking statements include statements with respect to the Company's vision, mission, strategies, goals, beliefs, plans, objectives, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business of the Company, including, but not limited to, (i) projections of revenues, costs of materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items and the effects of currency fluctuations, (ii) statements of our plans and objectives of the Company or its management or Board of Directors, including the introduction of new products, or estimates or predictions of actions of customers, suppliers, competitors or regulatory authorities, (iii) statements of future economic performance, (iv) statements of assumptions and other statements about the Company or its business, (v) statements made about the possible outcomes of litigation involving the Company, (vi) statements regarding the Company's ability to obtain financing to support its operations and other expenses, and (vii) statements preceded by, followed by or that include terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "future," "predict," "potential," "intend," or "continue," and similar expressions. These forward-looking statements involve risks and uncertainties which are subject to change based on various important factors. Some of these risks and uncertainties, in whole or in part, are beyond the Company's control. Factors that might cause or contribute to such a material difference include, but are not limited to, those discussed in this Annual Report on Form 10-K, in the section entitled "Risks Particular to Our Business." Shareholders are urged to review these risks carefully prior to making an investment in the Company's common stock.

The Company cautions that the foregoing list of important factors is not exclusive. 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.

References to fiscal 2010 or the 2010 fiscal year are references to the fifty-two week period ended February 26, 2010. References to fiscal 2009 or the 2009 fiscal year are references to the fifty-two week period ended February 27, 2009.

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

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 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. We are a designer, developer and contract manufacturer of various types of high-technology equipment. Our business activities are 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 and parts and service support.

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 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 representatives and organizations in seeking foreign orders for our products.

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

Significant Impacts and Transactions during Fiscal 2010

The following items had a material impact on our financial performance, cash flow and financial position for the fiscal year ended February 26, 2010:

- Increased production under U.S. Government contracts

The Base Realignment and Closure (BRAC) Act passed in 2005 by Congress mandated base closures and consolidations through all the U.S. defense services. As a result of this Act, in the past two years we have been awarded two major contracts for pilot training. Our fiscal 2010 opening backlog of firm orders included approximately \$19 million for a significant contract from the U.S. Navy for a research disorientation trainer. In September 2009, we were awarded a \$35 million contract from the U.S. Air Force to provide a high performance training and research human centrifuge. As a result of engineering and production activity on these two contracts, sales to the U.S. Government increased by \$3.6 million in our Training Services Group during the current fiscal year versus the prior year. Although at the current time we have a significant open proposal to the U.S. Government for additional equipment to be procured under the BRAC Act, given the current domestic economic conditions and political environment, it should not be assumed that any additional contracts will be awarded to us.

- Contract performance in our Simulation Division

Sales activity during fiscal 2010 in our Simulation Division that produces disaster management simulators was significantly higher than in any prior fiscal year, totaling \$4.4 million, an increase of \$3.6 million from the prior period. This Division opened the fiscal year with a backlog in excess of \$6 million, most under international contracts, and successfully executed a majority of those orders. Most importantly, we successfully delivered a multiple Advanced Disaster Management Simulator (ADMS)—COMMAND to a national training institute in the Middle East.

- Market disruptions in our Control Systems Group

The product groups in our CSG sell primarily to domestic commercial accounts. These businesses have been adversely impacted by current domestic economic conditions. Sales of automotive test products dropped by almost \$2.9 million as this industry experienced bankruptcies for two of the three major domestic producers. Additionally, sales for our domestic monoplace hyperbaric chamber line decreased by about \$1.1 million reflecting the cutback of capital expansion in hospitals and wound care centers.

- Exchange of long term debt, establishment of additional facility, and increase in bank line

On April 24, 2009, we entered into a transaction with H. F. Lenfest, a member of our Board of Directors and a significant shareholder, that provided for the following: (i) a \$7,500,000 credit facility to be provided by Lenfest to ETC; (ii) exchange of the Subordinated Note held by Lenfest, together with all accrued interest and warrants issuable under the Subordinated Note, and all Series B Preferred Stock and Series C Preferred Stock held by Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock, of the Company; and (iii) an increase of the existing \$15,000,000 revolving line of credit with PNC Bank to \$20,000,000. The completion of this transaction coupled with the generation of income and significant collections under major contracts resulted in free cash from operations of \$5.3 million and a net increase in cash of \$1.9 million. Having adequate cash from operations and additional availability under new and existing credit lines allowed us to effectively and efficiently execute on our contracts. Additionally, we expect to be adequately cash funded throughout fiscal 2011.

- Positive impact of income taxes

During fiscal 2010, an income tax benefit of \$1.8 million was reflected in our Consolidated Statements of Operations. We use the asset and liability method of accounting for income taxes. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carryforwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the realizability of the related deferred tax asset.

Valuation

allowances had been recorded against the entire deferred tax asset as of February 27, 2009 due an uncertainty of sustaining an appropriate level of profitability in future periods. As a result of our increase in booked contracts and our positive operating results, we reduced this reserve during the fiscal period.

- Continued expanded use of our NASTAR Center

Our National Aerospace Training and Research (NASTAR) 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.

During the past two fiscal years we have been successful in utilizing the NASTAR Center for research, space training and as a showroom to market our Authentic Tactical Fighting System technology. We feel that demonstrating tactical flight simulation in our NASTAR center was highly instrumental in our obtaining significant orders in our Aircrew Training Systems Division. Going forward, we hope to expand research aimed at examining the effectiveness of using centrifuge based simulation for Upset Recovery Training (“URT”).

Loss of control in flight is a major cause factor in loss of life and hull damage aircraft accidents. Modern day commercial aviation currently has no requirement for training of pilots to deal with these situations, commonly referred to as “upsets.” Realistic training for responding to and recovering from upsets, or URT, requires more than a non-centrifuged based simulator because non-centrifuge-based simulators do not reproduce the physiological stresses and disorientation that a pilot experiences during an actual upset. We believe our GYROLAB simulator series is an answer to providing pilots with the dynamic environment necessary for effective training.

- Increased selling and marketing expenses.

Selling and marketing expenses increased about 7% in fiscal 2010 versus fiscal 2009. This increase primarily reflected higher commissions on international contracts and increased bid and proposal expenses to prepare technical submissions to requests for quotes. The cost of pre-engineering and other technical development required to submit a response to a complex request for proposal can exceed \$500,000. Given the significant mix shift to U.S. Government work in the fiscal 2011 opening backlog, it is anticipated that commission expense will decrease in the coming fiscal year.

- Charge for loss on extinguishment of debt.

During fiscal 2010, we recorded a \$315,000 charge for loss on extinguishment of debt representing two transactions. In July 2009, the Company’s Subordinated Note was exchanged for preferred stock under the aforementioned Lenfest refinancing transaction, resulting in a charge of \$224,000, which represented the unamortized portion of the debt discount that was recorded at the issuance of this instrument. Additionally, a charge of \$91,000 resulted from the unamortized portion of the debt discount on a \$2 million note, which was repaid on September 1, 2009.

- Continued capital and consulting spending to enhance and market worldwide our Authentic Tactical Fighting Systems (ATFS) and other technologies.

During the past two fiscal years we have spent over \$4.8 million (including \$2.3 million in fiscal 2010) in capital, software development and consulting expenses. Most of this spending has been related to our pilot training simulation equipment. This includes engineering costs to improve the technical abilities of our ATFS line of products, validation effort associated with Upset Recovery Training, and consulting arrangements. Going forward, we expect spending to be significant for these efforts.

- Common stock dilution.

As a result of our aforementioned refinancing transaction with H. F. Lenfest, our average fully diluted shares have increased by approximately 12.2 million shares. Given our positive financial performance, this increase in equivalent common shares has a dilutive impact on our earnings per share.

CRITICAL ACCOUNTING ESTIMATES

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

- forecasting our effective income tax rate, including our future ability to utilize tax credits and to realize the deferred tax assets, and providing for uncertain tax positions;
- legal matters;
- valuations of long-lived assets, including intangible assets;
- inventory valuation and reserves; and
- percentage-of-completion accounting for long-term, construction-type contracts.

We base our estimates on historical experience and on various other assumptions we believe to be reasonable according to the current facts and circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We believe the following are the critical accounting policies used in the preparation of our consolidated financial statements, as well as the significant estimates and judgments affecting the application of these policies. This discussion and analysis should be read in conjunction with our consolidated financial statements and related notes included in this report.

We have discussed the development and selection of these critical accounting policies and estimates with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed the disclosure presented below.

- Revenue Recognition

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.

- Inventory

We periodically evaluates our inventory, which affects gross margin, to ensure that it is carried at the lower of cost or net realizable value. Cost includes appropriate overheads. Overheads allocated to inventory cost are only those directly related to our manufacturing activities. These include general supervision, utilities, supplies, etc., and depreciation and software amortization expense. Where necessary, provision is made for obsolete, slow-moving or damaged inventory. This provision represents the difference between the cost of the inventory and its estimated market value, based on the future demand of our products. To the extent that future events affect the salability of inventory these provisions could vary significantly.

- Income Taxes

We use the asset and liability method of accounting for income taxes. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carry forwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the reliability of the related deferred tax asset.

Results of Operations

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.

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 2010 versus Fiscal 2009

	Summary Table of Results			
	Fiscal year ended:			
	February 26, 2010	February 27, 2009	Variance s	Variance %
	(amounts in thousands)			
Sales:				
Domestic	\$ 12,870	\$ 14,442	\$ (1,572)	(10.9)%
US Government	7,711	3,096	4,615	149.1
International	21,690	19,149	2,541	13.3
Total Sales	42,271	36,687	5,584	15.2
Gross Profit	18,824	11,858	6,966	58.7
Selling and marketing expenses	5,010	4,670	(340)	(7.3)
General and administrative expenses	6,405	6,424	19	0.3
Research and development expenses	809	1,110	301	27.1
Operating income (loss)	6,600	(346)	6,946	2,007.5
Interest expense, net	1,308	1,569	261	16.6
Other expense, net	347	67	(280)	(417.9)
Loss on early extinguishment of debt	315	—	(315)	—
Income tax benefit	(1,819)	—	1,819	—
Minority interest	(4)	(8)	(4)	50.0
Net income (loss)	\$ 6,453	\$ (1,974)	\$ 8,427	426.9%
Net income (loss) per common share — basic	\$ 0.50	\$ (0.32)	\$ 0.82	
Net Income (loss) per common share — diluted	\$ 0.30	\$ (0.32)	\$ 0.73	

Net Income

ETC had net income of \$6,453,000 or \$0.30 per share (diluted), in fiscal 2010 versus a net loss of \$1,974,000, or \$(0.32) per share (diluted), in fiscal 2009, an increase in net income of \$8,427,000 or 426.9%. Operating profit in fiscal 2010 was \$6,600,000 versus an operating loss of \$346,000 in fiscal 2009, an increase in operating profit of \$6,946,000. The major factor contributing to the favorable performance in both operating and net income was an increase in sales and corresponding gross profit. Increased gross profit reflected the sales increase and a 12.2 percentage point increase in the gross margin rate. Net income also benefited from a reduction in the Company's deferred tax asset reserve related to the expected realization of net operating loss carryforwards.

Sales

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

Segment sales:	(amounts in thousands)				Fiscal year ended			
	February 26, 2010				February 27, 2009			
	Domestic	USG	Inter-national	Total	Domestic	USG	Inter-national	Total
Training Services Group:								
Pilot Training Services	\$ 93	\$ 6,261	\$ 13,101	\$ 19,455	\$ 108	\$ 2,612	\$ 14,633	\$ 17,353
Simulation	480	—	4,384	4,864	553	—	703	1,256
ETC-PZL and other	440	—	1,276	1,716	87	—	1,912	1,999
Total	\$ 1,013	\$ 6,261	\$ 18,761	\$ 26,035	\$ 748	\$ 2,612	\$ 17,248	\$ 20,608
Control Systems Group:								
Environmental	\$ 980	\$ 1,450	\$ 1,717	\$ 4,147	\$ 3,841	\$ 484	\$ 393	\$ 4,718
Sterilizers	5,841	—	2	5,843	3,685	—	172	3,857
Hyperbaric	3,116	—	1,062	4,178	4,259	—	1,232	5,491
Service and spares	1,920	—	148	2,068	1,909	—	104	2,013
Total	11,857	1,450	2,929	16,236	13,694	484	1,901	16,079
Company total	\$ 12,870	\$ 7,711	\$ 21,690	\$ 42,271	\$ 14,442	\$ 3,096	\$ 19,149	\$ 36,687

For the fiscal year ended February 26, 2010, total sales were \$42,271,000, an increase of \$5,584,000 or 15.2% from fiscal 2009. The increase reflected favorable performance in the U.S. Government and international geographic areas and in the pilot training, simulation and sterilizer product lines.

Geographically, domestic sales were \$12,870,000, down \$1,572,000, or 10.9%, from fiscal 2009, and represented 30.4% of total sales, down from 39.4% in fiscal 2009. The current period reflected reductions in environmental (down \$2,861,000, 74.5%) and hyperbaric (down \$1,143,000, 26.8%) partially offset by increased sterilizer sales (up \$2,156,000, 58.5%). Environmental sales in the prior period benefited from significant work on a large domestic automotive contract basically completed by the prior fiscal year end. Reduced hyperbaric sales reflected domestic economic disruptions and resulting reduced capital spending. Conversely, sterilizer sales benefited from production on two significant orders. U.S. Government sales increased \$4,615,000 or 149.1% from the prior fiscal year. Significant increases were evidenced in aircrew training systems sales reflecting three contracts with three different U.S. defense agencies. U.S. Government sales represented 18.3% of total sales, up from 8.4% in fiscal 2009. Given the existing U.S. Government sales contracts in the Company's backlog and the potential for significant awards in the future, the Company anticipates this increase in the concentration of sales with the U.S. Government to continue.

International sales, including those in the Company's foreign subsidiaries, were \$21,690,000, up \$2,541,000 or 13.3%, from the prior fiscal period, primarily due to increased simulation and environmental sales, and represented 51.3% of total sales, down slightly from 52.2% in fiscal 2009.

In fiscal 2010, two customers, both in the ATS division, each represented 10% or more of total sales. For the Company's February 26, 2010 sales backlog of \$96,964,000, three contracts (two with U.S. defense agencies and one with an international customer), each representing at least 10% of the total backlog, constituted \$85,724,000 or 88.4% of the total sales backlog. Aircrew training systems backlog totaled \$81,707,000 or 84.3% of the total 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

Domestic sales in fiscal 2010 were \$12,870,000 as compared to \$14,442,000 in fiscal 2009, a decrease of \$1,572,000 or 10.9%. The current period reflected reductions in environmental (down \$2,861,000, 74.5%) and hyperbaric (down \$1,268,000, 28.9%) partially offset by increased sterilizer sales (up \$2,156,000, 58.5%). Environmental sales in the prior period benefited from significant work on a large domestic automotive contract basically completed by the prior fiscal year end. Reduced hyperbaric sales reflected domestic economic disruptions and resulting reduced capital spending. Conversely, sterilizer sales benefited from production on two significant orders. Domestic sales represented 30.4% of our total sales in fiscal 2010, down from 39.4% in fiscal 2009.

Sales to the U.S. Government in fiscal 2010 were \$7,711,000 as compared to \$3,096,000 in fiscal 2009, representing an increase of \$4,615,000 or 149.1%. Significant increases were evidenced in aircrew training systems sales reflecting three contracts with three different U.S. defense agencies. U.S. Government sales represented 18.3% of total sales, up from 8.4% in fiscal 2009.

International Sales

International sales, including those in the Company's foreign subsidiaries, were \$21,690,000, up \$2,541,000 or 13.3%, from the prior fiscal period, primarily due to increased simulation and environmental sales, and represented 51.3% of total sales, slightly down from 52.2% in fiscal 2009. International sales totaling at least \$500,000 per country were made to customers in Saudi Arabia, Korea, Malaysia and Turkey. 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.

Segment Sales

Sales of our TSG products were \$26,035,000 in fiscal 2010, an increase of \$5,427,000, or 26.3% from fiscal 2009. Sales of these products accounted for 61.6% of our sales versus 56.2% in fiscal 2009. Sales in our other segment, the CSG, increased \$157,000 or 1.0%, and constituted 38.4% of our total sales compared to 43.8% in fiscal 2009.

Given the Company's backlog at February 26, 2010 and the existing and continuing difficult domestic economic conditions, going forward it is anticipated that the TSG segment will continue to experience growth at some level while the CSG segment will be significantly negatively impacted by the domestic marketplace. In the CSG, we expect domestic environmental sales to continue to be limited by the disruptions in that marketplace. The hyperbaric monoplace line will be hampered until capital and liquidity become more accessible. The sterilizer line will suffer from delays in government funding for universities which have been steady customers for our steam sterilizers. Given the product mix in the Company's opening backlog, we would expect most of the Company's anticipated earnings performance in fiscal 2011 to be generated by the TSG segment.

Gross Profit

Gross profit for fiscal 2010 increased by \$6,966,000 or 58.7%, from fiscal 2009. This reflected the increase in sales and resulting gross profit (approximately \$1.9 million). Improvement in gross margin as a percent of sales was due to higher sales in the TSG segment, which included high gross profit projects. Gross profit rate as a percent of sales improved to 44.5% for fiscal 2010 versus 32.3% for fiscal 2009. Significantly favorable margin rates were realized internationally in simulation and aircrew training systems and domestically in sterilizers.

Selling and marketing expenses

Selling and marketing expenses increased \$340,000, or 7.3%, from fiscal 2009. This increase primarily reflected increased marketing expenses (commissions and bid and proposal costs). As a percentage of sales, selling and marketing expenses were 11.9% in fiscal 2010 compared to 12.7% in fiscal 2009.

General and administrative expenses

General and administrative expenses decreased by \$19,000 or 0.3%. As a percentage of sales, general and administrative expenses were 15.2% compared to 17.5% in fiscal 2009.

Research and Development Expenses

Research and development expenses include spending for potential new products and technologies and work performed under government grant program, both in the United States and internationally. This spending, net of grant payments from the U.S., Polish and Turkish governments, totaled \$809,000 in fiscal 2010 as compared to \$1,110,000 for fiscal 2009, a decrease of \$301,000 or 27.1%. Gross spending for the periods was \$2,846,000 and \$1,195,000, which amounts were partially offset by funds under government grants in ETC Southampton, ETC-PZL, and our Turkish operation.

Most of the Company's research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates.

Operating Income

Operating income was \$6,600,000 in fiscal 2010 compared to an operating loss of \$346,000 in fiscal 2009, an increase in income of \$6,946,000. This improvement in operating results represented a combination of higher sales volume and gross profit coupled with reduced research and development expenses.

On a segment basis, the TSG had an operating income of \$6,128,000, a \$3,697,000 improvement over the segment operating income of \$2,431,000 in fiscal 2009. The CSG had an operating income of \$1,727,000 in fiscal 2010, an increase in operating income

of \$3,224,000, from fiscal 2009. These segment operating results were offset, in part, by unallocated corporate expenses of \$1,255,000 which were down \$25,000, from fiscal 2009.

Given the positive operating performance in fiscal 2010 versus the prior period, the level and mix of the Company's backlog at February 26, 2010, open proposals and proposals under preparation, which include quotations for some significant potential U.S. Government and international contract awards, and the Company's continuing positive feedback from potential customers for its ATFS technology, it is anticipated that the Company will experience positive performance in fiscal 2011. However, it is also anticipated that the product lines in the Company's CSG segment will continue to suffer from negative market conditions.

Interest Expense

Interest expense for fiscal 2010 was \$1,308,000 as compared to \$1,569,000 for fiscal 2009, a decrease of \$261,000 or 16.6%. The current period expense reflected a \$702,000 decrease in bank borrowings and reduced interest expense on the Company's subordinated debt. This debt was exchanged for preferred stock under the Lenfest Financing Transaction which was completed in July 2009.

Other Income/Expense, Net

Other income/expense, net, was a net expense of \$347,000 for fiscal 2010 versus a net expense of \$67,000 for fiscal 2009. The current period consisted primarily of foreign currency exchange losses whereas the prior period included proceeds from a property damage claim and a litigation settlement.

Loss on Extinguishment of Debt

During fiscal 2010, the Company recorded a loss on extinguishment of debt representing two transactions. In July 2009, the Company's Subordinated Note was exchanged for preferred stock under the Lenfest Financing Transaction, resulting in a charge of \$224,000, which represented the unamortized portion of the debt discount that was recorded at the issuance of this instrument. Additionally, a charge of \$91,000 resulted from the unamortized portion of the debt discount on a \$2 million note, which was repaid on September 1, 2009. See Note 2 — Long-term Obligations and Credit Arrangements in the accompanying Notes to the Condensed Consolidated Financial Statements.

Income Taxes

As a result of the Company's analysis during fiscal 2010 of the various components and realizability of the Company's net loss carryforwards, an income tax benefit of \$1,819,000 was recorded in the fiscal year ended February 26, 2010. No income tax expense or benefit was recorded in the prior fiscal year.

The Company uses the asset and liability method of accounting for income taxes. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carryforwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the realizability of the related deferred tax asset.

Valuation allowances had been recorded against the entire deferred tax asset as of February 27, 2009 due an uncertainty of sustaining an appropriate level of profitability in future periods. As of February 26, 2010, the Company has reviewed the components of its deferred tax asset and has determined, based upon all available information, that its current and expected future operating income will more likely than not result in the realization of a portion of its deferred tax assets relating primarily to its net operating loss carryforwards. The Company has realized a deferred tax asset related to its net operating loss carryforwards of \$4,983,000. As of February 26, 2010, the Company has approximately \$36.5 million of federal net loss carry forwards available to offset future income tax liabilities, beginning to expire in 2025. In addition, the Company has the ability to offset deferred tax assets against deferred tax liabilities created for such items as depreciation and amortization.

Liquidity and Capital Resources

The Company's liquidity position and borrowing availability improved significantly during fiscal 2010. Cash flow from operations was a positive \$5,272,000 and net cash increased by \$1,888,000. Working capital was \$15,326,000 and \$4,684,000 at February 26, 2010 and February 27, 2009, respectively. This positive performance primarily reflected the net income in the period and milestone payment collections under long term contracts. During fiscal 2010, availability under our existing bank line increased by \$5,000,000 and we also established a \$7,500,000 operating line with H. F. Lenfest to fund certain U.S. Government contracts.

On April 24, 2009, we entered into a transaction with H. F. Lenfest, a member of our Board of Directors and a significant shareholder, that provides for the following: (i) a \$7,500,000 credit facility to be provided by Lenfest to ETC; (ii) exchange of the Subordinated Note held by Lenfest, together with all accrued interest and warrants issuable under the Subordinated Note, and all Series B Preferred Stock and Series C Preferred Stock held by Lenfest, together with all accrued dividends thereon, for a new class of

preferred stock, Series E Preferred Stock, of the Company; and (iii) an increase of the existing \$15,000,000 revolving line of credit with PNC Bank to \$20,000,000. Having adequate cash from operations and additional availability under new and existing credit lines allowed us to effectively and efficiently execute on our contracts. Additionally, we expect to be adequately cash funded throughout fiscal 2011.

Net cash provided by (used for) operating activities:

Cash provided by operations is driven by income from sales of our products offset by the timing of receipts and payments in the ordinary course of business.

During fiscal 2010, we generated \$5,272,000 of cash from operating activities versus a usage of \$739,000 for fiscal 2009, an improvement of \$6,011,000. The current period favorable performance primarily reflected significantly improved operating results, customer advanced billings under long-term POC contracts, a reduction in inventories, and non-cash expenses of depreciation and amortization.

Net cash used for investing activities:

Cash used for investing activities primarily relates to funds used for capital expenditures in property and equipment. These uses of cash are offset by sales and borrowings under our credit facilities. The Company's investing activities used \$1,824,000 in fiscal 2010 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.

Net cash used for financing activities:

The Company's financing activities used \$1,686,000 of cash during fiscal 2010. This primarily reflected the repayments under the Company's bank line and payments of preferred stock dividends.

Outlook

We expect to use our cash, cash equivalents and credit facilities for working capital and general corporate purposes, products, product rights, technologies, property, plant and equipment, the payment of contractual obligations, including scheduled interest payments on our credit facilities and dividends on our preferred stock, the acquisition of businesses, and/or the purchase, redemption or retirement of our credit facilities and preferred stock. We expect that net sales of our currently marketed products should allow us to continue to generate positive operating cash flow in fiscal 2011. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated rate of sales growth in 2012 and beyond, such as the degree of market acceptance, the impact of competition, the effectiveness of our sales and marketing efforts and the outcome of our current efforts to develop, receive approval for and successfully market our products.

At the end of each fiscal quarter in fiscal 2011 and thereafter we expect to maintain a minimum aggregate EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of \$4,000,000 (calculated as the total of the fiscal quarter then ending and the three immediately preceding fiscal quarters).

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements during the fiscal year ended February 26, 2010 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.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by Security holders	863,519	\$ 2.23	1,437,001
Equity compensation plans not approved by security holders	—	N/A	187,322
Total	863,519	\$ 2.23	1,624,323

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 26, 2010 and February 27, 2009 and the related consolidated statements of operations, changes in stockholders' equity (deficiency), and cash flows for the fifty-two week periods ended February 26, 2010 and February 27, 2009. 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 26, 2010 and February 27, 2009, and the consolidated results of their operations and their cash flows for the each of the fifty-two weeks ended February 26, 2010 and February 27, 2009 in conformity with accounting principles generally accepted in the United States of America.

/s/ Friedman LLP
East Hanover, New Jersey
May 27, 2010

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

	February 26, 2010	February 27, 2009
ASSETS		
Cash and cash equivalents	\$ 2,408	\$ 520
Restricted cash	2,751	4,454
Accounts receivable, net	17,356	5,100
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	3,576	2,460
Inventories, net	5,114	4,435
Deferred tax assets, current	4,983	2,350
Prepaid expenses and other current assets	545	479
Total current assets	36,733	19,798
Property, plant and equipment, at cost, net	13,643	15,786
Construction in progress	316	275
Software development costs, net	691	1,013
Other assets	346	406
Total assets	\$ 51,729	\$ 37,278
LIABILITIES		
Current portion of long-term debt	\$ 285	\$ 9
Accounts payable – trade	1,783	2,105
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	13,944	4,155
Customer deposits	1,799	2,397
Accrued interest and dividends	782	4,197
Other accrued liabilities	2,814	2,251
Total current liabilities	21,407	15,114
Long-term obligations, less current portion:		
Credit facility payable to bank	9,808	10,510
Promissory note payable	—	1,891
Subordinated convertible debt	—	9,664
Other long-term debt	12	7
	<u>9,820</u>	<u>22,072</u>
Deferred tax liabilities	3,066	2,350
Unearned interest	22	152
Total liabilities	34,315	39,688
Commitments and contingencies	—	—
Cumulative convertible participating preferred stock, Series B, \$.05 par value, 15,000 shares authorized; 6,000 shares issued and outstanding	—	6,000
Cumulative convertible participating preferred stock, Series C, \$.05 par value, 3,300 shares authorized, issued and outstanding	—	3,300
STOCKHOLDERS' EQUITY (DEFICIENCY)		
Cumulative convertible participating preferred stock, Series D, \$.05 par value, 11,000 shares authorized; 155 shares outstanding	155	—
Cumulative convertible participating preferred stock, Series E, \$.05 par value, 25,000 shares authorized; 23,741 shares outstanding	23,741	—
Common stock, \$.05 par value, 20,000,000 shares authorized; 9,083,573 and 9,049,351 shares issued and outstanding as February 26, 2010 and February 27, 2009, respectively	454	452
Additional paid-in capital	14,050	15,399
Accumulated other comprehensive loss	(431)	(557)
Accumulated deficit	(20,593)	(27,046)
Total stockholders' equity (deficiency) before noncontrolling interest	17,376	(11,752)
Noncontrolling interest	38	42
Total stockholders' equity (deficiency)	17,414	(11,710)
Total liabilities and stockholders' equity (deficiency)	\$ 51,729	\$ 37,278

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

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

	Fiscal Years ended:	
	February 26, 2010	February 27, 2009
Net sales	\$ 42,271	\$ 36,687
Cost of goods sold	23,447	24,829
Gross profit	<u>18,824</u>	<u>11,858</u>
Operating expenses:		
Selling and marketing	5,010	4,670
General and administrative	6,405	6,424
Research and development	809	1,110
	<u>12,224</u>	<u>12,204</u>
Operating profit (loss)	<u>6,600</u>	<u>(346)</u>
Other expenses:		
Interest expense	1,308	1,569
Loss on extinguishment of debt	315	—
Other, net	347	67
	<u>1,970</u>	<u>1,636</u>
Income (loss) before income taxes	4,630	(1,982)
Income tax benefit	<u>1,819</u>	<u>—</u>
Income (loss) before noncontrolling interest	6,449	(1,982)
Loss attributable to noncontrolling interest	<u>(4)</u>	<u>(8)</u>
Net income (loss)	6,453	(1,974)
Preferred stock dividends	<u>(1,885)</u>	<u>(927)</u>
Income (loss) applicable to common shareholders	<u>\$ 4,568</u>	<u>\$ (2,901)</u>
Per share information:		
Earnings (loss) per common share:		
Basic	\$ 0.50	\$ (0.32)
Diluted	<u>\$ 0.30</u>	<u>\$ (0.32)</u>
Weighted average common shares:		
Basic	9,069,000	9,037,000
Diluted	<u>21,235,000</u>	<u>9,037,000</u>

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

Environmental Tectonics Corporation
Consolidated Statements of Changes in Stockholders' Equity (Deficiency)
For the fiscal years ended February 26, 2010 and February 27, 2009
(amounts in thousands, except share information)

	Preferred Stock	Common Stock		Additional Paid-in Capital	Accumulated other comprehensive loss	Accumulated deficit	Total Stockholders' Equity
		Shares	Amount				
Balance, February 29, 2008	\$ —	9,035,355	\$ 451	\$ 16,139	\$ (349)	\$ (25,072)	\$ (8,831)
Net loss for the year	—	—	—	—	—	(1,974)	(1,974)
Interest hedge valuation	—	—	—	—	(40)	—	(40)
Foreign currency translation adjustment	—	—	—	—	(168)	—	(168)
Total comprehensive loss							(2,182)
Stock compensation expense	—	—	—	44	—	—	44
Warrants issued with \$2 million promissory note	—	—	—	128	—	—	128
Issuance of stock under employee stock purchase plan and Board of Director's compensation	—	13,996	1	15	—	—	16
Preferred stock dividends	—	—	—	(927)	—	—	(927)
Balance, February 27, 2009	—	9,049,351	452	15,399	(557)	(27,046)	(11,752)
Net income for the year	—	—	—	—	—	6,453	6,453
Interest hedge valuation	—	—	—	—	184	—	184
Foreign currency translation adjustment	—	—	—	—	(58)	—	(58)
Total comprehensive income							6,579
Issuance of common shares to Lenfest	—	20,000	1	—	—	—	1
Issuance of Series D Preferred Stock	155	—	—	—	—	—	155
Issuance of Series E Preferred Stock	23,741	—	—	—	—	—	23,741
Preferred stock dividends	—	—	—	(1,885)	—	—	(1,885)
Stock compensation expense	—	—	—	33	—	—	33
Warrants issued to Lenfest in connection with line of credit guarantee	—	—	—	485	—	—	485
Issuance of stock under employee stock purchase plan and Board of Director's compensation	—	14,222	1	18	—	—	19
Balance before noncontrolling interest	23,896	9,083,573	454	14,050	(431)	(20,593)	17,376
Noncontrolling interest	—	—	—	—	—	—	38
Balance, February 26, 2010	\$ 23,896	9,083,573	\$ 454	\$ 14,050	\$ (431)	\$ (20,593)	\$ 17,414

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

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

	Fiscal years ended	
	February 26, 2010	February 27, 2009
Cash flows from operating activities:		
Net income (loss)	\$ 6,453	\$ (1,974)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,309	1,797
Decrease in valuation allowance for deferred tax assets	(1,917)	(38)
Loss on extinguishment of debt	315	—
Accretion of debt discount and amortization of deferred finance costs	258	298
Increase in allowances for accounts receivable and inventories, net	577	212
Loss attributable to noncontrolling interest	(4)	(8)
Stock option and stock compensation expense	51	44
Changes in operating assets and liabilities:		
Accounts receivable	(12,308)	(1,483)
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	(1,116)	962
Inventories	1,735	1,740
Prepaid expenses and other assets	506	11
Accounts payable	(322)	(955)
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	9,789	(2,336)
Customer deposits	(598)	(592)
Other accrued liabilities	544	1,583
Net cash provided by (used in) operating activities	<u>5,272</u>	<u>(739)</u>
Cash flows from investing activities:		
Acquisition of equipment	(1,603)	(1,566)
Capitalized software development costs	(221)	(342)
Net cash used in investing activities	<u>(1,824)</u>	<u>(1,908)</u>
Cash flows from financing activities:		
(Repayments) borrowings under lines of credit, net	(702)	1,700
(Repayment) issuance of note payable, Lenfest	(2,000)	2,000
(Decrease) increase in restricted cash from notes payable, Lenfest	2,000	(2,000)
Issuance of common stock	2	16
Borrowings (payments) of other debt obligations	281	(9)
Payment of dividends	(970)	—
Payment of claim settlement costs	—	(2,275)
(Decrease) increase in restricted cash	(297)	2,072
Net cash (used in) provided by financing activities	<u>(1,686)</u>	<u>1,504</u>
Effect of exchange rate changes on cash	126	(208)
Net increase (decrease) in cash	1,888	(1,351)
Cash at beginning of period	520	1,871
Cash at end of period	<u>\$ 2,408</u>	<u>\$ 520</u>
Supplemental schedule of cash flow information:		
Interest paid	\$ 982	\$ 475
Income taxes paid	—	—
Supplemental information on non-cash operating and investing activities:		
Accrued dividends on preferred stock	\$ 319	\$ 927

On July 2, 2009, the Company exchanged certain existing related-party financial instruments for a newly-created class of Series E Convertible Preferred Stock. The value of this exchange was \$23,741,000. Additionally, the Company issued \$155,000 of Series D Preferred Stock as loan origination fees in connection with the \$7,500,000 Lenfest Credit Facility. See Note 2 – Long-Term Obligations and Credit Arrangements.

In November 2009, the Company reclassified \$2,939,000 from property, plant and equipment to inventory.

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



Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements

1. Nature of Business:

Environmental Tectonics Corporation (“ETC” or the “Company”) 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 2010.

Sales Backlog

Below is a breakdown of the Company’s February 26, 2010 sales backlog (amounts in thousands except percentages):

Geographic area:	Business segment:		Total	%
	TSG	CSG		
Domestic	\$ 210	\$ 3,772	\$ 3,982	4.1%
US Government	49,111	48	49,159	51.0
International	36,244	7,579	43,823	44.9
Total	\$ 85,565	\$ 11,399	\$ 96,964	100.0%
% of total	88.2%	11.8%	100.0%	

Our sales backlog at February 26, 2010, for work to be performed and revenue to be recognized under written agreements after such dates, was \$96,964,000. Of the February 26, 2010 sales backlog, one product line represented at least 10% of the total backlog: aircrew training systems, \$81,707,000 or 84.3%. Additionally, three customers represented a total of \$85,724,000, or 88.4%, of the total backlog.

2. Summary of Significant Accounting Policies:

Basis of Presentation:

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

Fair Value of Financial Instrument:

This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. The standard utilizes a fair value hierarchy which is categorized into three levels based on the inputs to the valuation techniques used to measure fair value. The standard does not require any new fair value measurements, but discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flows) and the cost approach (cost to replace the service capacity of an asset or replacement cost). The levels of the hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices or identical assets or liabilities in markets that are not active;
- Level 3: Unobservable inputs that are supported by little or no market activity, which require the reporting entity's judgment or estimation.

The assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of financial assets and financial liabilities and their placement within the fair value hierarchy. The Company's financial liabilities that are accounted for at fair value on a recurring basis are summarized below:

Liabilities	Fair Value Measurement at February 26, 2010 using:			Total
	Level 1	Level 2	Level 3	
	(amounts in thousands)			
Credit facility payable to bank	\$ —	\$ —	\$ 10,551	\$ 10,551
ETC-PZL contract financing			453	453
Interest rate swap agreements	—	85	—	85
Total	\$ —	\$ 85	\$ 11,004	\$ 11,089

For the interest rate swap agreements, fair value is calculated using standard industry models used to calculate the fair value of the various financial instruments based on significant observable market inputs such as swap rates, interest rates, and implied volatilities obtained from various market sources. For the other financial instruments, fair value is determined using the discounted cash flow methodology.

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities are reasonable estimates of their fair values due to the short maturity of these financial instruments.

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 an uncompleted 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.

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, the completed contract method is applied and revenue is recognized on the date that the finished product is shipped to the customer.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

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 and Cash Equivalents:

Cash includes 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 \$250,000. During each fiscal year, the Company periodically has cash and cash equivalents in excess of insured amounts.

Restricted Cash:

Restricted cash as of February 26, 2010 represents the partial collateralization of a committed line of credit in the amount of \$5,422,405 which the Company used to satisfy performance bond and repayment guarantee requirements in a contract with an existing customer. As security for this line of credit, ETC and H.F. Lenfest, a member of the Company's Board of Directors and a significant shareholder of and investor in ETC ("Lenfest"), were each required to provide PNC Bank with the equivalent of \$2,711,000 in the form of cash or other financial instruments. To meet this requirement, ETC has deposited cash in this amount in a restricted bank account with PNC Bank. (See Note 7 – Long-term Obligations and Credit Arrangements.) Restricted cash as of February 27, 2009 represents proceeds from the issuance of a \$2 million promissory note to Lenfest in February 2009 specifically for a bid requirement as well as monies on deposit in Turkey securing a performance guarantee in Turkey.

Subsequent to fiscal year end, the Company fulfilled its requirement to fund the balance of the security to collateralize the committed line of credit by depositing approximately \$2,711,000 in a certificate of deposit. Mr. Lenfest's security was returned and his guarantee to cover the \$5.4 million line was terminated.

Accounts Receivable and Concentration of Credit Risk

The Company performs ongoing credit evaluations of our customers and adjusts credit limits based on payment history and the customer's current creditworthiness. The Company continuously monitors collections and payments from its customers and maintain a provision for estimated credit losses based on historical experience and any specific customer collection issues that have been identified. While credit losses have historically been within the Company's 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. Amounts due under contracts related to agencies of a foreign government totaled \$14,539,000 or 83.8%, of the total accounts receivable, net as of February 26, 2010. The majority of these receivables have been collected subsequent to fiscal year end.

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. Overheads allocated to inventory cost are only those directly related to our manufacturing activities. Where necessary, provision is made for obsolete, slow-moving or damaged inventory. This provision represents the difference between the cost of the inventory and its estimated market value, based on the future demand of our products.

In November 2009, the Company reclassified \$2,939,000 from property, plant and equipment to inventory. These costs had originally been capitalized as engineering costs associated with the ATS-400 flight simulator which is being used as a demonstrator model in ETC's NASTAR Center. The costs will be equally charged over a four quarter period to cost of sales for three specific contracts for this device. The Company currently has two contracts for these devices and, starting with the fourth quarter of fiscal 2010, approximately \$245,000 was transferred to each of these contracts.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Property, Plant and Equipment:

Property, plant and equipment are stated at cost. 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. Upon sale or retirement of property, plant and equipment, the costs and related accumulated depreciation are eliminated from the accounts with any resulting gains or losses.

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. Software amortization totaled \$543,000 and \$943,000, respectively, for fiscal 2010 and 2009.

Research and Development:

Research and development costs, which relate primarily to the development, design and testing of products, are expensed as incurred. The Company enters into research grants with various government entities, both in the United States and internationally. Payments received under these grants are recorded as a reduction of research and development costs. Research and development expenses include spending for potential new products and technologies and work performed under government grant program, both in the United States and internationally. This spending, net of grant payments from the U.S., and the governments of Poland and Turkey, totaled \$809,000 in fiscal 2010 as compared to \$1,110,000 for fiscal 2009. Gross spending for the periods was \$2,846,000 and \$1,195,000, respectively.

Income Taxes:

The Company uses the asset and liability method of accounting for income taxes. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carryforwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the realizability of the related deferred tax asset.

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

Long-Lived Assets:

The Company reviews its property and equipment for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the net undiscounted cash flows expected to be generated by the asset. An impairment loss would be recorded for the excess of net book value over the fair value of the asset impaired. The fair value is estimated based on expected undiscounted future cash flows. The results of impairment tests are subject to management's estimates and assumptions of projected cash flows and operating results. Actual results may differ.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Share-Based Compensation:

The Company follows Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC" or the "Codification") accounting guidance which addressed the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for either equity instruments of the enterprise or that may be settled by the issuance of such equity instruments. The guidance generally requires that such transactions be accounted for using a fair-value based method and stock-based compensation expense is recorded, based on the grant date fair value, estimated in accordance with the guidance, for all new and unvested stock awards that are ultimately expected to vest as the requisite service is rendered. The guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from these estimates.

The Company typically issues new shares of common stock upon the exercise of stock options, as opposed to using treasury shares.

The Company uses a Black-Scholes option valuation method to determine the fair-value of the stock-based compensation under the accounting guidance. The Black-Scholes model incorporates various assumptions including the expected term of awards, volatility of stock price, risk-free rates of return and dividend yield. The expected term of an award is no less than the award vesting period and is based on the Company's historical experience. The risk-free interest rate is approximated using rates available on U.S. Treasury securities in effect at the time of grant with a remaining term similar to the award's expected life. The Company uses a dividend yield of zero in the Black-Scholes option valuation model as it does not anticipate paying cash dividends in the near future.

Advertising Costs:

The Company expenses advertising costs, which include trade shows, as incurred. Advertising expense was \$413,000 and \$394,000 in fiscal 2010 and 2009, respectively.

Earnings Per Common Share:

Basic earnings (loss) per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options and common stock warrants using the "treasury stock" method plus the effect of all convertible financial instruments, including subordinated debt and preferred stock, as if they had been converted at the beginning of each period presented. If the effect of the conversion of any financial instruments would be anti-dilutive, it is excluded from the diluted earnings per share calculation.

At February 26, 2010, there was \$23,896,000 of cumulative convertible participating preferred stock. These instruments were convertible at exercise prices of:

- Series D Preferred Stock of \$55,000 at \$0.94 per share, equating to 58,511 shares of common stock, issued in April 2009;
- Series D Preferred Stock of \$100,000 at \$1.11 per share, equating to 90,090 shares of common stock, issued in July 2009;
- Series E Preferred Stock of \$23,741,000 at \$2.00 per share, equating to 11,870,500 shares of common stock, issued in July 2009.

On February 20, 2009, in connection with the issuance of a \$2,000,000 promissory note, the Company issued warrants to purchase 143,885 shares of the Company's common stock at \$1.39 per share. Additionally, on July 2, 2009, in consideration of an increase of the guarantee on the PNC line of credit, the Company issued warrants to purchase 450,450 shares of the Company's common stock at \$1.11 per share. (See Note 2, Long-Term Obligations and Credit Arrangements.)

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

At February 26, 2010 and February 27, 2009, there were options to purchase the Company's common stock totaling 269,185 and 157,652 shares at an average price of \$4.53 and \$5.90 per share, respectively. Due to the conversion price of these common stock options, these shares were excluded from the calculation of diluted earnings (loss) per share because the effect was antidilutive.

	Income (amounts in thousands)	Fiscal year ended February 26, 2010 Weighted average shares	Per share amount
Net income	\$ 6,453		
Less preferred stock dividends	<u>(1,885)</u>		
Basic earnings per share:			
Basic earnings available to common shareholders	<u>\$ 4,568</u>	9,069,000	<u>\$ 0.50</u>
Effect of dilutive securities:			
Preferred stock		12,019,000	
Stock warrants		<u>147,000</u>	
Diluted earnings per share:			
Basic earnings available to common shareholders	\$ 4,568		
Add: Preferred stock dividend	<u>1,885</u>		
Income available to common shareholders plus effect of Dilutive securities	<u>\$ 6,453</u>	21,235,000	<u>\$ 0.30</u>

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

3. Accounts Receivable:

The components of accounts receivable at February 26, 2010 and February 27, 2009 are as follows:

	<u>February 26,</u> <u>2010</u>	<u>February 27,</u> <u>2009</u>
	(amounts in thousands)	
U.S. government	\$ 438	\$ 551
U.S. commercial	1,403	1,002
International	15,930	3,911
	<u>17,771</u>	<u>5,464</u>
Less allowance for doubtful accounts	(415)	(364)
Accounts receivable, net	<u>\$ 17,356</u>	<u>\$ 5,100</u>

4. Costs and Estimated Earnings on Uncompleted Contracts:

Unbilled costs

The following is a summary of long-term contracts in progress at February 26, 2010 and February 27, 2009:

	<u>February 26,</u> <u>2010</u>	<u>February 27,</u> <u>2009</u>
	(amounts in thousands)	
Cost incurred on uncompleted long-term contracts	\$ 18,936	\$ 26,777
Estimated earnings	18,535	16,911
	<u>37,471</u>	<u>43,688</u>
Less billings to date	(47,839)	(45,383)
	<u>\$ (10,368)</u>	<u>\$ (1,695)</u>

	<u>February 26,</u> <u>2010</u>	<u>February 27,</u> <u>2009</u>
	(amounts in thousands)	
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	\$ 3,576	\$ 2,460
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(13,944)	(4,155)
	<u>\$ (10,368)</u>	<u>\$ (1,695)</u>

Included in billings in excess of costs and estimated earnings on uncompleted long-term contracts is a provision for unexpected losses on contracts of \$200,000 in fiscal 2010 and 2009.

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

5. Inventories:

Inventories consist of the following:

	February 26, 2010	February 27, 2009
	(amounts in thousands)	
Raw material	\$ —	\$ 92
Work in process	4,764	3,564
Finished goods	350	779
Total inventory, net	<u>\$ 5,114</u>	<u>\$ 4,435</u>

Inventory is presented above net of an allowance for obsolescence of \$2,345,000 (Raw material \$138,000, Work in process \$1,506,000 and Finished goods \$701,000) and \$1,820,000 (Raw material \$92,000, Work in process \$1,027,000 and Finished goods \$701,000) in fiscal 2010 and 2009, respectively.

In November 2009, the Company reclassified \$2,939,000 from property, plant and equipment to inventory. These costs had originally been capitalized as engineering costs associated with the ATS-400 flight simulator which is being used as a demonstrator model in ETC's NASTAR Center. The costs will be equally charged over a four quarter period to cost of sales for three specific contracts for this device. The Company currently has two contracts for these devices and, starting with the fourth quarter of fiscal 2010, approximately \$245,000 was transferred to each of these contracts.

6. Property, Plant and Equipment:

The following is a summary of property, plant and equipment, at cost, and estimated useful lives at February 26, 2010 and February 27, 2009:

	February 26, 2010	February 27, 2009
	(amounts in thousands)	
Land	\$ 100	\$ 100
Buildings and building additions	3,851	3,851
Machinery and equipment	20,792	22,426
Office furniture and equipment	1,194	1,194
Building improvements	<u>2,746</u>	<u>2,489</u>
	28,683	30,060
Less accumulated depreciation	<u>(15,040)</u>	<u>(14,274)</u>
Property, plant and equipment, net	<u>\$ 13,643</u>	<u>\$ 15,786</u>

Depreciation expense for the fiscal years ended February 26, 2010 and February 27, 2009 was \$766,000 and \$837,000, respectively.

As a result of the transfer of costs from property, plant and equipment to inventory, the estimated depreciation of the remaining asset value for the ATS-400 was reviewed and, \$233,000 of depreciation expense which had previously been amortized to the cost of sales was reversed in the fourth quarter of fiscal 2010.

7. Long-Term Obligations and Credit Arrangements:

Lenfest Financing Transaction

On April 24, 2009, the Company entered into a transaction (the "Lenfest Financing Transaction"), which was approved by shareholders on July 2, 2009, with Lenfest that provided for the following: (i) a \$7,500,000 credit facility provided by Lenfest to ETC, which expires on December 31, 2012; (ii) exchange of the Subordinated Note (as defined below) held by Lenfest, together with all accrued interest and warrants issuable under the Subordinated Note, and all Series B Preferred Stock (as defined below) and Series C Preferred Stock (as defined below) held by Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock, of the Company; and (iii) the guarantee by Lenfest of all of ETC's obligations to PNC Bank, National Association ("PNC Bank") in connection with an increase of the Company's existing \$15,000,000 revolving line of credit with

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

PNC Bank (the "2007 PNC Credit Facility") to \$20,000,000, and in connection with this guarantee, the pledge by Lenfest to PNC Bank of \$10,000,000 in marketable securities.

Lenfest Credit Facility

As part of the Lenfest Financing Transaction, the Company established a credit facility in the maximum amount of \$7,500,000 with Lenfest (the "Lenfest Credit Facility") to be used to finance certain government projects that ETC has been awarded or is seeking to be awarded. The terms of the Lenfest Credit Facility are set forth in a Secured Credit Facility and Warrant Purchase Agreement between the Company and Lenfest, dated as of April 24, 2009 (the "Lenfest Credit Agreement"). In connection with the Lenfest Credit Agreement, the Company has executed, and will in the future execute, promissory notes in favor of Lenfest, in the aggregate principal amount of up to \$7,500,000 (the "Lenfest Credit Facility Note") based on the amount borrowed by the Company pursuant to the Lenfest Credit Agreement. Each Lenfest Credit Facility Note issued under the Lenfest Credit Facility will accrue interest at the rate of 10% per annum, payable in cash or, at the option of Lenfest, in shares of Series D Preferred Stock of the Company, as described below. The Lenfest Credit Facility expires on December 31, 2012. As of February 26, 2010, the Company had not utilized any of the \$7.5 million available funding under this facility.

Exchange of Existing Instruments for Series E Preferred Stock

On April 24, 2009, the Company authorized the issuance of two newly-created classes of Convertible Preferred Stock, Series D and Series E. Shares of these have been issued in connection with the Lenfest Financing Transaction. In accordance with standards defined by generally accepted accounting principles on classification and measurement of redeemable securities, the Company has accounted for both of these issues as permanent equity under Shareholders' Equity in the accompanying consolidated condensed balance sheets. The Company's Series B and C Preferred Stock had been classified as mezzanine due to a preferential redemption feature of these instruments, which provided that a change in ownership would result in a forced liquidation. The Series D and E shares do not contain this provision. With respect to the convertibility of the Series D and E shares, in accordance with standards defined by generally accepted accounting principles on determining whether an instrument (or embedded feature) is indexed to an entity's own stock, and the Company has concluded that the embedded conversion feature did not have a material effect on its stated value.

As part of the Lenfest Financing Transaction, the senior subordinated convertible promissory note (the "Subordinated Note") in the original principal amount of \$10,000,000 issued by ETC to Lenfest on February 18, 2003, together with all accrued interest and warrants issuable pursuant to the terms of the Subordinated Note, and all Series B Convertible Preferred Stock (the "Series B Preferred Stock") and Series C Cumulative Convertible Preferred Stock of the Company (the "Series C Preferred Stock") held by Lenfest, together with all accrued dividends thereon, were exchanged (the "Series E Exchange") for shares of a newly-created class of Series E Convertible Preferred Stock of the Company (the "Series E Preferred Stock").

On July 2, 2009, following the receipt of the Shareholder Approvals, the Company filed with the Department of State of the Commonwealth of Pennsylvania a Statement with Respect to Shares of Series E Convertible Preferred Stock creating a new class of preferred stock consisting of 25,000 shares with a stated value of \$1,000 per share and designated Series E Convertible Preferred Stock. Immediately thereafter, the Series E Exchange occurred and the Company issued 23,741 shares of Series E Preferred Stock to Lenfest. The shares of Series E Preferred Stock are convertible to common stock at a conversion price per share equal to \$2.00 and would convert into 11,870,500 shares of ETC common stock.

Below is a summary of the instruments exchanged:

Description	Balance upon exchange
Subordinated convertible note	\$ 10,000,000
Accrued interest on subordinated convertible note	2,275,000
Series B Preferred stock	6,000,000
Series C Preferred Stock	3,300,000
Accrued dividends on preferred stock, Series B and C	2,166,000
Series E Preferred Stock issued in exchange	<u>\$23,741,000</u>

As a result of this exchange, the Company recorded a loss on extinguishment of debt on the Subordinated Note of \$224,000, representing the unamortized portion of the debt discount.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Subsequent to the fiscal year end, on March 10, 2010, the Company entered into an agreement (“Stock Repurchase Agreement”) with H.F. Lenfest to repurchase and retire 1,000 shares of Series E Preferred Stock currently owned by Lenfest. The repurchase price was the stated price of \$1,000.00 per share, or \$1,000,000 in the aggregate. Following this repurchase, Lenfest held 22,741 shares of Series E Preferred Stock.

Lenfest Promissory Note

On February 20, 2009, Lenfest made a loan to ETC in the principal amount of \$2,000,000 (the “\$2 Million Loan”), which amount was considered as advanced under the Lenfest Credit Facility. The \$2 million Loan was used by ETC solely to support ETC’s requirements under a proposal for a U.S. Government bid.

In connection with the \$2 million Loan, the Company issued 143,885 warrants to purchase the Company’s common stock at \$1.39 per share. Consequently, the Company recorded a debt discount of \$109,000 associated with these warrants using the Black-Scholes options-pricing model. Additionally, the Company issued 20,000 shares of the Company’s common stock as part of this transaction. The value of the stock issued, \$19,000, has been recorded as a loan origination fee. The \$2,000,000 in proceeds from the \$2 Million Loan was included in Restricted Cash on the accompanying Condensed Consolidated Balance Sheets as of February 27, 2009. On September 1, 2009, the Company repaid the \$2 Million Loan in full. The unamortized portion of the original debt discount, \$91,000, was expensed during the fiscal quarter ended November 27, 2009, and is reflected as extinguishment of debt on the accompanying Condensed Consolidated Statement of Operations.

Bank Credit and Facility

Increased PNC Bank Credit Facility and Issuance of New Guarantee

On April 24, 2009, PNC Bank agreed to increase the amount of financing available under the 2007 PNC Credit Facility from \$15,000,000 to \$20,000,000, subject to the condition that Lenfest continue to personally guarantee all of ETC’s obligations to PNC Bank (the “Lenfest Guaranty”) and that Lenfest pledged \$10,000,000 in marketable securities as collateral security for his guarantee (the “Lenfest Pledge”).

Following the receipt of the Shareholder Approvals on July 2, 2009, ETC and PNC Bank entered into the Amended and Restated Credit Agreement (the “Amended and Restated PNC Credit Agreement”) and the Second Amended and Restated Reimbursement Agreement for Letters of Credit (the “Amended and Restated Reimbursement Agreement”). The 2007 promissory note was cancelled and replaced with the Amended and Restated Promissory Note in the principal amount of \$20,000,000 (the “Amended and Restated PNC Note”).

In connection with the execution of the 2009 PNC Financing Documents, ETC paid to Lenfest an origination fee of 100 shares of Series D Convertible Preferred Stock of the Company (the “Series D Preferred Stock”), which is equal to one percent (1%) of the market value of the \$10,000,000 in marketable securities pledged by Lenfest to PNC Bank to secure ETC’s obligations to PNC Bank. The 100 shares of Series D Preferred Stock have a stated value of \$1,000 per share, or \$100,000 in the aggregate. These shares of Series D Preferred Stock have a conversion price per share equal to \$1.11, which price equaled the average closing price of ETC common stock during the 120 days prior to the issuance of such shares. Additionally, ETC will pay Lenfest annual interest equal to 2% of the amount of the Lenfest Pledge, payable in Series D Preferred Stock.

In consideration of Lenfest entering into the Amended and Restated Guaranty, ETC issued to Lenfest warrants to purchase 450,450 shares of ETC common stock, which shares were equal in value to ten percent (10%) of the amount of the \$5,000,000 increase under the 2007 PNC Bank Credit Facility. The warrants are exercisable for seven years following issuance at an exercise price per share equal to \$1.11, which price equaled the average closing price of ETC common stock during the 120 days prior to the issuance of the warrant.

The Company has recorded a loan origination deferred charge associated with these warrants of \$487,000 using the Black-Scholes options-pricing model with the following weighted average assumptions: expected volatility of 91.9%; risk-free interest rate of 0.49%; and an expected life of seven years.

Amounts borrowed under the Amended and Restated PNC Credit Agreement could be borrowed, repaid and reborrowed from time to time until June 30, 2010. Borrowings made pursuant to the Amended and Restated PNC Credit Agreement bear interest at either the prime rate (as described in the promissory note executed pursuant to the Amended and Restated PNC Credit Agreement) plus 0.50

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

percentage points or the London Interbank Offered Rate (“LIBOR”) (as described in the Promissory Note) plus 2.50 percentage points. Additionally, ETC is obligated to pay a fee of 0.125% per year for unused but available funds under the line of credit.

The Amended and Restated PNC Credit Agreement signed on April 24, 2009 contained affirmative and negative covenants including, but not limited to, limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business and transactions with affiliates. The Company was required to maintain a minimum Consolidated Tangible Net Worth (which, as defined, is total assets excluding intangibles less liabilities excluding the Subordinated Convertible Debt) of \$3,500,000 for each fiscal quarter starting February 27, 2009 and thereafter. Additionally, the Company was required to maintain a minimum Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”), defined as net income plus interest expense plus income tax expense plus amortization plus depreciation, as follows: fiscal 2010 third quarter \$1,000,000, fiscal 2010 fourth quarter \$900,000 and all fiscal quarters ending after February 28, 2010, \$1,300,000. The Company is in full compliance of its covenants as of February 26, 2010.

Amendment to the Credit Agreement

On October 1, 2009, the PNC Credit Agreement was amended to extend the maturity date to June 30, 2011. Additionally, the affirmative covenants were adjusted. The Consolidated Tangible Net Worth covenant was modified to reflect the impact on the Company’s balance sheet of the Lenfest Financing Transaction. Effective with each fiscal quarter ending after October 1, 2009, the Company must maintain a minimum Consolidated Tangible Net Worth of at least \$10,000,000. The EBITDA covenant was changed for fiscal periods beginning after December 1, 2009. Beginning with the first fiscal quarter ending after December 1, 2009, and for each fiscal quarter ending thereafter, the Company must maintain a minimum cumulative aggregate EBITDA of \$4,000,000 for the fiscal quarter then ending and the three preceding fiscal quarters.

As of February 26, 2010, the Company’s availability under the PNC Credit Agreement was approximately \$8,872,000. This reflected cash borrowings under the PNC Credit Agreement of \$9,600,000 and outstanding letters of credit of approximately \$1,528,000.

For the purpose of reducing the risk associated with variable interest rates, ETC has entered into an interest rate swap agreement (the “Swap Agreement”) with PNC Bank which provides for a fixed rate through June 30, 2010, the maturity date of the Swap Agreement, for a portion of the Company’s bank borrowings. If the Swap Agreement is terminated prior to maturity, an additional payment to PNC Bank 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 the generally accepted accounting principle for accounting for derivative instruments and hedging activities. At February 26, 2010, ETC recorded a Comprehensive Loss of \$85,000 reflecting the reduced value of the interest rate hedge in the accompanying Condensed Consolidated Balance Sheets.

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

Dedicated Line of Credit Agreement with PNC Bank

On November 16, 2009, the Company and PNC Bank entered into a Letter Agreement, Reimbursement Agreement, Pledge Agreement, and Amendment to Subordination Agreement (collectively, the “Dedicated Line of Credit Agreement”), pursuant to which the Company has received a committed line of credit in the amount of \$5,422,405 (the “Line of Credit”) which the Company used to satisfy performance bond and repayment guarantee requirements in a contract with an existing customer. Use of this dedicated line of credit is restricted to funding contract requirements under this specific contract.

As security for the Line of Credit, ETC and H.F. Lenfest were each required to provide PNC Bank with the equivalent of \$2,711,000 in the form of cash or other financial instruments. To meet this requirement, ETC has deposited cash in this amount in a restricted bank account with PNC Bank. H.F. Lenfest has guaranteed the Company’s obligations under the Dedicated Line of Credit Agreement, and has pledged to PNC Bank \$2,711,000 in certificated securities. ETC was required by August 19, 2010, to place additional cash funds of \$2,711,000 with PNC Bank, at which time the Lenfest guarantee would be terminated and the Lenfest securities would be returned to Lenfest.

Subsequent to fiscal year end, the Company fulfilled its requirement to fund the balance of the security to collateralize the committed line of credit by depositing approximately \$2,711,000 in a certificate of deposit. Mr. Lenfest’s security was returned and his guarantee to cover the \$5.4 million line was terminated.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Subordinated Convertible Debt

As part of the Lenfest Financing Transaction, subordinated convertible debt, which had a face-value of \$10 million, was exchanged for Series E Preferred Stock on July 2, 2009. The unamortized portion of the original debt discount of \$224,000 is reflected as extinguishment of debt on the accompanying Condensed Consolidated Statement of Operations.

At the Company's option, the quarterly interest payments due on this convertible debt were deferred and added to the outstanding principal. As part of the Lenfest Financing Transaction, \$2,275,000 in accrued interest was exchanged for Series E Preferred Stock.

ETC-PZL Project Financing

In September 2009, ETC-PZL, located in Warsaw, Poland, entered into a project financing agreement with a Warsaw bank to fund a research and development contract with the Polish government. The amount of this facility is \$604,000 and it is being repaid in quarterly installments of approximately \$70,000 which commenced in September 2009. This facility will expire in September 2011. Use of this line of credit is restricted to funding contract requirements under a specific research and development contract with the Polish government.

Long-term obligations at February 26, 2010 and February 27, 2009 consist of the following:

	<u>February 26,</u> <u>2010</u>	<u>February 27,</u> <u>2009</u>
	(amounts in thousands)	
Note payable to bank	\$ 9,600	\$ 10,510
ETC-PZL project financing	486	—
Automobile loan	7	16
Other	—	—
Promissory note, net of unamortized discount of \$109	—	1,891
Subordinated convertible debt, net of unamortized discount \$336	—	9,664
Total debt obligations	10,093	22,081
Less current maturities	285	9
Long-term obligations, net of current maturities	\$ 9,808	\$ 22,072

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

2010	\$ 285
2011	9,808
2012 and thereafter	—
Total future obligations	\$ 10,093

Environmental Tectonics Corporation
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 26, 2010 are \$177,000 in 2011; \$155,000 in 2012; \$28,000 in 2013; and \$16,000 in 2014 and thereafter. Total rental expense for all operating leases for the fiscal years ended February 26, 2010 and February 27, 2009 was \$256,000 and \$211,000, respectively.

10. Income Taxes:

The Company uses the asset and liability method of accounting for income taxes. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes as well as the valuation of net loss carryforwards. Valuation allowances are reviewed each fiscal period to determine whether there is sufficient positive or negative evidence to support a change in judgment about the realizability of the related deferred tax asset.

Valuation allowances had been recorded against the entire deferred tax asset as of February 27, 2009 due an uncertainty of sustaining an appropriate level of profitability in future periods. As of February 26, 2010, the Company has reviewed the components of its deferred tax asset and has determined, based upon all available information, that its current and expected future operating income will more likely than not result in the realization of a portion of its deferred tax assets relating primarily to its net operating loss carryforwards. As of February 26, 2010, the Company had approximately \$36.5 million of federal net loss carry forwards available to offset future income tax liabilities, beginning to expire in 2025. In addition, the Company has the ability to offset deferred tax assets against deferred tax liabilities created for such items as depreciation and amortization.

As a result of the Company's analysis, an income tax benefit of \$1,819,000 has been recorded in the Consolidated Statement of Operations for the fiscal year ended February 26, 2010.

	(in thousands)	
	Fiscal Year Ended February 26, 2010	Fiscal Year Ended February 27, 2009
	\$	\$
Currently (receivable) payable		
Federal	133	—
State	—	—
Foreign (benefits) taxes	23	—
	<u>156</u>	<u>—</u>
Deferred:		
Federal	(1,598)	—
State	(377)	—
Foreign benefit	—	—
	<u>(1,975)</u>	<u>—</u>
	<u>\$ (1,819)</u>	<u>\$ —</u>

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

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

	Fiscal year ended February 26, 2010	Fiscal year ended February 27, 2009
Statutory income tax (benefit)	34.0%	(34.0)%
State income tax, net of federal tax benefit	3.8	(2.5)
Research and experimentation and other tax credits	(3.1)	(7.3)
Benefit of foreign and foreign-source income or loss	.6	5.5
Change in valuation allowance	(73.4)	32.8
Effect of change in effective tax rate	—	4.0
Other, net	(1.1)	1.5
	<u>(39.2)%</u>	<u>—%</u>

For the fifty-two week period ended February 27, 2009, the Company did not record any benefit for income taxes due to the prior and continuing operating losses and the low probability that any recorded tax receivables would ever be realized.

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

	February 26, 2010	February 27, 2009
(amounts in thousands)		
Deferred tax assets:		
Net operating loss and credits	\$ 15,607	\$ 16,520
Vacation reserve	80	74
Inventory reserve	880	676
Receivable reserve	156	135
Warranty reserve	117	63
Compensation and other reserves	32	76
Stock options	—	96
Other, net	74	74
	<u>16,946</u>	<u>17,714</u>
Valuation Reserve	(11,963)	(15,364)
Total current deferred tax asset	<u>4,983</u>	<u>2,350</u>
Deferred tax liabilities:		
Amortization of capitalized software	350	462
Depreciation	2,716	1,888
Total non-current deferred tax liability	<u>3,066</u>	<u>2,350</u>
Net deferred tax asset	<u>\$ 1,917</u>	<u>\$ —</u>

During the fiscal years ended February 26, 2010 and February 27, 2009, the Company did not have any unrecognized tax benefits and accordingly did not recognize interest expense or penalties related to unrecognized tax benefits. The Company or one of its subsidiaries files income tax returns in U.S. federal jurisdiction, various states and foreign jurisdiction. The Company is no longer subject to U.S. federal tax examinations by tax authorities for the fiscal years before 2007.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

11. Business Segment Information:

The Company operates in two business segments — Training Services Group (“TSG”) and Control Systems Group (“CSG”). Core technologies include the design, manufacture and sale of training services which includes (1) software driven products and services used to create and monitor the physiological effects of flight; (2) high performance jet tactical flight simulation, and; (3) driving and disaster simulation systems, and control systems which includes: (1) steam and gas sterilization; (2) testing and simulation devices for the automotive industry, and; (3) hyperbaric and hypobaric chambers. Product categories included in TSG are Aircrew Training Systems (ATS) and flight simulators, disaster management systems and entertainment applications. CSG includes sterilizers, environmental control devices and hyperbaric chambers along with parts and service support.

The following segment information reflects the accrual basis of accounting.

	<u>Training Services Group (TSG)</u>	<u>Control Systems Group (CSG)</u>	<u>Corporate</u>	<u>Company Total</u>
	(amounts in thousands)			
Fiscal 2010				
Net sales	\$ 26,035	\$ 16,236	\$ —	\$ 42,271
Interest expense	1,023	285	—	1,308
Depreciation and amortization	728	581	—	1,309
Operating income (loss)	6,128	1,727	(1,255)	6,600
Income tax benefit	—	—	(1,819)	(1,819)
Identifiable assets	31,177	4,928	15,624	51,729
Expenditures for segment assets	1,206	358	378	1,824
Fiscal 2009				
Net sales	\$ 20,608	\$ 16,079	\$ —	\$ 36,687
Interest expense	1,161	408	—	1,569
Depreciation and amortization	616	1,181	—	1,797
Operating income (loss)	2,431	(1,497)	(1,280)	(346)
Income tax benefit	—	—	—	—
Identifiable assets	19,545	5,046	12,687	37,278
Expenditures for segment assets	1,550	358	—	1,908
	<u>2010</u>	<u>2009</u>		
Reconciliation to consolidated net income (loss):				
Operating income (loss)	\$ 6,600	\$ (346)		
Interest expense	(1,308)	(1,569)		
Loss on extinguishment of debt	(315)	—		
Other, net	(347)	(67)		
Income tax benefit	1,819	—		
Noncontrolling interest	4	8		
Net income (loss)	<u>\$ 6,453</u>	<u>\$ (1,974)</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. For presentation purposes, income, expenses and assets not specifically identifiable to an individual business group or applicable to all groups and general corporate expenses, primarily central administrative office expenses, are reflected in the Corporate category. Property, plant, and equipment associated with the Company’s NASTAR Center are included in the TSG segment; the remaining property, plant and equipment are not identified with specific business segments because most of these assets are used in each of the segments.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

In fiscal 2010, international sales totaling a least \$500,000 per country were made to customers in Saudi Arabia, Korea, Malaysia and Turkey. In fiscal 2009, international sales totaling at least \$500,000 per country were made to customers in Saudi Arabia, Turkey, Thailand, Malaysia and Egypt. 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 both fiscal 2010 and 2009, sales to one customer (the same customer) represented individually 10% or more of total sales, the Royal Saudi Air Force.

Included in the segment information for the fiscal years ended February 26, 2010 and February 27, 2009 are export sales of \$21,690,000 and \$19,149,000, respectively. Sales to the U.S. government and its agencies aggregated \$7,711,000 and \$3,096,000 for the fiscal years ended February 26, 2010 and February 27, 2009, 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 26, 2010		February 27, 2009	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	157,652	\$ 5.90	371,928	\$ 6.70
Granted	113,000	2.64	—	—
Exercised	—	—	—	—
Forfeited	(1,467)	6.07	(214,276)	—
Outstanding at end of year	<u>269,185</u>	4.53	<u>157,652</u>	5.90
Options exercisable at year end	156,185		157,652	
Weighted average fair value of options granted during the year		\$ 2.64		\$ —

The following information applies to options outstanding at February 26, 2010:

Fiscal 2010	Options outstanding		Options exercisable		
	Number outstanding at February 26, 2010	Weighted average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable at February 26, 2010	Weighted Average Exercise Price
Range of exercise prices:					
\$2.64	113,000	9.75	2.64	—	\$ 2.64
\$5.12	80,000	7.00	5.12	80,000	5.12
\$6.07 to \$7.35	<u>76,185</u>	5.07	6.71	<u>76,185</u>	6.71
Total	269,185			156,185	

The cost for stock option compensation was \$33,000 and \$44,000 for the years ended February 26, 2010 and February 27, 2009, respectively. At February 26, 2010, the Company had two stock-based compensation plans.

Employee, Director and Consultant Stock Plan:

In July 2009, the Company adopted the 2009 Employee, Director and Consultant Stock Plan. This Plan authorizes the Board of Directors (or a committee appointed under the Board) to grant option awards for the purchase of common stock or common stock awards of up to 1,000,000 shares of common stock to employees, officers, directors, consultants and advisors of the Company and its Subsidiaries. The plan allows for the establishment of an exercise price at the time each option is granted. The exercise price shall not be less than the fair market value (or in the case of a ten percent owner, 110%) of a share of the Company's common stock on the date of grant of such option. The plan also allows the Board or its appointed committee to establish the exercise period(s) of any option awards. Granted options have a maximum term of 10 years. This Plan was approved by the shareholders on July 2, 2009. As of February 26, 2010, there were 887,000 shares available to be granted under this Plan. At February 26, 2010, there were 76,185 options outstanding under the 1999 Incentive Stock Option Plan, which expired in August 2008,

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Non-employee Director Stock Plan:

In September 2005, the Company adopted 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 26, 2010, there were 520,000 shares available to be granted under this 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 2010: expected volatility of 112.1% to 354.0%; risk-free interest rate of 0.41%; and an expected life of 10 years. There were 113,000 grants in 2010 and no grants of stock options in fiscal 2009.

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 2010 and 2009, the Company purchased \$626,000 and \$325,000, respectively, from Industrial Instruments. ETC also rents office space to Industrial Instruments at ETC's corporate headquarters. During fiscal 2010 and 2009, Industrial Instruments paid to ETC rent in the amounts of \$5,200 and \$8,450, respectively.

ETC purchases travel accommodations from Jet Set, a company that employs Kathleen Mahon, the daughter of Mr. Mitchell. During fiscal 2010 and 2009, ETC purchased travel through Jet Set totaling \$317,000 and \$237,000, respectively, and Ms. Mahon received approximately \$9,000 in fiscal 2010 and \$12,000 in fiscal 2009 from her employer 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 2010 and 2009, Ms. Mahon received \$17,000 and \$16,000, 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 2010, William F. Mitchell, Jr., received \$134,000 and David Mitchell received \$132,000 in compensation from ETC.

14. Commitments and Contingencies

Mends International, Ltd.

On May 29, 2008, a Request for Arbitration was filed against the Company with the Secretariat of the International Court of Arbitration by Mends International Ltd. ("Mends"). Mends' Request for Arbitration arose out of a February 3, 1999 contract between the Company and Mends wherein Mends purchased aeromedical equipment for sale to the Nigerian Air Force. Mends asserted a claim for breach of contract and demanded \$797,486, plus interest and costs. On September 16, 2008, Mends filed an Amended Request for Arbitration, adding tort claims for conversion and breach of fiduciary duty and seeking punitive damages. In response, the Company asserted a counterclaim seeking damages for other disputes with Mends that have arisen under the contract that Mends has put at issue in this arbitration. On April 27, 2009 the Company participated in an arbitration hearing in the United Kingdom on this matter. A decision had not been determined in this matter, although one is anticipated in the near future. The Company is contesting this arbitration case; however, the Company has recorded a reserve in this matter.

Administrative Agreement with U.S. Navy

In 2007, the Company entered into a settlement agreement with the Department of the Navy to resolve litigation filed by the Company in May 2003 in connection with a contract for submarine rescue decompression chambers. As of May 14, 2008, the Company made all payments required under this settlement agreement and transferred the chambers to the Department of the Navy. From October 2, 2007 through December 12, 2007, the Company was suspended by the Department of the Navy from soliciting work for the federal government pursuant to the Federal Acquisition Regulation. However, 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.

Environmental Tectonics Corporation
Notes to the Consolidated Financial Statements, continued

Other Matters

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against the Company. In the event that the Company is unable to meet its delivery schedules on certain of its contracts, the Company may be subject to penalties, which may have an adverse impact on its business. In the Company's 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 the Company's financial position or results of operations if disposed of unfavorably.

15. Employee Benefit Plans:

The Company maintains a retirement savings 401(k) plan for eligible employees. The Company's contributes 100% to the plan based on the first 4% of the employees' qualifying contributions. The Company's contributions totaled \$177,000 and \$145,000 in fiscal 2010 and fiscal 2009, 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 originally reserved 270,000 shares for issuance under this plan, of which 187,322 shares are still remaining.

16. Subsequent Events:

See Note 7 to the Financial Statements regarding the repurchase of 1,000 shares of Series E Preferred Stock for \$1,000,000.

List of Subsidiaries

Name	Jurisdiction	% Ownership
Entertainment Technology Corporation	PA	100%
ETC International Corporation	Barbados	100%
ETC-PZL Aerospace Industries	Poland	9.5%
ETC-Europe	Great Britain	9.9%
ETC-Delaware	Delaware	100%
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. 333-161737, effective September 4, 2009) of Environmental Tectonics Corporation and Subsidiaries, of our report, dated May 27, 2010 relating to the consolidated financial statements, which appear in this Form 10-K.

/s/ Friedman LLP

East Hanover, New Jersey

May 27, 2010

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 27, 2010

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 27, 2010

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 26, 2010 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.

Date: May 27, 2010

/s/ William F. Mitchell

William F. Mitchell
Chief Executive Officer

/s/ Duane D. Deaner

Duane D. Deaner
Chief Financial Officer

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.