

ETC ANNUAL REPORT

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QUALITY THROUGH
INTEGRITY AND TECHNOLOGY

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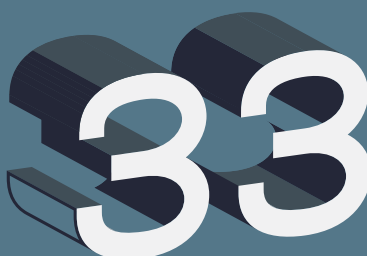
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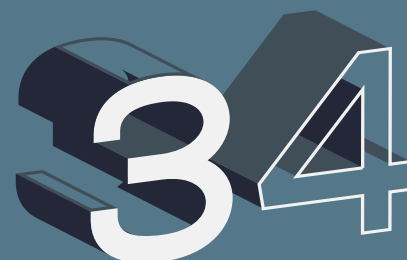
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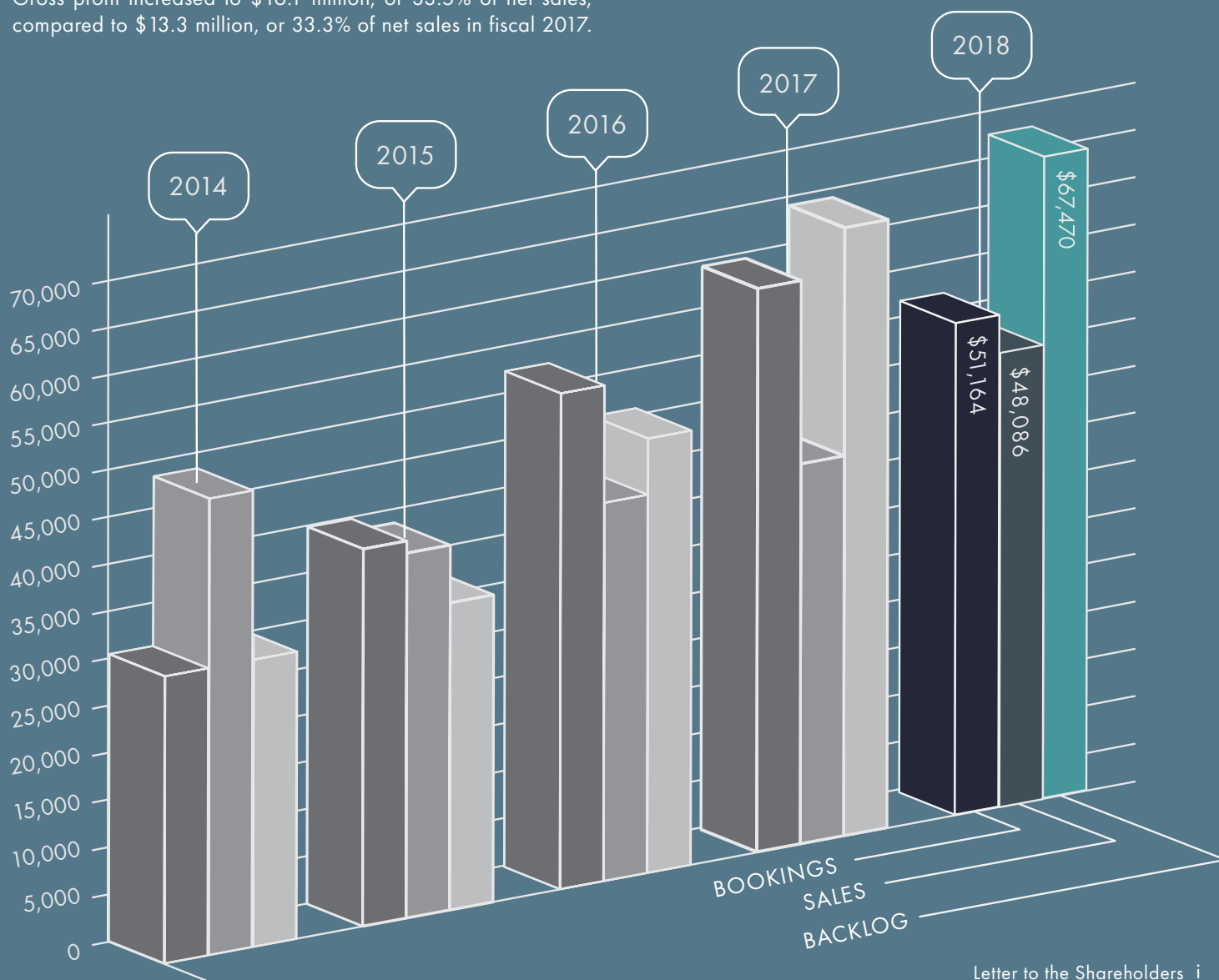
LETTER → TO THE SHAREHOLDERS

We entered fiscal 2018 with a strong backlog and with continued strong international orders from the Middle East and Asia for our Aircrew Training Systems products, and increased orders for our Simulation products, Environmental Testing and Simulation Systems ("ETSS") products and Sterilizer products, our net sales in fiscal 2018 increased by **20.7%** to **\$48.1 million** from \$39.8 million in fiscal 2017, while our backlog of orders increased by **4.8%** to **\$67.5 million** at fiscal 2018 year end compared to \$64.4 million at fiscal 2017 year end. This is the fourth consecutive year end with increased backlog, positioning the company well entering fiscal 2019.

This increase in net sales reflected positively on profitability. Gross profit increased to \$16.1 million, or 33.5% of net sales, compared to \$13.3 million, or 33.3% of net sales in fiscal 2017.

Increased gross profit margins reflect a more favorable customer mix and greater operational efficiencies, offset, in part, by expenses related to two contracts at Wright-Patterson Air Force Base, of which the centrifuge was accepted by the U.S. Air Force on May 30, 2018, and the contract for a suite of Research Altitude Chambers nears completion. Gross margins were also affected by lower margins on several ETSS contracts, which reflected new products being developed for the automotive industry.

Increased sales also resulted in operating income increasing to \$3.1 million, or 6.4% of net sales, from \$0.6 million, or 1.4% of net sales, in fiscal 2017.



AEROSPACE SOLUTIONS

FISCAL 2018 AEROSPACE SOLUTIONS NET SALES INCREASED **15.1% TO \$34.6 MILLION** FROM **\$30.1 MILLION** IN FISCAL 2017. BACKLOG AT YEAR END IN AEROSPACE SOLUTIONS OF **\$53.5 MILLION** WAS DOWN SLIGHTLY FROM THE PRIOR YEAR END OF **\$54.8 MILLION**.

Included in this backlog are contracts for products such as ATFS-400-25, GL-1500, IPT-II, Pilot Selection System, Ejection Seat Simulator, GAT-II Helo, and Night Vision Trainer. Of particular interest is that the IPT-II now has interchangeable cockpits creating the capability for critical spatial disorientation training in both fixed wing and rotary wing (helicopter) configurations. The GAT-II Helo for the U.S. Army is a newly designed product with night vision goggle compatibility.

We are pleased to announce the U.S. Air Force acceptance of its ATFS-400-31, the most sophisticated human centrifuge in the world today. The U.S. Air Force will use the centrifuge for training its pilots to withstand G-forces, and for research purposes. We are also continuing to see significant international opportunities for our Aircrew Training Systems, where the international community continues to invest in high performance aircraft, which then requires an investment in aeromedical and other forms of training for pilots to fly safely.

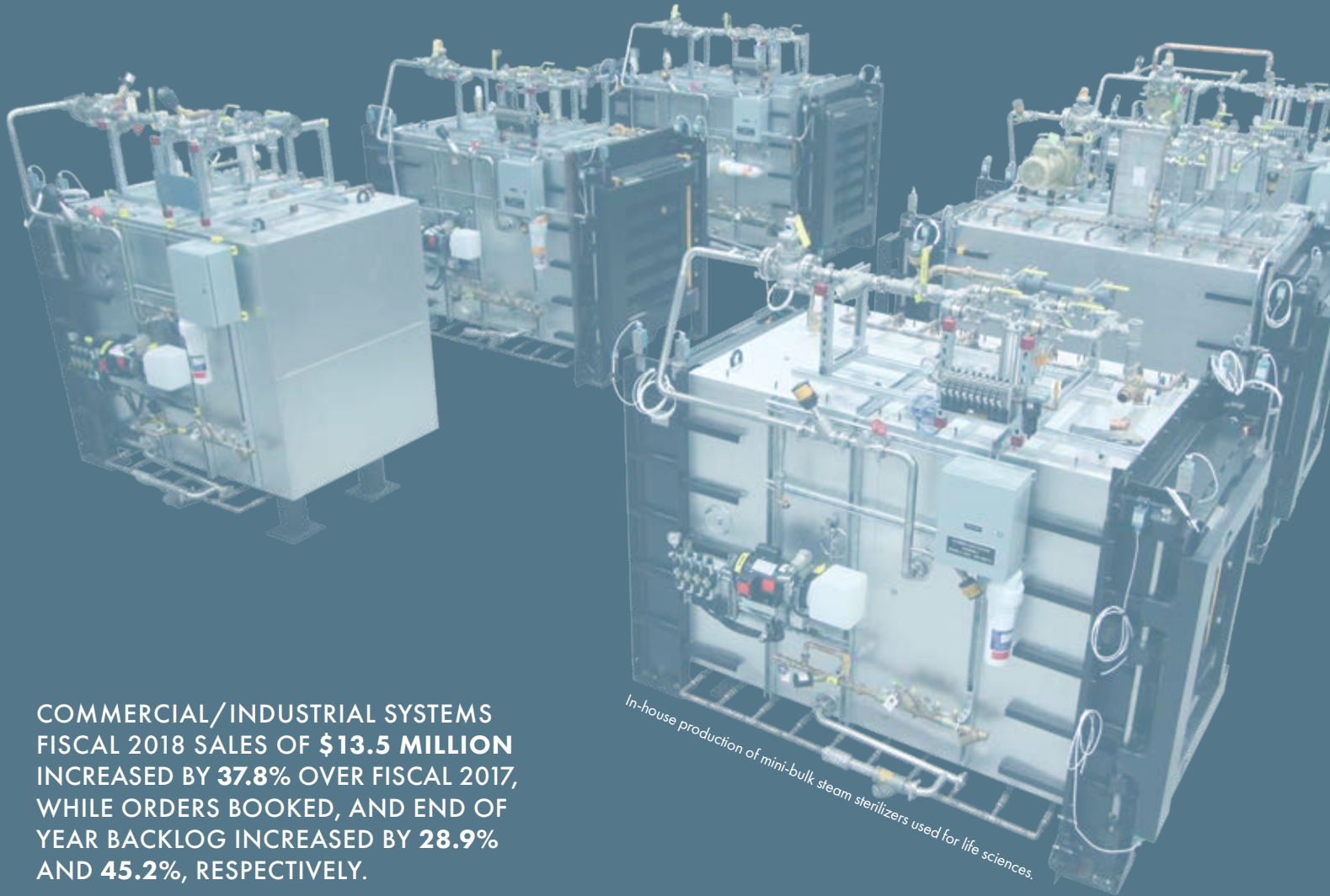
We are also pleased to have been awarded on May 10, 2018, the first ever **David M. Clark Award**, which was established to honor the Aerospace Medical Association corporate member who has made significant contributions to the advancement of aerospace medicine.

ETC Simulation sales **increased 172.8%** in fiscal 2018 as a result of significant international orders, many of them for Disaster Management and Homeland Security Training organizations (ADMS-COMMAND & ADMS-POLICE), Airport Fire Truck manufacturers (ADMS-ARFF), and military customers (ADMS-AIRBASE). ADMS-COMMAND / POLICE / AIRBASE are all systems to train command and control from on-scene responders up to strategic command level. ADMS-ARFF simulators are used to train tactical vehicle positioning and operating the on-board firefighting equipment.

ETC-PZL Aerospace Industries Sp. z o.o., our 95%-owned subsidiary in Warsaw, Poland, experienced an **85% increase** in sales during fiscal 2018. This increase was due primarily to a strong backlog entering fiscal 2018 of **\$6.6 million**, and solid orders booked of **\$4.4 million**. These contracts were primarily in simulator upgrade services and training devices.



COMMERCIAL/ INDUSTRIAL SYSTEMS



COMMERCIAL/INDUSTRIAL SYSTEMS
FISCAL 2018 SALES OF **\$13.5 MILLION**
INCREASED BY **37.8%** OVER FISCAL 2017,
WHILE ORDERS BOOKED, AND END OF
YEAR BACKLOG INCREASED BY **28.9%**
AND **45.2%**, RESPECTIVELY.

A strong year for Sterilizers, with a sales **increase of 135.8%**, was due to a higher level of both ethylene oxide sterilizers and control system upgrades. This increase in ethylene oxide sterilizers reflects a trend after several years of weak sales.

The ETSS business unit **increased sales by 98.2%**, due mainly to an increased focus on Climatic Chamber related systems. The offerings in this line have been extended to include the supply and integration of various independent testing systems for the automotive industry. These include 4-Post Shakers, Roller Shakers, Solar (IR & Full Spectrum) Simulation, and Altitude Simulation. Another factor in this growth has been the positive reputation and repeat business that results from many successful recent projects that have positioned ETC to be viewed as a reliable, high quality supplier of automotive test equipment.

These increases were partially offset by our Hyperbaric business unit, which experienced a **decrease in sales of 68.5%**. Increased backlog in Sterilizers and ETSS indicate a continued positive trend entering fiscal 2019.

With a continued strong backlog of orders, combined with a continued strong pipeline, and with continued improvement in gross profit and operating margins, we look forward to a solid fiscal 2019. ETC's growth in orders and margins and significant technical achievements, such as the acceptance of the ATFS-400-31 by the U.S. Air Force, are a testament to our team of dedicated employees who span the globe and work hard every day to provide outstanding products and service to our customers. I thank them for their passion and pursuit of excellence.

As ETC continues to explore strategic alternatives, I'd also like to express my gratitude to our Board of Directors for their guidance and counsel, and to you, our Shareholders, for your continued support.



Robert L. Laurent, Jr.

Robert L. Laurent, Jr.
Chief Executive Officer and President



ATFS-400-31

FINANCIAL REVIEW

(in thousands, except per share information)

	Fiscal year ended	
	February 23, 2018	February 24, 2017
Net sales	\$ 48,086	\$ 39,834
Gross profit	16,127	13,279
Operating income	3,087	555
Net income (loss) attributable to ETC	2,377	(923)
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	\$ -	\$ -
Preferred	\$ 0.08	\$ 0.08
Undistributed earnings (loss) per share:		
Common	\$ 0.12	\$ (0.09)
Preferred	\$ 0.12	\$ (0.09)
Diluted earnings (loss) per share	\$ 0.12	\$ (0.09)
Working capital	\$ 18,306	\$ 13,242
Total long-term debt obligations	20,893	17,940
Total assets	46,423	44,538
Total shareholders' equity	9,629	7,976
Weighted average common and participating shares:		
Basic	15,533	15,248
Diluted	15,536	15,250

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

We have never paid any cash dividends on our Common Stock and do not anticipate that any cash dividends will be declared or paid on our Common Stock in the foreseeable future.

Dividends on the Company's Preferred Stock, as declared, are accrued according to the terms of the Preferred Stock and when paid, are paid in cash. The Preferred Stock is currently entitled to receive cumulative dividends at the rate of four percent (4%) per year in preference to the holders of the Company's Common Stock with respect to dividends. Series E Preferred Stock dividends accrued as of February 23, 2018, which totaled \$2,428 thousand, remained unpaid as of June 26, 2018, the date of issuance of our consolidated financial statements, per the restrictions stipulated in the October 11, 2013 amendment to the September 28, 2012 Loan Agreement with PNC Bank, National Association ("PNC Bank").

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 to Shareholders include forward-looking statements that may involve risks and uncertainties. Some of these discussions are contained under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD & A"). We have based these forward-looking statements on our current expectations and projections about future events or future financial performance, which include implementing our business strategy, developing and introducing new technologies, obtaining, maintaining and expanding market acceptance of the technologies we offer, and competition in our markets. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about ETC and its subsidiaries that may cause actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements.

These forward-looking statements include statements with respect to the Company's vision, mission, strategies, goals, beliefs, plans, objectives, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance, and business of the Company, including, but not limited to, (i) projections of revenues, costs of materials, income or loss, earnings or loss per share, capital expenditures, growth prospects, dividends, capital structure, other financial items, and the effects of foreign currency fluctuations, (ii) statements of our plans and objectives of the Company or its management or the Company's Board of Directors (the "Board of Directors"), including the introduction of new products, or estimates or predictions of actions of customers, suppliers, competitors, or regulatory authorities, (iii) statements of future economic performance, (iv) statements of assumptions and other statements about the Company or its business, (v) statements made about the possible outcomes of litigation involving the Company, (vi) statements regarding the Company's ability to obtain financing to support its operations and other expenses, and (vii) statements preceded by, followed by, or, that include, words such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "future", "predict", "potential", "intend", or "continue", and similar expressions. These forward-looking statements involve risks and uncertainties that are subject to change based on various important

factors. Some of these risks and uncertainties, in whole or in part, are beyond the Company's control.

The Company's fiscal year is the fifty-two week or fifty-three week annual accounting period ending the last Friday in February. References to fiscal 2018 are references to the fifty-two week period ended February 23, 2018. References to fiscal 2017 are references to the fifty-two week period ended February 24, 2017. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2018.

Overview

ETC was incorporated in 1969 in Pennsylvania. For over four decades, we have provided our customers with products, services, and support. Innovation, continuous technological improvement and enhancement, and product quality are core values that are critical to our success. We are a significant supplier and innovator in the following areas: (i) software driven products and services used to create and monitor the physiological effects of flight, including high performance jet tactical flight simulation, upset recovery and spatial disorientation, and both suborbital and orbital commercial human spaceflight, collectively, Aircrew Training Systems ("ATS"); (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); (iv) Advanced Disaster Management Simulators ("ADMS"); (v) steam and gas (ethylene oxide) sterilizers; (vi) environmental testing and simulation systems ("ETSS"); and (vii) hyperbaric (100% oxygen) chambers for one person (monoplace chambers). We operate in two primary business segments, Aerospace Solutions ("Aerospace") and Commercial/Industrial Systems ("CIS").

Aerospace encompasses the design, manufacture, and sale of: (i) ATS products; (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); and (iv) ADMS, as well as integrated logistics support ("ILS") for customers who purchase these products or similar products manufactured by other parties. These products and services provide customers with an offering of comprehensive solutions for improved readiness and reduced operational costs. Sales of our Aerospace products are made principally to U.S. and foreign government agencies and to civil aviation organizations.

Specific products within Aerospace include:

- Authentic Tactical Fighting System ("ATFS") Motion Platforms;
 - ATFS-400-31 High Performance Human Centrifuge
 - ATFS-400-25 High Performance Human Centrifuge
- Cockpit Modules;
- Turnkey Aeromedical Centers;
- GYROLAB GL-6000 KRAKEN Advanced Spatial Disorientation Training and Research Device;
- GYROLAB GL-4000;
- GYROLAB GL-2500;
- GYROLAB GL-2000;
- GYROLAB GL-1500;
- GYRO Integrated Physiological Trainer, Generation 3, Extended Field of View ("GYRO IPT-III EFOV");
- GYRO IPT-II;
- GyroFlight;
- HeloFlight;
- GAT-II Fixed Wing Aviation Trainer;
- GAT-II Helo;
- G-LAB Motion Platform;
- Integrated Avionics Maintenance Trainer ("IAMT");
- FALCON Altitude (Hypobaric) Chambers;
- Multiplace Hyperbaric Chambers;
- Vestibular Illusion Demonstrator ("VID");
- Ejection Seat Simulator ("ESS");
- Pilot Selection System ("PSS");
- Water Survival Training equipment;

Specific products within Aerospace include (continued):

- Night Vision Training System ("NVTs");
- Night Vision Goggle Training System ("NVGTS");
- Interactive motion based simulation and virtual reality equipment designed for the education/entertainment industry; and our
- ADMS line of products (primarily AIRBASE, COMMAND, CONTROL, DRIVE, FIRE, and the Aircraft Rescue and Firefighting ("ARFF") Vehicle Simulator).

Specific services within Aerospace include:

- Tactical flight training;
- High-G training;
- Hypoxia training;
- Situational awareness and spatial disorientation training;
- Aeromedical training;
- Suborbital and orbital commercial human spaceflight training;
- Upset prevention and recovery training ("UPRT");
- Crew resource management ("CRM") training;
- Advanced pilot training;
- Basic pilot training;
- Pilot selection;
- Emergency response training; and
- Integrated logistics support.

CIS encompasses the design, manufacture, and sale of:

- Environmental testing and simulation systems ("ETSS");
- Hyperbaric (100% oxygen) chambers for one person (monoplace chambers); and
- Steam and gas (ethylene oxide) sterilizers;
- Parts and service support.

Net sales, operating income (loss), identifiable assets, and other financial information regarding our segments may be found in Note 8 – Business Segment Information.

ETC-PZL Aerospace Industries Sp. z o.o. ("ETC-PZL"), our 95%-owned subsidiary in Warsaw, Poland, is currently our only operating subsidiary. ETC-PZL manufactures certain simulators and provides software to support products manufactured domestically within our Aerospace segment. Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"), our formerly 99%- owned subsidiary, which was officially dissolved on August 15, 2017, functioned as a sales office in the United Kingdom.

We utilize both employees and independent representatives to market our products and services. As of February 23, 2018, approximately twenty-four (24) employees were committed to sales and marketing functions. In addition to our one operating subsidiary, we have employees stationed in the United Kingdom, the Netherlands, Egypt, Turkey, Saudi Arabia, the United Arab Emirates, India, and Malaysia. In certain countries outside the United States, we have relationships with independent sales representatives and distributors.

We sell integrated products and training services. 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 Aerospace segment, we offer integrated ATS products to commercial, governmental, and military defense agencies, and training devices, including altitude (hypobaric) and multiplace chambers ("Chambers"), to governmental and military defense agencies and civil aviation organizations both in the United States and internationally. We sell our ADMS line of products to governmental organizations both in the United States and internationally, original equipment manufacturers in the global special fire truck market (including ARFF vehicles), fire and emergency training schools, universities, and airports. We also provide integrated ILS for customers who purchase these products or similar products manufactured by other parties.

In the CIS segment, we sell our sterilizers to medical device and pharmaceutical manufacturers. We sell our ETSS primarily to commercial automotive and heating, ventilation, and air conditioning ("HVAC") manufacturers. We sell our hyperbaric products (primarily "monoplace" chambers) to hospitals and wound care clinics. We also provide upgrade, maintenance, and repair services for our products and similar products manufactured by other parties.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of 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 estimates, and how they can impact our consolidated 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:

- estimating budget costs for large, multi-year contracts that involve significant engineering and software development;
- percentage-of-completion ("POC") accounting for long-term, construction-type contracts;
- inventory valuation and reserves;
- valuations of long-lived assets, including equipment housed within our National Aerospace Training and Research Center (the "NASTAR Center") and intangible assets such as capitalized software;
- legal reserves and contingencies; and
- forecasting our effective income tax rate, including our future ability to value and utilize tax credits and to realize the deferred tax assets, and providing for uncertain tax positions.

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 Annual Report to Shareholders.

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

Revenue Recognition

We recognize revenue, which is recorded net of any applicable sales tax, using three methods:

On long-term contracts, with a contract value over \$250 thousand and a minimum completion period of six months, the POC method is applied based on costs incurred from inception to date as a percentage of estimated total costs required to fulfill the contract. This percentage is then multiplied by the total estimated contract value to determine the cumulative amount of revenue to be recognized, from which previously recognized revenue would be subtracted to determine 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 an 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 (i.e. milestone payments) in excess of revenue recognized on uncompleted long-term contracts are reflected as a liability on the balance sheet under the caption "Billings in excess of costs and estimated earnings on uncompleted long-term contracts". If at any time during performance 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 that require us to revise our cost and profit estimates. Progress billings are based upon contract provisions for customer advance payments, contract costs incurred, and completion of specified contract milestones. Costs related to post shipment obligations, including field installation, warranty, and any additional contracted items are included in the estimated total costs required to fulfill the contract. 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. Some of our long-term contracts contain provisions that require us to pay liquidated damages if we are responsible for the failure to meet specified

contractual milestone dates and the applicable customer asserts a claim under these provisions. Management uses its best judgment to estimate not only the cost to perform the work, but also the price we will eventually be paid on such contracts.

For contracts under \$250 thousand, or contracts to be completed in less than six months, and where there are no post-shipment services included in the contract (such as installation and customer acceptance), the completed contract method is applied and revenue is recognized on the date that the finished product is shipped to the customer. Estimated warranty costs for these contracts are accrued and this accrual is adjusted periodically based on actual warranty expenses and the amount and type of products shipped. Revenue derived from 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. There are no post contract expenses associated with these types of contracts.

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, dispute resolution, and audit by the customer or governmental agency.

Inventory

We periodically evaluate our inventory, which affects gross margin, to ensure that it is carried at the lower of cost or net realizable value. Cost includes appropriate overhead. Overhead allocated to inventory cost includes only costs directly related to our manufacturing activities. These include, but are not limited to, general supervision, utilities, supplies, 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

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

Results of Operations

Because of the nature of our business, 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 2018 VERSUS FISCAL 2017

(in thousands, except per share information)

	Summary Table of Results			
	Fiscal 2018	Fiscal 2017	Variance (\$)	Variance (%)
Net sales:				
Domestic sales	\$ 14,987	\$ 9,980	\$ 5,007	50.2
U.S. Government sales	1,296	276	1,020	369.6
International sales	31,803	29,578	2,225	7.5
Net sales total	48,086	39,834	8,252	20.7
Gross profit	16,127	13,279	2,848	21.4
Gross profit margin %	33.5%	33.3%	0.2%	0.6%
Operating expenses:				
Selling and marketing	5,102	5,559	(457)	(8.2)
General and administrative	6,430	5,554	876	15.8
Research and development	1,508	1,611	(103)	(6.4)
Operating expenses total	13,040	12,724	316	2.5
Operating income	3,087	555	2,532	456.2
Operating margin %	6.4%	1.4%	5.0%	357.1%
Interest expense, net	857	559	298	53.3
Other expense, net	464	727	(263)	(36.2)
Income (loss) before income taxes	1,766	(731)	2,497	
Pre-tax margin %	3.7%	-1.8%	5.5%	
Income tax (benefit) provision	(662)	161	(823)	
Net income (loss)	2,428	(892)	3,320	
Income attributable to non-controlling interest	(51)	(31)	(20)	64.5
Net income (loss) attributable to ETC	\$ 2,377	\$ (923)	\$ 3,300	
Per share information:				
Basic earnings (loss) per common and participating share:				
Distributed earnings per share:				
Common	\$ -	\$ -	\$ -	
Preferred	\$ 0.08	\$ 0.08	\$ -	0.0
Undistributed earnings (loss) per share:				
Common	\$ 0.12	\$ (0.09)	\$ 0.21	
Preferred	\$ 0.12	\$ (0.09)	\$ 0.21	
Diluted earnings (loss) per share	\$ 0.12	\$ (0.09)	\$ 0.21	

Net income (loss) attributable to ETC

Net income attributable to ETC was \$2.4 million, or \$0.12 diluted earnings per share, in fiscal 2018, compared to a net loss attributable to ETC of \$0.9 million during fiscal 2017, equating to \$0.09 diluted loss per share. The \$3.3 million variance is due to the combined effect of a \$2.8 million increase in gross profit, a \$0.8 million variance between the \$0.6 million income tax benefit recorded in fiscal 2018 compared to the \$0.2 million income tax provision recorded in fiscal 2017, and a \$0.3 million decrease in other expense, offset, in part, by a \$0.3 million increase in operating expenses and a \$0.3 million increase in interest expense.

Net sales

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

	Fiscal 2018				Fiscal 2017			
	Domestic	U.S. Gov't	International	Total	Domestic	U.S. Gov't	International	Total
Aerospace Solutions								
ATS (including Chambers)	\$ 1,738	\$ 1,247	\$ 22,571	\$ 25,556	\$ 832	\$ 255	\$ 24,803	\$ 25,890
Simulation (ADMS)	1,039	-	3,100	4,139	551	20	946	1,517
ETC-PZL and other	94	-	4,845	4,939	17	-	2,648	2,665
Subtotal	2,871	1,247	30,516	34,634	1,400	275	28,397	30,072
Commercial/ Industrial Systems								
Sterilizers	5,161	-	18	5,179	2,135	-	62	2,197
Environmental (ETSS)	4,580	49	965	5,594	2,541	1	280	2,822
Hyperbaric Chambers	574	-	304	878	1,998	-	788	2,786
Service and Spares	1,801	-	-	1,801	1,906	-	51	1,957
Subtotal	12,116	49	1,287	13,452	8,580	1	1,181	9,762
Net sales total	\$ 14,987	\$ 1,296	\$ 31,803	\$ 48,086	\$ 9,980	\$ 276	\$ 29,578	\$ 39,834

Net sales for fiscal 2018 were \$48.1 million, an increase of \$8.3 million, or 20.7%, from fiscal 2017. The increase reflects higher sales within our CIS segment of ethylene oxide sterilizers and control systems upgrades to Domestic customers within the Sterilizers business unit and ETSS within the Environmental business unit to both Domestic and International customers, and higher overall sales of our ADMS line of products and higher sales of simulator upgrade services and training devices provided by ETC-PZL within our Aerospace segment, offset, in part, by an overall decrease in sales of monoplace chambers within the Hyperbaric Chambers business unit of our CIS segment.

In fiscal 2018, two customers, both International and each within the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling \$17.2 million represented 35.8% of total net sales. In fiscal 2017, one International customer within the Aerospace segment represented 10.0% or more of total net sales, and sales to this customer totaling \$17.3 million represented 43.4% of total net sales. Within the Company's February 23, 2018

sales backlog of \$67.5 million for work to be performed and revenue to be recognized under written agreements after such date, four contracts, all with International customers (three within the Aerospace segment and one within the CIS segment), represented at least 10% of the total sales backlog and constituted \$41.8 million, or 62.0%, of the total sales backlog. As of February 23, 2018, two business units, ATS and ETSS, represented 10.0% or more of total sales backlog. ATS sales backlog was \$45.3 million, or 67.2%, of the total sales backlog and ETSS sales backlog was \$8.5 million, or 12.5%, of the total sales backlog.

We have historically experienced significant variability in our sales performance. This reflects the existing sales backlog, product mix, nature of contracts (size and performance time), manufacturing cycle, installation time, customer acceptance, and certain factors not in our control such as customer delays and the time required to obtain U.S. Government export approvals. A small number of contracts may account for a substantial percentage of our net sales in any period.

Domestic sales

Domestic sales in fiscal 2018 were \$15.0 million, an increase of \$5.0 million, or 50.2%, compared to fiscal 2017, and represented 31.2% of total net sales compared to 25.1% in fiscal 2017. The increase in Domestic sales is comprised of a \$3.0 million increase in sales within our Sterilizers business unit due primarily to higher sales of ethylene oxide sterilizers and control systems upgrades, a \$2.0 million increase in sales within our Environmental business unit, a \$0.9 million increase in sales related to ATS products, specifically a suite of interactive motion based simulation and virtual reality equipment, and a \$0.5 million increase in sales of our ADMS line of products, offset, in part, by a \$1.4 million decrease in sales within the Hyperbaric Chambers business unit of our CIS segment.

U.S. Government sales

U.S. Government sales in fiscal 2018 were \$1.3 million, an increase of \$1.0 million, or 369.6%, from fiscal 2017 primarily as a result of receiving several new U.S. Government contracts. The \$1.0 million increase was comprised almost entirely of sales related to ATS products including Chambers. U.S. Government sales represented 2.7% of total net sales in fiscal 2018 compared to 0.7% in fiscal 2017.

International sales

International sales in fiscal 2018, including those of ETC-PZL, were \$31.8 million, an increase of \$2.2 million, or 7.5%, from fiscal 2017. The increase in International sales is primarily a result of a \$2.2 million increase in sales of simulator upgrade services and training devices provided by ETC-PZL, a \$2.1 million increase in sales of our ADMS line of products, and a \$0.7 million increase in sales within our Environmental business unit, offset, in part, by a \$2.3 million decrease in sales related to ATS products including Chambers and a \$0.5 million decrease in sales within the Hyperbaric Chambers business unit. In aggregate, International sales represented 66.1% of the Company's total net sales in fiscal 2018 compared to 74.2% in fiscal 2017. In fiscal 2018, International sales totaling at least \$500 thousand were made to customers in nine (9) different countries; in fiscal 2017, International sales totaling at least \$500 thousand were made to customers in eleven (11) different countries.

Segment sales

Aerospace sales were \$34.6 million in fiscal 2018, an increase of \$4.6 million, or 15.2%, from sales of \$30.0 million in fiscal 2017. This increase was primarily due to higher sales of simulator upgrade services and training devices provided by ETC-PZL and of our ADMS line of products. Sales of Aerospace products accounted for 72.0% of our total net sales in fiscal 2018 versus 75.5% in fiscal 2017. Sales in our CIS segment increased \$3.7 million, or 37.8%, and constituted 28.0% of our total net sales in fiscal 2018 compared to 24.5% in fiscal 2017. The increase was primarily due to higher sales of ethylene oxide sterilizers and control systems upgrades within the Sterilizers business unit and higher sales of ETSS, offset, in part, by a decrease in sales of monoplace chambers within the Hyperbaric Chambers business unit.

Given the Company's sales backlog as of February 23, 2018, it is anticipated that ETC will generate the majority of its sales from International contracts.

Gross profit

Gross profit for fiscal 2018 was \$16.1 million compared to \$13.3 million in fiscal 2017, an increase of \$2.8 million, or 21.4%. The increase in gross profit was due primarily to higher net sales as the gross profit margin as a percentage of net sales increased slightly to 33.5% in fiscal 2018 compared to 33.3% in fiscal 2017.

Selling and marketing expenses

Selling and marketing expenses for fiscal 2018 of \$5.1 million decreased by \$0.5 million, or 8.2%, compared to fiscal 2017 due primarily to a decrease in commission expense based on a lower concentration of International sales related to ATS products. As a percentage of net sales, selling and marketing expenses decreased to 10.6% in fiscal 2018 from 14.0% in fiscal 2017 due to the aforementioned decrease in commission expense and an overall increase in sales that was able to better absorb fixed selling and marketing expenses.

General and administrative expenses

General and administrative expenses for fiscal 2018 of \$6.4 million increased by \$0.9 million, or 15.8%, from fiscal 2017, which included a \$0.3 million reduction in the allowance for doubtful accounts related to the recovery of a long overdue International receivable. Absent of this reduction in the allowance for doubtful accounts, general and administrative expenses would have increased by only \$0.6 million due primarily to an increase in expenses related to the Company's process to explore strategic alternatives, offset, in part, by the conclusion of a consulting agreement with the Company's former Chief Executive Officer and the dissolution of ETC-Europe. As a percentage of net sales, general and administrative expenses decreased to 13.4% in fiscal 2018 compared to 13.9% in fiscal 2017 due primarily to an overall increase in sales that was able to better absorb fixed general and administrative expenses.

Research and development expenses

Research and development expenses include spending for potential new products and technologies, and work performed internationally under government grant programs. This spending, net of grant payments from the Polish and Turkish governments, totaled \$1.5 million for fiscal 2018 compared to \$1.6 million in fiscal 2017, a decrease of \$0.1 million, or 6.4%. The decrease is primarily the result of more research and development employees being assigned to specific contracts; thus, expenses related to these employees were included in cost of sales in fiscal 2018. 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. As a percentage of net sales, research and development expenses decreased to 3.1% in fiscal 2018 compared to 4.0% in fiscal 2017.

Operating income

Operating income in fiscal 2018 was \$3.1 million compared to \$0.6 million in fiscal 2017. The \$2.5 million increase is due primarily to the increase in gross profit resulting from higher net sales, offset, in part, by an increase in operating expenses related to the Company's process to explore strategic alternatives.

On a segment basis, Aerospace posted operating income of \$5.3 million for fiscal 2018, a \$4.1 million, or 334.6%, improvement compared to \$1.2 million in fiscal 2017. The increase in Aerospace operating income is due to the combination of reaching acceptance on the US Air Force Centrifuge Contract, nearing the customer testing phase on the last of three contracts requiring additional work, and a higher concentration of net sales from more off-the-shelf type products requiring less initial design and engineering work. CIS posted an operating loss of \$0.9 million for fiscal 2018, a \$1.2 million variance compared to operating income of \$0.3 million in fiscal 2017. Losses on ETSS contracts, which were due to a combination of factors including, but not limited to, new product development, entering new markets, and cost overruns, as well as a decrease in sales of monoplace chambers were the primary contributing factors of this variance. These segment operating results were offset, in part, by unallocated corporate expenses.

Interest expense, net

Interest expense, net, for fiscal 2018 was \$0.9 million compared to \$0.6 million in fiscal 2017, an increase of \$0.3 million, or 53.3%, due primarily to the interest income associated with the recovery of a two decade old International receivable during fiscal 2017.

Other expense, net

Other expense, net, for fiscal 2018 was \$0.4 million compared to \$0.7 million in fiscal 2017, a decrease of \$0.3 million, or 36.2%, due primarily to a decrease in letter of credit fees and a decrease in realized foreign currency exchange net losses.

Income taxes

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act, among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. Consequently, we wrote down approximately \$2.2 million of our net deferred tax assets as of February 23, 2018 to reflect the re-measurement of certain net deferred tax assets using the lower U.S. corporate income tax rate; however, due to the previously established valuation allowance for such deferred tax assets, the impact was minimal. As of February 23, 2018, the Company reviewed the components of its deferred tax assets and determined, based upon all available information, that it is more likely than not that deferred tax assets relating to its federal and state net operating loss carryforwards and research and development tax credits will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established a \$5.9 million valuation allowance for such deferred tax assets that we do not expect to realize. If there is a change in our ability to realize our deferred tax assets for which a valuation allowance has been established, then our tax valuation allowance may decrease in the period in which we determine that realization is more likely than not.

An income tax benefit of \$0.6 million was recorded in fiscal 2018 compared to an income tax provision of \$0.2 million recorded in fiscal 2017. Effective tax rates were 37.5% and 22.0% for fiscal 2018 and fiscal 2017, respectively. The resulting income tax benefit and change in effective tax rate were driven primarily by a net one-time benefit of \$0.4 million to reflect the estimated impact of the Tax Act. This net one-time benefit of \$0.4 million was comprised of a reduction in the valuation allowance related to our alternative minimum tax credit (approximately \$0.6 million), offset, in part, by a deemed repatriation tax (approximately \$0.2 million, for which we were allowed to net against our federal net operating loss carryforwards).

While we have substantially completed our provisional analysis of the income tax effects of the Tax Act and recorded a reasonable estimate of such effects, the net one-time benefit related to the Tax Act may differ, due to, among other things, further refinement of our calculations, changes in interpretations and assumptions that we have made, additional guidance that may be issued by the U.S. Government, and actions and related accounting policy decisions we may take as a result of the Tax Act. We will complete our analysis over a one-year measurement period ending December 22, 2018, and any adjustments during this measurement period will be included in net earnings from continuing operations as an adjustment to income tax (benefit) expense in the reporting period when such adjustments are determined.

Liquidity and Capital Resources

On June 10, 2016, the Company received a waiver as of the fiscal quarter ended February 26, 2016 for failing to exceed the permitted minimum Consolidated Tangible Net Worth. The waiver also provides that ETC must maintain at all times a minimum Consolidated Tangible Net Worth of \$7.5 million; further, commencing with the fiscal quarter ended May 26, 2017, ETC is to maintain as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio increased to 1.10 to 1 on August 25, 2017, and will remain at that level at all times thereafter. The waiver extended the maturity date of the PNC Line of Credit to August 10, 2016, during which time the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, the following:

- (i) The PNC Line of Credit and the Term Loan were consolidated into a \$21.0 million Revolving Line of Credit (the "Revolving Line of Credit"), under which amounts may be borrowed, repaid, and re-borrowed until the maturity date.
- (ii) The existing Committed Line of Credit (the "Committed Line of Credit") is capped at \$8.6 million, an amount equivalent to the total outstanding standby letters of credit under which the Committed Line of Credit covered as of May 27, 2016. Total outstanding standby letters of credit covered by the Committed Line of Credit decreased to approximately \$4.0 million as of June 26, 2018, the date of issuance of our consolidated financial statements.
- (iii) A new \$1.0 million FX Equivalent Line of Credit (the "FX Equivalent Line of Credit") for potential future foreign exchange obligations.
- (iv) The Revolving Line of Credit, the Committed Line of Credit, and the FX Equivalent Line of Credit (collectively, the

"2016 PNC Credit Facilities") had an original maturity date of December 31, 2017, which on May 26, 2017 was subsequently extended to June 30, 2018.

(v) The interest rate on the 2016 PNC Credit Facilities will be based on the PNC Daily LIBOR Rate (2.0007% as of June 2, 2018, the date of our most current Revolving Line of Credit statement) plus a margin of 3.00%.

(vi) The 2016 PNC Credit Facilities are collateralized by a combination of the Company's pledged restricted cash (\$6.0 million as of February 23, 2018), substantially all of the Company's additional assets, and the pledged cash collateral of H.F. Lenfest ("Mr. Lenfest"), a major shareholder and member of the Board of Directors.

On April 9, 2018, subsequent to the end of fiscal 2018, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, the following:

- (i) The Revolving Line of Credit was increased from \$21.0 million to \$25.0 million.
- (ii) The maturity date of the 2016 PNC Credit Facilities was extended from June 30, 2018 to June 30, 2019.
- (iii) The interest rate margin on the 2016 PNC Credit Facilities was lowered from 3.00% to 2.75%.

As of February 23, 2018, the Company's availability under the Revolving Line of Credit was \$0.9 million. This reflected cash borrowings of \$18.8 million and net outstanding standby letters of credit not covered by the Committed Line of Credit of approximately \$1.3 million. As of June 2, 2018, the date of our most current Revolving Line of Credit statement, the Company's availability under the Revolving Line of Credit was approximately \$1.2 million. The Company had working capital of \$18.3 million as of February 23, 2018 compared to working capital of \$13.2 million as of February 24, 2017. The increase in working capital was primarily the result of a transition from billings in excess of costs and estimated earnings on uncompleted long-term contracts to costs and estimated earnings in excess of billings on uncompleted long-term contracts. Under POC revenue recognition, these accounts represent the timing differences of spending on production activities versus the billing and collecting of customer payments. With unused availability under the Company's various current lines of credit, the conversion of costs and estimated earnings in excess of billings on uncompleted long-term contracts into cash, the collection of milestone payments associated with several International contracts, and expected deposits on fiscal 2019 bookings, the Company anticipates its sources of liquidity will be sufficient to fund its operating activities, anticipated capital expenditures, and debt repayment obligations throughout fiscal 2019.

Cash flows from operating activities

Cash flows from operations are driven by income from the sale of our products and services and changes in operating assets and liabilities, which primarily depend on the timing of receipts, offset by payments, in the ordinary course of business.

During fiscal 2018, due primarily from the decrease in billings in excess of costs and estimated earnings on uncompleted long-term contracts and an increase in costs and estimated earnings in excess of billings on uncompleted long-term contracts, offset, in part, by the increase in net income, the increase in accounts payable, and the decrease in accounts receivable, the Company used \$2.1 million of cash in operating activities compared to generating \$1.4 million of cash from operating activities in fiscal 2017.

Cash flows from investing activities

Cash used for investing activities primarily relates to funds used for capital expenditures in property, plant, and equipment and software development. The Company's fiscal 2018 investing activities used \$0.5 million, which consisted primarily of equipment and software enhancements for our ATFS and ADMS technologies, and costs to upgrade existing information technology systems and enhance our ETSS testing capabilities. This is a decrease of \$0.2 million from cash used in investing activities in fiscal 2017.

Cash flows from financing activities

During fiscal 2018, the Company's financing activities provided \$3.0 million of cash from borrowings under the Company's various lines of credit. During fiscal 2017, the Company's financing activities used \$1.3 million of cash on payments on the Term Loan, offset, in part, by borrowings under the Company's various lines of credit and a decrease in restricted cash.

Outlook

We expect to use our cash, cash equivalents, and credit facilities for working capital and general corporate purposes, products, technologies, property, plant, and equipment, the payment of contractual and other legal obligations, including scheduled interest payments on credit facilities and dividends on Preferred Stock and/or the purchase, redemption, or retirement of our credit facilities and Preferred Stock when allowable per the October 11, 2013 amendment to the September 28, 2012 Loan Agreement with PNC Bank. We expect that net sales of our currently marketed products and services, combined with the current and anticipated future availability under our various lines of credit, the conversion of costs and estimated earnings in excess of billings on uncompleted long-term contracts into cash, the collection of milestone payments associated with several International contracts, and expected deposits on fiscal 2019 bookings, should continue to provide us sufficient funds for fiscal 2019. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated results in fiscal 2020 and beyond because of factors such as the degree of market acceptance, the impact of competition, the effectiveness of our sales and marketing efforts, and the outcome of our efforts to develop new products.

Off-Balance Sheet Arrangements

There were no unconsolidated legal entities, "special purpose" entities, or other off balance sheet arrangements during either fiscal 2018 or fiscal 2017 other than disclosed in Note 10 – Commitments and Contingencies 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 shareholders.

MANAGEMENT'S REPORT

Management is responsible for the preparation as well as the integrity and objectivity of the accompanying consolidated financial statements of Environmental Tectonics Corporation. These consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and necessarily include amounts that represent the best estimates and judgments of management.

Environmental Tectonics Corporation maintains an accounting system of internal controls to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that financial records are reliable for preparing financial statements and maintaining accountability for assets. Reasonable assurance recognizes that the cost of a system of internal controls should not exceed its benefits and that the evaluation of these factors requires estimates and judgments by management. The internal control system includes the selection and training of management and supervisory personnel; an organizational structure providing for delegation of authority and establishment of responsibilities; communication of requirements for compliance with approved accounting control and business practices throughout the organization; and business planning and review.

RSM US LLP, our independent auditor, is engaged to audit and report on these consolidated financial statements. Their audit is conducted in accordance with auditing standards generally accepted in the United States of America. Those standards require that they plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

The Audit Committee of the Board of Directors meets regularly with management, and the independent auditors to review matters relating to financial reporting, internal controls, and auditing. Management and the independent auditors each have direct and confidential access to this committee.



Robert L. Laurent, Jr.
Chief Executive Officer and President



Mark Prudenti
Chief Financial Officer



RSM US LLP

Independent Auditor's Report

To the Board of Directors
Environmental Tectonics Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Environmental Tectonics Corporation and Subsidiaries (the Company) which comprise the consolidated balance sheets as of February 23, 2018 and February 24, 2017 the related consolidated statements of operations and comprehensive income (loss), changes in shareholders' equity, and cash flows for the years then ended and the related notes to the financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Environmental Tectonics Corporation and Subsidiaries as of February 23, 2018 and February 24, 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Blue Bell, Pennsylvania
June 26, 2018

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CONSOLIDATED BALANCE SHEETS

(in thousands, except share information)

	February 23, 2018	February 24, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 329	\$ 445
Restricted cash	5,954	5,956
Accounts receivable, net	5,912	7,053
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	16,548	12,931
Inventories, net	2,377	2,842
Prepaid expenses and other current assets	2,374	2,071
Total current assets	33,494	31,298
Property, plant, and equipment, at cost, net	12,353	13,094
Capitalized software development costs, net	87	146
Deferred tax assets, non-current, net	489	-
Total assets	\$ 46,423	\$ 44,538
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt obligations, net of debt issuance costs	\$ -	\$ 362
Accounts payable, trade	3,886	2,709
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	4,494	9,663
Customer deposits	1,436	1,101
Accrued taxes	162	154
Accrued interest and dividends	2,495	1,995
Other accrued liabilities, current	2,715	2,072
Total current liabilities	15,188	18,056
Long-term debt obligations, net of debt issuance costs, less current portion		
Credit facility payable to bank, net of debt issuance costs	20,893	17,554
Total long-term debt obligations, net of debt issuance costs, less current portion	20,893	17,554
Deferred tax liabilities, non-current, net	-	297
Other accrued liabilities, non-current	713	655
Total liabilities	36,794	36,562
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Cumulative convertible participating Preferred Stock, Series E, \$0.05 par value, 25,000 shares authorized; 12,127 shares outstanding as of February 23, 2018 and February 24, 2017	12,127	12,127
Common Stock, \$0.05 par value, 50,000,000 shares authorized; 9,428,071 and 9,185,161 shares issued and outstanding as of February 23, 2018 and February 24, 2017, respectively	471	459
Additional paid-in capital	8,563	8,798
Accumulated deficit	(10,687)	(13,064)
Accumulated other comprehensive loss	(995)	(443)
Total shareholders' equity before non-controlling interest	9,479	7,877
Non-controlling interest	150	99
Total shareholders' equity	9,629	7,976
Total liabilities and shareholders' equity	\$ 46,423	\$ 44,538

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except per share information)

	Fiscal Year Ended	
	Feb. 23, 2018	Feb. 24, 2017
Net sales	\$ 48,086	\$ 39,834
Cost of goods sold	31,959	26,555
Gross profit	16,127	13,279
Operating expenses:		
Selling and marketing	5,102	5,559
General and administrative	6,430	5,554
Research and development	1,508	1,611
Operating expenses total	13,040	12,724
Operating income	3,087	555
Other expenses:		
Interest expense, net	857	559
Other expense, net	464	727
Other expenses total	1,321	1,286
Income (loss) before income taxes	1,766	(731)
Income tax (benefit) provision	(662)	161
Net income (loss)	2,428	(892)
Income attributable to non-controlling interest	(51)	(31)
Net income (loss) attributable to ETC	2,377	(923)
Foreign currency translation adjustment	(552)	128
Comprehensive income (loss)	\$ 1,825	\$ (795)
Preferred Stock dividends	(484)	(484)
Income (loss) attributable to common and participating shareholders	\$ 1,893	\$ (1,407)
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	\$ -	\$ -
Preferred	\$ 0.08	\$ 0.08
Undistributed earnings (loss) per share:		
Common	\$ 0.12	\$ (0.09)
Preferred	\$ 0.12	\$ (0.09)
Diluted earnings (loss) per share	\$ 0.12	\$ (0.09)
Basic weighted average common and participating shares:		
Common weighted average number of shares	9,412	9,185
Participating preferred shares	6,121	6,063
Total basic weighted average common and participating shares	15,533	15,248
Diluted weighted average shares:		
Basic weighted average common and participating shares	15,533	15,248
Dilutive effect of stock options	3	2
Total diluted weighted average shares	15,536	15,250

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands, except share information)

	Preferred Stock	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
		Shares	Amount				
Balance, February 26, 2016	\$ 12,127	9,185,161	\$ 459	\$ 9,169	\$ (12,141)	\$ (571)	\$ 9,111
Less: Prior year non-controlling interest	-	-	-	-	-	-	(68)
Net loss attributable to ETC	-	-	-	-	(923)	-	(923)
Foreign currency translation adjustment	-	-	-	-	-	128	128
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	113	-	-	113
Balance before non-controlling interest, February 24, 2017	12,127	9,185,161	459	8,798	(13,064)	(443)	7,877
Non-controlling interest	-	-	-	-	-	-	99
Balance, February 24, 2017	\$ 12,127	9,185,161	\$ 459	\$ 8,798	\$ (13,064)	\$ (443)	\$ 7,976
Less: Prior year non-controlling interest	-	-	-	-	-	-	(99)
Net income attributable to ETC	-	-	-	-	2,377	-	2,377
Foreign currency translation adjustment	-	-	-	-	-	(552)	(552)
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	98	-	-	98
Issuance of stock for officer compensation	-	242,910	12	151	-	-	163
Balance before non-controlling interest, February 23, 2018	12,127	9,428,071	471	8,563	(10,687)	(995)	9,479
Non-controlling interest	-	-	-	-	-	-	150
Balance, February 23, 2018	\$ 12,127	9,428,071	\$ 471	\$ 8,563	\$ (10,687)	\$ (995)	\$ 9,629

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Fiscal year ended	
	Feb. 23, 2018	Feb. 24, 2017
Cash flows from operating activities:		
Net income (loss)	\$ 2,428	\$ (892)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,265	1,360
Deferred income taxes	2,790	(1,213)
(Decrease) increase in valuation allowance for deferred tax assets	(3,576)	1,310
Increase (decrease) in allowance for doubtful accounts and inventory obsolescence	28	(436)
Accretion of loan origination deferred charge and deferred financing costs	24	36
Stock compensation expense	98	113
Issuance of Common Stock	163	-
Changes in operating assets and liabilities:		
Accounts receivable	1,121	(2,518)
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	(3,617)	2,042
Inventories	457	(119)
Prepaid expenses and other assets	(327)	(653)
Accounts payable, trade	1,177	(515)
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(5,169)	3,515
Customer deposits	335	40
Accrued taxes	8	(256)
Accrued interest and dividends	16	(22)
Other accrued liabilities	701	(439)
Net cash (used in) provided by operating activities	(2,078)	1,353
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(402)	(622)
Capitalized software development costs	(63)	(80)
Net cash used in investing activities	(465)	(702)
Cash flows from financing activities:		
Borrowings under lines of credit	2,977	6,320
Decrease in restricted cash	2	206
Payments on the Term Loan and of other debt obligations	-	(7,819)
Payments of deferred financing costs	-	(17)
Net cash provided by (used in) financing activities	2,979	(1,310)
Effect of exchange rate changes on cash	(552)	128
Net decrease in cash and cash equivalents	(116)	(531)
Cash and cash equivalents at beginning of period	445	976
Cash and cash equivalents at end of period	\$ 329	\$ 445
Supplemental schedule of cash flow information:		
Interest paid	\$ 805	\$ 797
Income taxes paid	\$ -	\$ 59
Supplemental information on non-cash operating and investing activities:		
Preferred Stock dividends accrued during each respective fiscal year	\$ 484	\$ 484

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share information)

Description of Business

ETC was incorporated in 1969 in Pennsylvania. For over four decades, we have provided our customers with products, services, and support. Innovation, continuous technological improvement and enhancement, and product quality are core values that are critical to our success. We are a significant supplier and innovator in the following areas: (i) software driven products and services used to create and monitor the physiological effects of flight, including high performance jet tactical flight simulation, upset recovery and spatial disorientation, and both suborbital and orbital commercial human spaceflight, collectively, Aircrew Training Systems ("ATS"); (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); (iv) Advanced Disaster Management Simulators ("ADMS"); (v) steam and gas (ethylene oxide) sterilizers; (vi) environmental testing and simulation systems ("ETSS"); and (vii) hyperbaric (100% oxygen) chambers for one person (monoplace chambers). We operate in two primary business segments, Aerospace Solutions ("Aerospace") and Commercial/Industrial Systems ("CIS"). Net sales, operating income (loss), identifiable assets, and other financial information regarding our segments may be found in Note 8 – Business Segment Information.

Aerospace encompasses the design, manufacture, and sale of: (i) ATS products; (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); and (iv) ADMS, as well as integrated logistics support ("ILS") for customers who purchase these products or similar products manufactured by other parties. These products and services provide customers with an offering of comprehensive solutions for improved readiness and reduced operational costs. Sales of our Aerospace products are made principally to U.S. and foreign government agencies and to civil aviation organizations. We offer integrated ATS products to commercial, governmental, and military defense agencies, and training devices, including altitude (hypobaric) and multiplace chambers ("Chambers"), to governmental and military defense agencies and civil aviation organizations both in the United States and internationally. We sell our ADMS line of products to governmental organizations both in the United States and internationally, original equipment manufacturers in the global special fire truck market (including Aircraft Rescue and Firefighting vehicles), fire and emergency training schools, universities, and airports. We also provide ILS for customers who purchase these products or similar products manufactured by other parties.

CIS encompasses the design, manufacture, and sale of: (i) steam and gas (ethylene oxide) sterilizers; (ii) ETSS; and (iii) hyperbaric (100% oxygen) chambers for one person (monoplace chambers), as well as parts and service support for customers who purchase these products or similar products manufactured by other parties. Sales of our CIS products are made principally to the healthcare, pharmaceutical, and automotive industries. We sell our sterilizers to medical device and pharmaceutical manufacturers. We sell ETSS primarily to commercial automotive and heating, ventilation, and air conditioning ("HVAC") manufacturers. We sell our monoplace chambers to hospitals and wound care clinics. We also provide upgrade, maintenance, and repair services for our products and similar products manufactured by other parties.

The Company's fiscal year is the fifty-two week or fifty-three week annual accounting period ending the last Friday in February. References to fiscal 2018 are references to the fifty-two week period ended February 23, 2018. References to fiscal 2017 are references to the fifty-two week period ended February 24, 2017. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2018.

Geographic Area	Business segment			%
	Aerospace	CIS	Total	
Domestic	\$ 467	\$ 6,193	\$ 6,660	9.9
U.S. Government	2,803	-	2,803	4.2
International	50,255	7,752	58,007	85.9
Total	\$ 53,525	\$ 13,945	\$ 67,470	100.0
% of Total	79.3%	20.7%	100.0%	

Sales Backlog

Below is a breakdown of the Company's February 23, 2018 sales backlog (amounts in thousands, except percentages):

Our sales backlog as of February 23, 2018, for work to be performed and revenue to be recognized under written agreements after such dates, was \$67,470. Of the February 23, 2018 sales backlog, two business units, ATS and ETSS, represented at least 10.0% of the total backlog. ATS sales backlog as of February 23, 2018 was \$45,314, or 67.2%, of the total sales backlog. ETSS sales backlog as of February 23, 2018 was \$8,464, or 12.5%, of the total sales backlog. Of the February 23, 2018 sales backlog, \$41,832, or 62.0%, represents four International contracts (three within the Aerospace segment and one within the CIS segment).

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of ETC, ETC-PZL Aerospace Industries Sp. z o.o. ("ETC-PZL"), our 95%-owned subsidiary in Warsaw, Poland, and our formerly 99%-owned subsidiary Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"), which was officially dissolved on August 15, 2017. "ETC-SH" refers to the Company's corporate headquarters and main production plant located in Southampton, Pennsylvania, USA. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, 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 consolidated 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 ("POC") method, valuations of long-lived assets, inventory and legal reserves, and income taxes.

Fair Value of Financial Instruments

The carrying amounts of cash, accounts receivable, accounts payable, and bank debt approximate fair value because of the short maturity associated with each of these instruments. Other assets and liabilities that are measured at fair value on a recurring basis include the unrealized gains or losses on interest rate swap contracts. For these assets and liabilities, we use significant other observable market data or assumptions (Level 2 inputs as defined in the accounting guidance) that we believe market participants would use in pricing similar assets or liabilities, including assumptions about counterparty risk. Our fair value estimates reflect an income approach based on the terms of the interest rate contracts and inputs corroborated by observable market data including interest rate curves.

Revenue Recognition

Revenue, which is recorded net of any applicable sales tax, is recognized using three methods:

On long-term contracts, with a contract value over \$250 and a minimum completion period of six months, the POC method is applied based on costs incurred from inception to date as a percentage of estimated total costs required to fulfill the contract. This percentage is then multiplied by the total estimated contract value to determine the cumulative amount of revenue to be recognized, from which previously recognized revenue would be subtracted to determine 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 an 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 (i.e. milestone payments) in excess of revenue recognized on uncompleted long-term contracts are reflected as a liability on the balance sheet under the caption "Billings in excess of costs and estimated earnings on uncompleted long-term contracts". If at any time during performance 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 that require us to revise our cost and profit estimates. Progress billings are based upon contract provisions for customer advance payments, contract costs incurred, and completion of specified contract milestones. Costs related to post shipment obligations, including field installation, warranty, and any additional contracted items are included in the estimated total costs required to fulfill the contract. 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. Some of our long-term contracts contain provisions that require us to pay liquidated damages if we are responsible for the failure to meet specified contractual milestone dates and the applicable customer asserts a claim under these provisions. Management uses its best judgment to estimate not only the cost to perform the work, but also the price that will eventually be paid by our customers on such contracts.

For contracts under \$250, or contracts to be completed in less than six months, and where there are no post-shipment services included in the contract (such as installation and customer acceptance), the completed contract method is applied and revenue is recognized on the date that the finished product is shipped to the customer. Estimated warranty costs for these contracts are accrued and this accrual is adjusted periodically based on actual warranty expenses and the amount and type of products shipped. Revenue derived from 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. There are no post contract expenses associated with these types of contracts.

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, dispute resolution, 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 several locations internationally. Accounts in each domestic institution are insured by the Federal Deposit Insurance Corporation up to \$250. During each fiscal year, the Company may periodically have cash and cash equivalents in excess of insured amounts.

Restricted Cash

Restricted cash was \$5,954 as of February 23, 2018 compared to \$5,956 as of February 24, 2017. Restricted cash is comprised primarily of collateral for any obligations under our loan agreements with PNC Bank, National Association ("PNC Bank") as defined in Note 6 – Long-Term Obligations and Related Equity Arrangements.

Accounts Receivable and Concentration of Credit Risk

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based on payment history and the customer's current creditworthiness. Terms are cash upon delivery, except where satisfactory open account credit is established, in which case terms are generally payment net thirty (30) days from the date of the invoice. Accounts receivable are deemed past due if payment is not received by the payment due date. Overdue payments are subject to interest penalty of the delinquent amount at the rate of one and one-half percent (1.5%) per month. The Company continuously monitors collections and payments from its customers, and maintains a provision for estimated credit losses based on historical experience and any specific customer collection issues that are identified. While credit losses have historically been within the Company's expectations and the provisions established, we cannot guarantee that the Company will continue to experience the same credit loss rates. Additionally, as a result of the concentration of international receivables, the Company cannot predict the effect, if any, that geopolitical disputes and financial constraints will have on the ultimate collection of its international receivables. Amounts due under contracts related to agencies of a foreign government totaled \$829 or 14.0%, of total net accounts receivable as of February 23, 2018. Subsequent to fiscal year end and prior to June 26, 2018, the date of issuance of our consolidated financial statements, 90.1% of these receivables have been collected. See Note 2 – Accounts Receivable for additional disclosures related to our accounts receivable.

Inventories

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

In accordance with accounting principles generally accepted in the United States of America, the Company may capitalize certain costs of simulation equipment into property, plant, and equipment. This equipment may be used to provide training or as a demonstration device to market the technology, and may be sold as a product if appropriate.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost, and are depreciated over their estimated useful lives using 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. The Company manufactures certain equipment that is used primarily for both research and demonstration purposes to support its sales effort and is not listed for sale, although sales of such demonstration equipment are not precluded. The gross value of demonstration equipment was \$16,932 and \$16,880 as of February 23, 2018 and February 24, 2017, respectively. The net book value of demonstration equipment was \$8,577 and \$9,328 as of February 23, 2018 and February 24, 2017, respectively. Upon sale of such demonstration devices, their costs, net of accumulated depreciation, are transferred to cost of sales. 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. In fiscal 2018 and fiscal 2017, \$2 and \$52, respectively, of machinery and equipment, all of which was fully depreciated, was retired.

Capitalized Software Development Costs

The Company capitalizes the qualifying costs of developing software contained in certain products. Capitalization of such costs commences when technological feasibility has been established in accordance with the Financial Accounting Standards Board's ("FASB") guidance on accounting for the costs of computer software to be sold, leased, or otherwise marketed. Technological feasibility is defined as the point in time when the Company has completed all planning, designing, coding, and testing activities that are necessary to establish that a software product can be produced to meet its design specifications, including functions, features, and technical performance requirements. When the software is ready for commercial release, capitalization of development costs cease and amortization commences on a straight-line basis over a period ranging from three (3) to five (5) years, depending upon the life of the product. The establishment of technological feasibility and the ongoing assessment of the recoverability of these costs require considerable judgment by management with respect to certain external factors including, but not limited to, anticipated future gross product revenue, estimated economic product lives, and changes in software and hardware technology. Software amortization totaled \$122 and \$106 in fiscal 2018 and fiscal 2017, respectively. Estimated software amortization, which is based on existing capitalized software, for each of the next five (5) fiscal years is as follows: \$68 in fiscal 2019 and \$19 in fiscal 2020.

Research and Development Costs

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. During fiscal 2018 and fiscal 2017, the Company was involved with two (2) and three (3) such grants, respectively. Payments received under these grants are recorded as a reduction of research and development costs. Such payments totaled \$239 in fiscal 2018 and \$497 in fiscal 2017. Research and development expenses, which totaled \$1,747 in fiscal 2018 and \$2,108 in fiscal 2017, include spending for potential new products and technologies and work performed under government grant programs, both in the United States and internationally. This spending, net of grant payments from the United States, and the governments of Poland and Turkey, as detailed above, was \$1,508 for fiscal 2018 compared to \$1,611 for fiscal 2017.

Income Taxes

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

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, plant, 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. There were no impairment losses recorded in either fiscal 2018 or fiscal 2017.

Share-Based Compensation

Share-based compensation expense is measured at the stock option grant date, based on the fair value of the award, and is recorded primarily to general and administrative expense. The Company uses the Black-Scholes option-pricing model and the straight-line attribution approach to determine the fair value of share-based awards in accordance with Accounting Standards Codification ("ASC") 718, Compensation. This option-pricing model requires the input of highly subjective assumptions, including the option's expected term, the price volatility of the underlying stock, risk-free rates of return, dividend yield, and expected forfeitures. The expected term of an award is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility is based on the Company's historical stock prices. 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-pricing model as it does not anticipate paying cash dividends in the near future. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense for only those awards that are 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. There were 10,000 options granted in fiscal 2017; there were no such options granted in fiscal 2018.

Advertising Costs

The Company expenses advertising costs, which include trade shows, as incurred. Advertising costs were \$174 and \$206 in fiscal 2018 and fiscal 2017, respectively.

Warranty Costs

The Company provides warranties against defects in materials and workmanship in our products. Warranty periods for our products generally range from ninety (90) days to two (2) years. The Company maintains 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.

Earnings per Share

The Company utilizes the two-class method for computing and presenting earnings per share. The Company currently has one class of Common Stock (the "Common Stock") and one class of cumulative convertible participating Preferred Stock currently outstanding, Series E (the "Preferred Stock"). Under its terms, the Preferred Stock is entitled to participate in any cash dividends on a one-for-one basis for the equivalent converted common shares if the Preferred Stock were to be converted by the holder by the dividend record date; therefore, the Preferred Stock is considered a participating security requiring the two-class method for the computation and presentation of net income per share – basic.

The two-class computation method for each period segregates basic earnings per common and participating share into two categories: distributed earnings per share (i.e., the Preferred Stock stated dividend) and undistributed earnings per share, which allocates earnings after subtracting the Preferred Stock dividend to the total of weighted average common shares outstanding plus equivalent converted common shares related to the Preferred Stock. Basic earnings per common and participating share excludes the effect of Common Stock equivalents, and is computed using the two-class computation method.

Diluted earnings per share reflects the potential dilution that could result if securities or other contracts to issue Common Stock were exercised or converted into Common Stock. Diluted earnings per share continues to be computed using the if-converted method. Diluted earnings per share assumes the exercise of stock options and warrants using the treasury stock method. If the effect of the conversion of any financial instruments would be anti-dilutive, it is excluded from the diluted earnings per share calculation.

As of both February 23, 2018 and February 24, 2017, there was \$12,127 of cumulative convertible participating Series E Preferred Stock originally issued in July 2009. As of February 23, 2018, Series E Preferred Stock was convertible at an exercise price of \$1.98 per share, equating to 6,124,567 shares of Common Stock. As of February 24, 2017, Series E Preferred Stock was convertible at an exercise price of \$2.00 per share, equating to 6,063,321 shares of Common Stock.

On February 28, 2009, in connection with the issuance of a \$2,000 promissory note, the Company issued 200,000 warrants to purchase 143,885 shares of the Company's Common Stock at \$1.39 per share. As of February 28, 2016, these warrants have expired. Additionally, on July 2, 2009, in consideration of an increase of the guarantee on the 2007 PNC Credit Facility (as defined in Note 6 – Long-Term Obligations and Related Equity Arrangements), the Company issued 500,000 warrants to purchase 450,450 shares of the Company's Common Stock at \$1.11 per share. As of July 2, 2016, these warrants have expired.

As of February 23, 2018 and February 24, 2017, there were outstanding options to purchase the Company's Common Stock totaling 509,500 and 511,500 shares at an average price of \$1.24. Due to the conversion price of the Common Stock options, 499,500 and 501,500 shares were excluded from the calculation of diluted earnings per share as of February 23, 2018 and February 24, 2017, respectively, because the effect of their conversion would be anti-dilutive.

Recent Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, as part of its ongoing efforts to assist in the convergence of accounting principles generally accepted in the United States of America and International Financial Reporting Standards ("IFRS"), the FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. Under the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Further amendments and technical corrections were made to ASU 2014-09 during calendar 2016.

Given the nature of our products and terms and conditions in our contracts, in particular our long-term firm fixed price contracts that comprise the majority of our business, the customer obtains control as we perform work under the contract; therefore, we expect to recognize revenue over time for substantially all of our contracts using a method similar to our current POC cost-to-cost method, which is consistent with current guidance. Accordingly, the Company does not believe the adoption of ASU 2014-09 will have a material impact on the Company's financial statements and related disclosures. As of February 23, 2018, the Company intends to adopt ASU 2014-09 on a modified retrospective basis on February 24, 2018. We are finalizing the impact of ASU 2014-09 on the disclosures for its financial statement footnotes and expect the disclosures to be enhanced in the fiscal 2019 first quarter.

Leases

In February 2016, as part of its initiative to increase transparency and comparability among organizations, the FASB issued ASU 2016-02, Leases (Topic 842), which introduces a lessee model that brings most leases on the balance sheet. ASU 2016-02 will be effective for our fiscal 2021, which will begin on February 29, 2020. Based on our current operating lease commitments as disclosed in Note 10 – Commitments and Contingencies, we do not expect this standard to have a material impact on our consolidated financial statements; however, we do anticipate significant changes in internal controls and related business processes during the implementation phase.

Statement of Cash Flows

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. This guidance is effective for fiscal years beginning after December 15, 2017. ASU 2016-15 will be effective for our fiscal 2019, which began on February 24, 2018. We do not expect this standard to have a material impact on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires a company to include in its cash and cash equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash, a reconciliation between the statement of financial position and the statement of cash flows when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents, and proper disclosure about the nature of the restrictions when company has a material balance of amounts generally described as restricted cash and restricted cash equivalents. This guidance is effective for fiscal years beginning after December 15, 2017. ASU 2016-18 will be effective for our fiscal 2019, which began on February 24, 2018. We do not expect this standard to have a material impact on our consolidated financial statements.

2. Accounts Receivable

The components of accounts receivable are as follows:

	Feb. 23, 2018	Feb. 24, 2017
U.S. Commercial ("Domestic")	\$ 2,495	\$ 2,745
U.S. Government	61	77
International	3,666	4,521
	6,222	7,343
Less: allowance for doubtful accounts	(310)	(290)
Accounts receivable, net	\$ 5,912	\$ 7,053

3. Costs and Estimated Earnings on Uncompleted Contracts

The following is a summary of long-term contracts in progress:

	Feb. 23, 2018	Feb. 24, 2017
Cost incurred on uncompleted long-term contracts	\$ 150,364	\$ 138,131
Estimated earnings	39,609	36,371
	189,973	174,502
Less: billings to date	(177,919)	(171,234)
	\$ 12,054	\$ 3,268

Included in accompanying balance sheets under the following captions:

	Feb. 23, 2018	Feb. 24, 2017
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	\$ 16,548	\$ 12,931
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(4,494)	(9,663)
	\$ 12,054	\$ 3,268

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 in both fiscal 2018 and fiscal 2017.

In accordance with industry practices, costs and estimated earnings in excess of billings on uncompleted long-term contracts are classified as current even though a portion of these amounts may not be realized within one year.

4. Inventories

Inventories are valued at the lower of cost or market using the FIFO method and consist of the following:

	Feb. 23, 2018	Feb. 24, 2017
Raw materials	\$ 202	\$ 108
Work in process	1,311	2,292
Finished goods	864	442
Inventories, net	\$ 2,377	\$ 2,842

Inventory is presented net of an allowance for obsolescence of \$196 (raw material \$63 and work in process \$133) and \$188 (raw material \$55 and work in process \$133) as of February 23, 2018 and February 24, 2017, respectively.

In accordance with accounting principles generally accepted in the United States of America, the Company may capitalize certain costs of simulation equipment into property, plant, and equipment. This equipment may be used to provide training or as a demonstration device to market the technology, and may be sold as a product if appropriate.

5. Property, Plant, and Equipment

The following is a summary of property, plant, and equipment, at cost, and estimated useful lives:

	Feb. 23, 2018	Feb. 24, 2017
Land	\$ 100	\$ 100
Buildings and building additions	3,851	3,851
Machinery and equipment	11,202	10,945
Demonstration equipment	16,932	16,880
Office furniture and equipment	1,324	1,324
Building improvements	3,145	3,145
Construction in process	498	406
	37,052	36,651
Less: accumulated depreciation	(24,699)	(23,557)
Property, plant, and equipment, at cost, net	\$ 12,353	\$ 13,094

Depreciation expense for fiscal 2018 and fiscal 2017 was \$1,144 and \$1,254, respectively.

As of both February 23, 2018 and February 24, 2017, substantially all of the Company's long-lived assets were located in the United States of America.

6. Long-Term Obligations and Related Equity Arrangements

2009 Lenfest Financing Transaction

On April 24, 2009, the Company entered into a transaction (the "2009 Lenfest Financing Transaction") with H.F. Lenfest ("Mr. Lenfest"), a major shareholder and member of the Company's Board of Directors (the "Board of Directors"), that provided for, among other things, the following:

- (i) a \$7,500 credit facility provided by Mr. Lenfest to ETC (the "Lenfest Credit Facility"), which has expired;
- (ii) the exchange of the senior subordinated convertible promissory note in the original principal amount of \$10,000 issued by ETC to Mr. Lenfest on February 18, 2003, together with all accrued interest and warrants issuable under the note, and all Series B Preferred Stock and Series C Preferred Stock held by Mr. Lenfest, together with all accrued dividends thereon, for a new class of preferred stock, Series E Preferred Stock, the terms of which are described below; and
- (iii) the guarantee by Mr. Lenfest of all of ETC's obligations to PNC Bank in connection with an increase of the existing \$15,000 revolving line of credit with PNC Bank (the "2007 PNC Credit Facility") to \$20,000, and in connection with this guarantee, the pledge by Mr. Lenfest to PNC Bank of \$10,000 in marketable securities to secure ETC's obligations to PNC Bank (the "Lenfest Pledge").

2012 Financial Restructuring

On September 28, 2012, the Company entered into transactions, collectively the 2012 Financial Restructuring, that provided for, among other things, the following:

(i) The Company's Line of Credit with PNC Bank ("PNC Line of Credit") was reduced from \$20,000 to \$15,000; however, the term of the PNC Line of Credit was extended twenty-eight (28) months, from June 30, 2013 to October 31, 2015.

(ii) PNC Bank provided to the Company a new five (5) year \$15,000 Term Loan. The Company used \$10,000 of the proceeds from the Term Loan to repurchase and retire 10,000 shares of its Series D and Series E Preferred Stock owned by Mr. Lenfest at the stated price of \$1,000 per share. The remaining \$5,000 was used to partially decrease the amount outstanding on the PNC Line of Credit and to pay Mr. Lenfest \$417 of interest due under the Lenfest Pledge, in cash, in lieu of Series D Preferred Stock. The \$10,000 in marketable securities associated with the Lenfest Pledge was returned to Mr. Lenfest and the Lenfest Pledge was terminated; therefore, as of both February 24, 2017 and February 26, 2016, no interest has been accrued for under the Lenfest Pledge.

(iii) The PNC Line of Credit was no longer guaranteed by Mr. Lenfest. Instead, the PNC Line of Credit was secured by substantially all of the Company's assets. In addition, the Term Loan was originally guaranteed by Mr. Lenfest for a period of thirty (30) months, (i.e., until March 31, 2015), after which the guarantee was to be removed.

(iv) Following the close of the transactions on September 28, 2012, and as approved by the Company's Common Stock holders at the 2013 Annual Meeting of Shareholders, the dividend rate on the outstanding Preferred Stock was reduced from ten percent (10%) to four percent (4%).

The material agreements providing for these transactions are described below:

September 28, 2012 Loan Agreement with PNC Bank

Effective September 28, 2012, ETC and PNC Bank entered into a loan agreement (the "September 28, 2012 Loan Agreement"), which included ETC executing a Line of Credit Note and a Term Loan Note (as defined below). As set forth in the September 28, 2012 Loan Agreement, borrowings under the PNC Line of Credit were available for working capital and other general business purposes, and for issuances of letters of credit. Amounts were borrowed, repaid, and re-borrowed under the PNC Line of Credit from time to time until August 5, 2016, the date on which the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the consolidation of the PNC Line of Credit and the Term Loan into a \$21,000 Revolving Line of Credit (the "Revolving Line of Credit"); see "Fiscal 2017 Amendment to the September 28, 2012 Loan Agreement" below for details. The Company's obligation to repay the advances under the Revolving Line of Credit is set forth in the Amended and Restated Committed Line of Credit Note (the "Line of Credit Note"). The Company is also obligated to pay a fee of 0.25% for unused but available funds under the

Revolving Line of Credit. As of February 23, 2018, the Company's availability under the Revolving Line of Credit was \$888. This reflected cash borrowings of \$18,809 and net outstanding standby letters of credit not covered by the Committed Line of Credit of \$1,303. As of June 2, 2018, the date of our most current Revolving Line of Credit statement, the Company's availability under the Revolving Line of Credit was approximately \$1,206.

As security for repayment of the Line of Credit Note, as noted above, and the Term Loan Note, which set forth the Company's obligation to repay the principal on the Term Loan, including interest, on a monthly basis, the Company also concurrently entered into the Third Amended and Restated Reimbursement Agreement for Letters of Credit between ETC and PNC Bank dated September 28, 2012, a Security Agreement between ETC and PNC Bank dated September 28, 2012, a Pledge Agreement executed by ETC on September 28, 2012 in favor of PNC Bank ("Pledge Agreement"), an Amended and Restated Guaranty and Suretyship Agreement executed by Mr. Lenfest on September 28, 2012 in favor of PNC Bank, and an Open-End Mortgage and Security Agreement between ETC and PNC Bank dated September 28, 2012. Pursuant to the Pledge Agreement, which was subsequently amended and restated in conjunction with the Fiscal 2017 Amendment to the September 28, 2012 Loan Agreement (as defined below), the Company pledged to PNC Bank as collateral the Company's ownership interest in certain subsidiaries of the Company.

The September 28, 2012 Loan Agreement contains both affirmative and negative covenants that are customary for transactions of this type, including such financial covenants as a minimum net worth, a maximum operating leverage ratio, and a minimum fixed charge coverage ratio, as well as limitations with respect to indebtedness, liens, investments, distributions, dispositions of assets, change of business, and transactions with affiliates. The September 28, 2012 Loan Agreement also provides for customary events of default, 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 certain judgments, and the liquidation of ETC. Upon an event of default under the September 28, 2012 Loan Agreement, including the non-payment of principal or interest, the obligations of the Company under the September 28, 2012 Loan Agreement may be accelerated and the assets securing the obligations secured. See "Fiscal 2017 Amendment to the September 28, 2012 Loan Agreement" below for current financial covenant requirements.

Interest Rate Swap Agreement

On September 28, 2012, the Company entered into an interest rate swap agreement to protect against certain interest rate fluctuations of the LIBOR interest rate initially on \$5,000 of the \$15,000 variable rate Term Loan. The effective date of the interest rate swap was September 28, 2012, and it expired on September 28, 2017. The notional amount of \$5,000 decreased ratably over the duration of the interest

rate swap agreement. The interest rate swap effectively fixed our LIBOR interest rate on the notional amount at a rate of 0.74% in excess of the margin. We have not recorded an unrealized gain or loss related to the fair value of our interest rate swap in either fiscal 2018 or fiscal 2017. We have designated our current interest rate swap as a cash flow hedge instrument. We have determined the hedge to be effective through the date of expiration. See Note 12 – Fair Value Measurements and Interest Rate Swap for additional disclosures related to the interest rate swap.

Preferred Stock Repurchase Agreement

Effective September 28, 2012, ETC and Mr. Lenfest entered into a Preferred Stock Repurchase and Financial Restructuring Agreement. Immediately following the closing of the September 28, 2012 Loan Agreement, the Company purchased from Mr. Lenfest, at the stated price of \$1,000 per share, (i) 386 shares of Series D Preferred Stock, representing all of the Company's issued and outstanding shares of Series D Preferred Stock, and (ii) 9,614 shares of Series E Preferred Stock, representing a significant portion of the Company's issued and outstanding Series E Preferred Stock. Mr. Lenfest is the only holder of the outstanding Series E Preferred Stock, and 12,127 shares of Series E Preferred Stock remain outstanding as of both February 23, 2018 and February 24, 2017. Following the execution of the Preferred Stock Repurchase and Financial Restructuring Agreement, and as approved by the Company's Common Stock holders at the 2013 Annual Meeting of Shareholders, the dividend rate on the outstanding Preferred Stock was reduced from ten percent (10%) to four percent (4%).

Termination of Certain Lenfest Agreements

On September 28, 2012, upon the execution of the Preferred Stock Repurchase and Financial Restructuring Agreement described above, the following prior agreements between ETC and Mr. Lenfest were terminated: (i) Secured Credit Facility and Warrant Purchase Agreement between the Company and Mr. Lenfest, dated as of April 24, 2009; (ii) the Security Agreement, dated February 18, 2009, by the Company in favor of Mr. Lenfest; (iii) the Security Agreement, dated April 24, 2009, among the Company, Entertainment Technology Corporation, a defunct Pennsylvania corporation and once wholly-owned subsidiary of the Company ("ETC Entertainment"), and Mr. Lenfest; (iv) the Guaranty, dated April 24, 2009, by ETC Entertainment in favor of Mr. Lenfest; and (v) the Amended and Restated Open-End Mortgage and Security Agreement, dated April 24, 2009, by the Company in favor of Mr. Lenfest. These Agreements were entered into as part of, or directly related to, the 2009 Lenfest Financing Transaction. As part of the 2012 Financial Restructuring, the \$10,000 in marketable securities associated with the Lenfest Pledge has been returned to Mr. Lenfest and the Lenfest Pledge has been terminated. The warrants ETC issued to Mr. Lenfest as part of the 2009 Lenfest Financing Transaction were, however, not terminated. See "Common Stock Warrants" below.

Fiscal 2017 Amendment to the September 28, 2012 Loan Agreement

On June 10, 2016, the Company received a waiver as of the fiscal quarter ended February 26, 2016 for failing to exceed the permitted minimum Consolidated Tangible Net Worth. The waiver also provides that ETC must maintain at all times a minimum Consolidated Tangible Net Worth of \$7,500; further, commencing with the fiscal quarter ending May 26, 2017, ETC was to have maintained as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio was to increase to 1.10 to 1 on August 25, 2017, and was to remain at that level at all times thereafter. The waiver extended the maturity date of the PNC Line of Credit to August 10, 2016, during which time the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, the following:

- (i) The PNC Line of Credit and the Term Loan were consolidated into a \$21,000 Revolving Line of Credit, under which amounts may be borrowed, repaid, and re-borrowed until the maturity date.
- (ii) The existing Committed Line of Credit (the "Committed Line of Credit") is capped at \$8,600, an amount equivalent to the total outstanding standby letters of credit under which the Committed Line of Credit covered as of May 27, 2016. Total outstanding standby letters of credit covered by the Committed Line of Credit decreased to approximately \$4,015 as of June 26, 2018, the date of issuance of our consolidated financial statements.
- (iii) A new \$1,000 FX Equivalent Line of Credit (the "FX Equivalent Line of Credit") for potential future foreign exchange obligations.
- (iv) The Revolving Line of Credit, the Committed Line of Credit, and the FX Equivalent Line of Credit (collectively, the "2016 PNC Credit Facilities") had an original maturity date of December 31, 2017, which on May 26, 2017 was subsequently extended to June 30, 2018.
- (v) The interest rate on the 2016 PNC Credit Facilities will be based on the PNC Daily LIBOR Rate (2.0007% as of June 2, 2018, the date of our most current Revolving Line of Credit statement) plus a margin of 3.00%.
- (vi) The 2016 PNC Credit Facilities are collateralized by a combination of the Company's pledged restricted cash (\$5,954 as of February 23, 2018), substantially all of the Company's additional assets, and the pledged cash collateral Mr. Lenfest.

Fiscal 2019 Amendment to the September 28, 2012 Loan Agreement

On April 9, 2018, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, the following:

- (i) The Revolving Line of Credit was increased from \$21,000 to \$25,000.
- (ii) The maturity date of the 2016 PNC Credit Facilities was extended from June 30, 2018 to June 30, 2019.
- (iii) The interest rate margin on the 2016 PNC Credit Facilities was lowered from 3.00% to 2.75%.

Preferred Stock

Presently, the Company has one class of cumulative convertible participating Preferred Stock currently outstanding, Series E (25,000 shares authorized) (the "Preferred Stock").

The Preferred Stock was authorized by the Board of Directors in April 2009 as part of the 2009 Lenfest Financing Transaction. The Preferred Stock has a par value of \$0.05 per share and a stated value of \$1,000 per share. The Preferred Stock is currently entitled to receive cumulative dividends at the rate of four percent (4%) per year in preference to the holders of the Company's Common Stock with respect to dividends. These dividends are payable only upon a liquidation event or when otherwise declared by the Board of Directors, provided that the Company's Fixed Charge Coverage Ratio is at least 1.10 to 1 as stipulated in the October 11, 2013 amendment to the September 28, 2012 Loan Agreement. The Company cannot declare or pay any dividends on its Common Stock until the dividends on the Preferred Stock have been paid. The Preferred Stock holders are entitled to receive any dividends paid with respect to the Common Stock on an "as-converted" basis. The Preferred Stock may be converted by the holder at any time and from time to time into the Company's Common Stock by dividing the stated value of the Preferred Stock by the conversion price established at the time of issuance (see "Series E Preferred Stock" below). Upon a liquidation event, the holders of the Preferred Stock would be entitled to participate in any proceeds in preference to any Common Stock holders. The Preferred Stock would also participate in any liquidation event with the Common Stock holders on an "as-converted" basis. The Preferred Stock conversion price is subject to adjustment for certain transactions including stock splits and issuance of equity securities below the conversion prices.

The Company has reviewed the accounting principles generally accepted in the United States of America applicable to the Preferred Stock; specifically, the Company has reviewed both Accounting Standards Codification ("ASC") 480 – Distinguishing Liabilities from Equity and ASC 815 – Derivatives and Hedging. Upon its review, the Company determined that the Preferred Stock is within the control of the Company and that the attributes of the Preferred Stock are more akin to equity than debt. The specific attributes considered by the Company include the designation of the instruments, the conversion of the instruments to the Company's Common Stock, the participation feature, the non-mandatory conversion, the voting rights, and the ability to appoint directors. Secondly, the Company determined that the Preferred Stock qualifies as permanent equity because the Preferred Stock is not mandatorily redeemable, and there is no obligation to either repurchase the instruments or issue a variable amount of common shares. Lastly, the Company determined that the conversion feature qualifies for the scope exception of ASC 815 – Derivatives and Hedging as it is clearly and closely related to the Preferred Stock instrument. Due to the Company's accumulated deficit as of February 24, 2012, all Preferred Stock dividends accruing through this date were recorded in the accompanying consolidated financial statements as a reduction of additional paid-in capital. During fiscal 2013, the Company entered into a position of retained earnings;

thus, all \$1,511 and \$493 of dividends recorded during fiscal 2013 and fiscal 2014, respectively, were recorded as a reduction to retained earnings. Due to the accumulated deficit position entered into beginning in fiscal 2015, all \$484 of dividends recorded during each of the fiscal years since were recorded as a reduction of additional paid-in capital.

Series E Preferred Stock

On July 2, 2009, the Company issued 23,741 shares of Series E Preferred Stock to Mr. Lenfest in connection with the 2009 Lenfest Financing Transaction. The shares of Series E Preferred Stock are convertible to Common Stock at a conversion price per share equal to \$2.00 and would have converted into 11,870,391 shares of the Company's Common Stock.

On March 10, 2010, August 12, 2010, and February 9, 2011, ETC entered into three separate agreements with Mr. Lenfest to repurchase and retire a total of 2,000 shares of Series E Preferred Stock owned by Mr. Lenfest. In the three agreements, the repurchases were made at the stated price of \$1,000 per share for a total of \$2,000.

On September 28, 2012, as part of the 2012 Financial Restructuring and immediately following the closing of the Loan Agreement, the Company purchased from Mr. Lenfest, at the stated price of \$1,000 per share, 9,614 shares of Series E Preferred Stock, representing a significant portion of the Company's issued and outstanding Series E Preferred Stock. Mr. Lenfest is the only holder of the outstanding Series E Preferred Stock, and 12,127 shares of Series E Preferred Stock remain outstanding as of both February 23, 2018 and February 24, 2017.

As of February 23, 2018, Series E Preferred Stock was convertible at an exercise price of \$1.98 per share, equating to 6,124,567 shares of Common Stock. As of February 24, 2017, Series E Preferred Stock was convertible at an exercise price of \$2.00 per share, equating to 6,063,321 shares of Common Stock. All Series E Preferred Stock dividends accrued through February 22, 2013 have been paid in cash. Series E Preferred Stock dividends accrued during the period February 23, 2013 through February 23, 2018, which totaled \$2,428, remained unpaid as of June 26, 2018, the date of issuance of our consolidated financial statements, per the restrictions stipulated in the October 11, 2013 amendment to the September 28, 2012 Loan Agreement.

Common Stock Warrants

On February 28, 2009, in connection with a \$2,000 loan made by Mr. Lenfest to the Company, the Company issued to Mr. Lenfest warrants to purchase 143,885 shares of ETC Common Stock, which were equal in value to ten percent (10%) of the \$2,000 note. The warrants were exercisable for seven (7) years following issuance at an exercise price of \$1.39, which equaled the average closing price of ETC Common Stock during the 120 days prior to the issuance of the warrant. As of February 28, 2016, these warrants have expired.

On July 2, 2009, in consideration of Mr. Lenfest's agreement to guarantee the \$5,000 increase to the 2007 PNC Credit Facility, ETC issued to Mr. Lenfest warrants to purchase 450,450 shares of ETC Common Stock, which were equal in value to ten percent (10%) of the amount of the \$5,000 increase. The warrants were exercisable for seven (7) years following issuance at an exercise price per share equal to \$1.11, equaling the average closing price of ETC Common Stock during the 120 days preceding the issuance of the warrant. As of July 2, 2016, these warrants have expired.

ETC-PZL Line of Credit Agreement

On July 6, 2017, ETC-PZL entered into a new loan agreement with a bank in Warsaw, Poland, whereby ETC-PZL now has two lines of credit (collectively, the "ETC-PZL Line of Credit") in the amount of \$3,150 and \$575 to fund two large multi-year long-term construction-type contracts and current activity, respectively. Amounts borrowed to fund long-term contracts must be repaid by March 29, 2019. Amounts borrowed to fund current activity must be repaid by May 31, 2019. As of February 23, 2018 and February 24, 2017, outstanding borrowings under the ETC-PZL Line of Credit were approximately \$2,084 and \$362, respectively.

Summary of Long-Term Debt Obligations

Long-term debt obligations consist of the following:

	Feb. 23, 2018	Feb. 24, 2017
Credit facility payable to bank	\$ 18,809	\$ 17,578
Borrowed under ETC-PZL Line of Credit	2,084	362
Total long-term debt obligations	20,893	17,940
Less: debt issuance costs	-	(24)
Total long-term debt obligations, net of debt issuance costs	20,893	17,916
Less: current portion	-	(362)
Total long-term debt obligations, net of debt issuance costs, less current portion	\$ 20,893	\$ 17,554

The amounts of future long-term debt obligations maturing in each of the next five (5) fiscal years are as follows:

Fiscal Year	Amount
Fiscal 2019	\$ -
Fiscal 2020	20,893
Fiscal 2021	-
Fiscal 2022	-
Fiscal 2023	-
Total future long-term debt obligations	\$ 20,893

7. Income Taxes

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

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act, among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. Consequently, we wrote down approximately \$2,175 of our net deferred tax assets as of February 23, 2018 to reflect the re-measurement of certain net deferred tax assets using the lower U.S. corporate income tax rate; however, due to the previously established valuation allowance for such deferred tax assets, the impact was minimal. As of February 23, 2018, the Company reviewed the components of its deferred tax assets and determined, based upon all available information, that it is more likely than not that deferred tax assets relating to its federal and state net operating loss carryforwards and research and development tax credits will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established a \$5,937 valuation allowance for such deferred tax assets that we do not expect to realize. If there is a change in our ability to realize our deferred tax assets for which a valuation allowance has been established, then our tax valuation allowance may decrease in the period in which we determine that realization is more likely than not.

An income tax benefit of \$662 was recorded in fiscal 2018; whereas, an income tax provision of \$161 was recorded in fiscal 2017. Our income tax (benefit) provision consists of the following:

	Fiscal year ended	
	Feb. 23, 2018	Feb. 24, 2017
Current tax expense (benefit):		
U.S. Federal	\$ 19	\$ 20
U.S. State	28	(24)
Foreign	77	68
Total current tax expense, net	124	64
Deferred tax (benefit) expense:		
U.S. Federal	\$ (1,429)	\$ 26
U.S. State	412	10
Foreign	231	61
Total deferred tax (benefit) expense	(786)	97
Income tax (benefit) provision	\$ (662)	\$ 161

Effective tax rates were 37.6% and 22.0% for fiscal 2018 and fiscal 2017, respectively. The resulting income tax benefit and change in effective tax rate were driven primarily by a net one-time benefit of \$420 to reflect the estimated impact of the Tax Act. This net one-time benefit of \$420 was comprised of a reduction in the valuation allowance related to our alternative minimum tax credit (approximately \$586), offset, in part, by a deemed repatriation tax (approximately \$166, for which we were allowed to net against our federal net operating loss carryforwards).

While we have substantially completed our provisional analysis of the income tax effects of the Tax Act and recorded a reasonable estimate of such effects, the net one-time benefit related to the Tax Act may differ, due to, among other things, further refinement of our calculations, changes in interpretations and assumptions that we have made, additional guidance that may be issued by the U.S. Government, and actions and related accounting policy decisions we may take as a result of the Tax Act. We will complete our analysis over a one-year measurement period ending December 22, 2018, and any adjustments during this measurement period will be included in net earnings from continuing operations as an adjustment to income tax (benefit) expense in the reporting period when such adjustments are determined.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As of February 23, 2018, the Company had approximately \$23,758 of federal net operating loss carryforwards available to offset future income tax liabilities, which will begin to expire in 2025. The Company is no longer subject to U.S. federal tax examinations by tax authorities for the fiscal years before and including 2015. ETC-PZL is no longer subject to tax examinations in Poland for tax periods prior to December 31, 2012; ETC-Europe is no longer subject to tax examinations in the United Kingdom now that it is dissolved. We are, however, subject to examination in various other foreign and state jurisdictions for fiscal years 2008-2018. We believe appropriate provisions for all outstanding tax issues have been made for all jurisdictions and all open years.

As of February 23, 2018, the Company has a net deferred tax asset of \$489 compared to a net deferred tax liability of \$297 as of February 24, 2017. Significant components of our net deferred tax liability are as follows:

	Feb. 23, 2018	Feb. 24, 2017
Deferred tax assets:		
Net operating loss carryforwards	\$ 5,807	\$ 9,719
U.S. R&D tax credits	1,487	1,406
U.S. AMT credits	586	584
Foreign	265	296
Vacation accrual	170	263
Inventory reserve	44	66
Receivable reserve	69	101
Other, net	232	316
	8,660	12,751
Valuation allowance	(5,937)	(9,513)
Total deferred tax assets	2,723	3,238
Deferred tax liabilities:		
Depreciation	(1,733)	(2,972)
Amortization of capitalized software	(42)	(86)
Foreign	(363)	(168)
APB 23 liability	(96)	(309)
Total deferred tax liabilities	(2,234)	(3,535)
Total net deferred tax asset (liability)	\$ 489	\$ (297)

U.S. income taxes have been provided on deemed repatriated earnings of \$1,661 related to our non-U.S. subsidiaries as of February 23, 2018, as a result of the enactment of the Tax Act. The additional net transition tax of \$166 on the deemed repatriated earnings was recorded for fiscal 2018. Before the Tax Act, U.S. we have provided for U.S. deferred income taxes and foreign withholding tax in the amount of \$309 for all undistributed earnings not considered permanently reinvested in our non-U.S. subsidiaries.

As of February 23, 2018, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of \$53 and penalties of \$81. As of February 24, 2017, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of \$48 and penalties of \$73. The interest and penalties recorded during both fiscal 2018 and fiscal 2017 primarily related to domestic state tax and foreign tax issues.

As of February 23, 2018 and February 24, 2017, the total amount of unrecognized tax benefits was \$702 and \$646, respectively, of which \$248 would affect the effective tax rate, if recognized. These amounts, which are recorded on the Company's balance sheet within other accrued liabilities, are primarily associated with U.S. federal tax issues such as the amount of research and development tax credits claimed and taxation of foreign earnings. Also included in these amounts are accruals for domestic state tax issues such as the allocation of income among various state tax jurisdictions.

8. Business Segment Information

We operate in two primary business segments, Aerospace and CIS. Aerospace encompasses the design, manufacture, and sale of: (i) ATS products; (ii) altitude (hypobaric) chambers; (iii) hyperbaric chambers for multiple persons (multiplace chambers); and (iv) ADMS, as well as ILS for customers who purchase these products or similar products manufactured by other parties. These products and services provide customers with an offering of comprehensive solutions for improved readiness and reduced operational costs. Sales of our Aerospace products are made principally to U.S. and foreign government agencies and to civil aviation organizations. CIS encompasses the design, manufacture, and sale of: (i) steam and gas (ethylene oxide) sterilizers; (ii) ETSS; and (iii) hyperbaric (100% oxygen) chambers for one person (monoplace chambers), as well as parts and service support for customers who purchase these products or similar products manufactured by other parties. Sales of our CIS products are made principally to the healthcare, pharmaceutical, and automotive industries.

Segment operating income (loss) consists of net sales less applicable costs and expenses relating to these sales. 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 our National Aerospace Training and Research Center (the "NASTAR Center") are included in the Aerospace 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.

In fiscal 2018, two customers, both International and each within the Aerospace segment, represented 10.0% or more of total net sales, and sales to these two customers totaling \$17,210 represented 35.8% of total net sales. In fiscal 2017, one International customer within the Aerospace segment represented 10.0% or more of total net sales, and sales to this customer totaling \$17,290 represented 43.4% of total net sales.

Included in the segment information for fiscal 2018 and fiscal 2017 are export sales of \$31,803 and \$29,578, respectively. In fiscal 2018, International sales totaling at least \$500 were made to customers in nine (9) different countries; in fiscal 2017, International sales totaling at least \$500 were made to customers in eleven (11) different countries. Sales to the U.S. Government and its agencies aggregated to \$2,752 and \$276 for fiscal 2018 and fiscal 2017, respectively.

The following segment information reflects the accrual basis of accounting:

	Aerospace	CIS	Corporate	Company Total
Fiscal 2018:				
Net sales	\$ 34,634	\$ 13,452	\$ -	\$ 48,086
Interest expense, net	617	240	-	857
Depreciation and amortization	872	333	60	1,265
Operating income (loss)	5,359	(941)	(1,331)	3,087
Income tax benefit	-	-	(662)	(662)
Identifiable assets	31,235	5,130	10,058	46,423
Expenditures for segment assets	303	127	35	465
Fiscal 2017:				
Net sales	\$ 30,072	\$ 9,762	\$ -	\$ 39,834
Interest expense, net	422	137	-	559
Depreciation and amortization	941	359	60	1,360
Operating income (loss)	1,233	282	(960)	555
Income tax provision	-	-	161	161
Identifiable assets	29,908	5,221	9,409	44,538
Expenditures for segment assets	612	61	29	702
Reconciliation to consolidated net income (loss) attributable to ETC				
	Fiscal 2018		Fiscal 2017	
Operating income	\$ 3,087		\$ 555	
Interest expense, net	(857)		(559)	
Other expense, net	(464)		(727)	
Income tax benefit (provision)	662		(161)	
Income attributable to non-controlling interest	(51)		(31)	
Net income (loss) attributable to ETC	\$ 2,377		\$ (923)	

9. Stock Option Plans

The following is a summary of the status of the Company's Stock Option Plans:

	Fiscal year ended			
	Feb. 23, 2018		Feb. 24, 2017	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	511,500	\$ 1.24	637,917	\$ 1.25
Granted	-	\$ -	10,000	\$ 0.57
Exercised	-	\$ -	-	\$ -
Forfeited	(2,000)	\$ 1.25	(136,417)	\$ 1.25
Outstanding at end of year	509,500	\$ 1.24	511,500	\$ 1.24
Options exercisable at fiscal year end	134,000		130,167	
Weighted average fair value of options granted during the fiscal year		\$ -		\$ 0.39

The following information applies to options outstanding as of February 23, 2018:

Options outstanding				Options exercisable	
Exercise price	Number outstanding as of Feb. 23, 2018	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at Feb. 23, 2018	Weighted average exercise price
\$ 0.57	10,000	8.39	\$ 0.57	-	
\$ 1.25	499,500	6.52	\$ 1.25	134,000	\$ 1.25
Total	509,500			134,000	

The Company uses the Black-Scholes option-pricing model and the straight-line attribution approach to determine the fair value of share-based awards in accordance with ASC 718, Compensation. This option-pricing model requires the input of highly subjective assumptions, including the option's expected term, the price volatility of the underlying stock, risk-free rates of return, dividend yield, and expected forfeitures. The expected term of an award (10 years for options granted in fiscal 2017) is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility (60.8% for options granted in fiscal 2017) is based on the Company's historical stock prices. The risk-free interest rate (0.8% for options granted in fiscal 2017) 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-pricing model as it does not anticipate paying cash dividends in the near future. The Company is required to estimate forfeitures at the time of grant, and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense for only those awards that are 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. There were 10,000 options granted in fiscal 2017; there were no such options granted in fiscal 2018. Stock option compensation expense was \$98 and \$113 in fiscal 2018 and fiscal 2017, respectively.

As of February 23, 2018, 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 of Directors) 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 (10%) owner, one-hundred and ten percent (110%), of a share of the Company's Common Stock on the date of grant of such option. The plan also allows the Board of Directors or its appointed committee to establish the exercise period(s) of any option awards. Granted options have a maximum term of ten (10) years. This Plan was approved by the shareholders on July 2, 2009. As of February 23, 2018, there were 650,500 shares available to be granted under this Plan.

Non-employee Director Stock Plan

In September 2005, the Company adopted a stock option plan that allows for the granting to non-employee members of the Board of Directors of options to purchase up to 600,000 shares of Common Stock. The Plan provides that the exercise price shall not be less than one-hundred percent (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 ten (10) years. The Plan shall remain in effect until terminated by the Board of Directors. As of February 23, 2018, there were 440,000 shares available to be granted under this Plan.

10. Commitments and Contingencies

Operating Lease Obligations

The Company leases certain premises and office equipment under operating leases. Future minimum rental payments over the next five (5) years required under non-cancelable operating leases having a remaining term expiring after one fiscal year as of February 23, 2018 are \$470 in fiscal 2019; \$421 in fiscal 2020; \$403 in fiscal 2021; \$406 in fiscal 2022; and \$256 in fiscal 2023. Total rental expense for all operating leases for fiscal 2018 and fiscal 2017 was \$580 and \$579, respectively.

Retirement and Consulting Agreement Obligations

William F. Mitchell, Sr., who founded the Company in 1969, has retired and resigned from the Board of Directors effective September 19, 2014. He was engaged as a senior technical consultant to the Company. Mr. Mitchell's consulting engagement expired September 18, 2017, and prior to expiration, he was eligible to receive consulting fees upon request from the Company, which were comparable to, but less than, his cash compensation as Chief Executive Officer. He was also entitled to receive certain other benefits prior to expiration of the consulting engagement. As of February 23, 2018, there were no remaining consulting fees or other benefits payments to be made under this consulting engagement.

Legal Proceedings

Orbit Movers & Erectors, Inc.

Orbit Movers & Erectors, Inc. ("Orbit") filed suit in the Court of Common Pleas in Montgomery County, Ohio, seeking damages for alleged additional costs that Orbit claims to have incurred under a contract (the "Orbit Contract") pursuant to which Orbit was to fabricate and install certain piping systems for an ETC Aerospace product (the "Orbit Litigation"). The amount of the alleged additional costs claimed by Orbit was approximately \$500. The litigation was removed to federal district court in Ohio, after which the Company filed its answer and counterclaim for breach of contract. Following a pre-trial conference, the Court scheduled a jury trial in 2017. Last year, the Company filed a Motion for Leave to Amend Answer With Affirmative Defenses and Amended Counterclaims ("Amended Answer"), which was granted. The Amended Answer was subsequently filed and Orbit has replied to ETC's Amended Answer. On July 26, 2016, the Company settled the Orbit Litigation in its entirety. The Company and Orbit have carried out their respective obligations under the Court-approved settlement agreement during fiscal 2017, and the Orbit Litigation was dismissed on February 28, 2017. The settlement did not have a material adverse effect on the Company's financial position or results of operations.

US Air Force Centrifuge Contract Settlement

The Company is a party to a firm fixed price contract with the US Air Force ("USAF") dated September 23, 2009 to build a centrifuge at the Wright Patterson Air Force Base (the "Contract"). During the course of the Company's performance under the Contract, the Company believed that the USAF made changes to the scope and terms of the Contract which increased cost and resulted in delay to the program schedule. The Company previously made objections to these changes and reserved its rights. Subsequent to the end of fiscal 2018, the parties executed a modification to the Contract which, among other things, incorporated into the Contract the technical provisions of an engineering change proposal which made minor modifications to the device specification to conform it to the as-delivered Centrifuge, provided for the USAF's final acceptance of the Centrifuge, resulted in a reduction in the Contract base price of approximately two percent (2%), and resolved all potential claims regarding Contract changes and program delay. The execution of the Contract modification did not have a material effect on the Company's financial position or results of operations.

Other Matters

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against us. We believe, after consultation with legal counsel handling these specific matters, all such matters are reserved for or adequately covered by insurance or, if not so covered, are without merit or are of such kind, or involve such amounts, as would not be expected to have a significant effect on our financial position or results of operations if determined adversely against us.

11. Employee Benefit Plans

The Company maintains a 401(k) retirement savings plan for eligible employees. The Company historically contributed one-hundred percent (100%) to the plan based on the first four percent (4%) of the employees' qualifying contributions; however, effective January 1, 2013, the Company now contributes one-hundred percent (100%) to the plan based on the first four percent (4%) of the employees' qualifying contributions plus an additional fifty percent (50%) of the next two percent (2%) of the employees' qualifying contributions. The Company's contributions totaled \$458 and \$455 in fiscal 2018 and fiscal 2017, respectively.

12. Fair Value Measurements and Interest Rate Swap

Our assets and liabilities that are measured at fair value on a recurring basis include the unrealized gains or losses on interest rate swap contracts. We use significant other observable market data or assumptions (Level 2 inputs as defined in the accounting guidance) that we believe market participants would use in pricing similar assets or liabilities, including assumptions about counterparty risk. Our fair value estimates reflect an income approach based on the terms of the interest rate contracts and inputs corroborated by observable market data including interest rate curves.

As of February 24, 2017, we had one interest rate swap contract in place to reduce our exposure to fluctuations in interest rates on our Term Loan. The swap expired on September 28, 2017. The swap converted the variable interest rate to a fixed interest rate initially on \$5,000 of our \$15,000 Term Loan. The effective date of the interest rate swap was September 28, 2012. The notional amount of \$5,000 decreased ratably over the duration of the interest rate swap agreement. The interest rate swap effectively fixed our LIBOR interest rate on the notional amount at a rate of 0.74% in excess of the margin. We have not recorded an unrealized gain or loss related to the fair value of our interest rate swap in either fiscal 2018 or fiscal 2017.

We recognize any differences between the variable interest rate payments and the fixed interest rate settlements from our swap counterparty as an adjustment to interest expense over the life of the swap. We have designated the swap as a cash flow hedge and we record the changes in the estimated fair value of the swap to accumulated other comprehensive loss. If our interest rate swap became ineffective, we would immediately recognize the change in the estimated fair value of our swap in earnings. Since inception, we have not recognized any gains or losses on these swaps through income and there has been no effect on income from hedge ineffectiveness.

Failure of our swap counterparty would result in the loss of any potential benefit to us under our swap contracts. Additionally, failure of our swap counterparty would not eliminate our obligation to continue to make payments under our existing swap contract if we continue to be in a net pay position.

13. Subsequent Events

The Company has evaluated subsequent events through June 26, 2018, the date of issuance of its consolidated financial statements, and determined that there were no material subsequent events other than disclosed below requiring adjustment to, or disclosure in, the consolidated financial statements for the fiscal year ended February 23, 2018.

On April 9, 2018, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, an increase in the Revolving Line of Credit from \$21,000 to \$25,000, an extension of the maturity date of the 2016 PNC Credit Facilities from June 30, 2018 to June 30, 2019, and a reduction in the interest rate margin on the 2016 PNC Credit Facilities from 3.00% to 2.75%. See Note 6 – Long-Term Obligations and Related Equity Arrangements for further details regarding the Company's loan agreements with PNC Bank.

On May 30, 2018, the acceptance milestone was achieved on the Centrifuge Contract. See Note 10 – Commitments and Contingencies for further details regarding the settlement of this contract.

FIVE YEAR SUMMARY

(in thousands, except per share information)

	Fiscal 2014	Fiscal 2015	Fiscal 2016	Fiscal 2017	Fiscal 2018
Net sales	\$ 48,274	\$ 37,340	\$ 39,632	\$ 39,834	\$ 48,086
Gross profit	14,559	7,850	11,592	13,279	16,127
Gross profit margin %	30.2%	21.0%	29.2%	33.3%	33.5%
Operating income (loss)	2,461	(4,837)	(2,375)	555	3,087
Operating margin %	5.1%	-13.0%	-6.0%	1.4%	6.4%
Income (loss) before income taxes	1,272	(6,021)	(4,140)	(731)	1,766
Pre-tax margin %	2.6%	-16.1%	-10.4%	-1.8%	3.7%
Income tax provision (benefit)	670	(2,293)	6,620	161	(662)
Net income (loss)	602	(3,728)	(10,760)	(892)	2,428
(Income) loss attributable to non-controlling interest	(3)	13	(23)	(31)	(51)
Net income (loss) attributable to ETC	\$ 599	\$ (3,715)	\$ (10,783)	\$ (923)	\$ 2,377
Preferred Stock dividends	(493)	(484)	(484)	(484)	(484)
Income (loss) attributable to common and participating shareholders	\$ 106	\$ (4,199)	\$ (11,267)	\$ (1,407)	\$ 1,893
Diluted earnings (loss) per share	\$ 0.01	\$ (0.27)	\$ (0.74)	\$ (0.09)	\$ 0.12
Working capital	\$ 26,536	\$ 6,731	\$ 1,720	\$ 13,242	\$ 18,306
Total long-term debt obligations	21,483	20,621	19,439	17,940	20,893
Total assets	56,192	51,650	44,249	44,538	46,423
Total shareholders' equity	24,326	20,253	9,111	7,976	9,629
Capital expenditures	1,432	1,505	1,244	702	465
Depreciation and amortization	1,803	1,809	1,645	1,360	1,265
Interest expense, net	808	745	920	559	857
EBITDA *	\$ 3,913	\$ (3,431)	\$ (1,428)	\$ 1,301	\$ 4,149

* In addition to disclosing financial results that are determined in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), we also disclose Earnings Before Income Taxes, Depreciation, and Amortization ("EBITDA"). The presentation of a non-U.S. GAAP financial measure such as EBITDA is intended to enhance the usefulness of financial information by providing a measure that management uses internally to evaluate our expenses and operating performance and factors into several of our financial covenant calculations.

A reader may find this item important in evaluating our performance. Management compensates for the limitations of using non-U.S. GAAP financial measures by using them only to supplement our U.S. GAAP results to provide a more complete understanding of the factors and trends affecting our business.

SUPPLEMENTAL INFORMATION

Company Affiliates and Locations

The consolidated financial statements include the accounts of ETC, our 95%-owned subsidiary ETC-PZL, and our formerly 99%-owned subsidiary ETC-Europe, which was officially dissolved on August 15, 2017. ETC does not have any unconsolidated legal entities, “special purpose” entities, or other off balance sheet arrangements other than disclosed in Note 10 – Commitments and Contingencies 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 shareholders. As of February 23, 2018, we had 280 full-time employees, compared to 277 full-time employees as of February 24, 2017, of which 4 were employed in executive positions, 121 were

engineers, engineering designers, or draftspersons, 55 were administrative (sales, sales support, accounting, or general administrative) or clerical personnel, and 100 were engaged principally in production, operations, or field support. A total of 119 employees were stationed at ETC-SH in Southampton, Pennsylvania, a northern suburb of Philadelphia, Pennsylvania.

We are an ISO 9001 certified manufacturer. We are also ISO 13485 certified for our medical devices. We operate in four major locations consisting of manufacturing facilities, product development, and administration. A summary of square footage and current use as of February 23, 2018 is presented below:

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

The NASTAR Center, which is included in the Company’s Southampton, Pennsylvania owned property, includes the following aerospace training and research equipment:

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

Corporate Governance

The Board of Directors is comprised of seven (7) members, five (5) of whom who are considered “independent” directors (not an employee, not affiliated with the Company’s auditors, and not part of an interlocking directorate). Directors are nominated based on their individual qualifications and experience, the overall balance of the Board of Directors’ background and experience, and each individual’s willingness to fulfill their obligations and to contribute appropriately.

The Board of Directors meets four times per year in addition to various Board committee meetings held throughout the year. Standing committees consist of the Audit Committee, the Compensation Committee, and the Nominating and Governance Committee. These committees each have defined charters that address the committees’ purpose, goals, and responsibilities. All committees meet on a scheduled basis. Please refer to the Investors section of our website (www.etcusa.com) for more information on corporate governance.

Reporting Requirements

The Company is not currently required to register with the U.S. Securities and Exchange Commission ("SEC") and therefore is not subject to the reporting requirements of a public company; however, the Company issues periodic press releases, quarterly unaudited interim consolidated financial statements, and an annual report with audited consolidated financial statements.

Interim Consolidated Financial Statements

Interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for fiscal 2018. The results for any interim period are not necessarily indicative of results for the full fiscal year. Certain information and footnote disclosures normally included in audited financial statements have been omitted. As mentioned previously, the Company is not subject to SEC reporting requirements and therefore its quarterly interim consolidated financial statements are not subject to an interim review by Independent Auditors as prescribed by the SEC.

Investor and Shareholder Information Shareholder Inquiries

Questions concerning your account, address changes, consolidation of duplicate accounts, lost certificates, and other related matters should be addressed to ETC's transfer agent:

American Stock Transfer & Trust Company, LLC
6201 15th Avenue
Brooklyn, NY 11219
Toll Free: (800) 937-5449
Telephone: (718) 921-8124
Website: www.astfinancial.com

Stock Exchange Listing

The Common Stock of ETC is traded under the symbol "ETCC" on the electronic Pink Sheets and is listed by the OTC Markets Group, Inc., reporting service for over-the-counter stocks. Stock quotation information is available through stock reporting services on the Internet at www.otcm Markets.com.

Annual Meeting

The Company's Annual Meeting of Shareholders is scheduled for 10:00 a.m. Tuesday, July 17, 2018 and is to be held at Sofitel Philadelphia located at 120 South 17th Street, Philadelphia, PA 19103, USA.

Corporate Data

Environmental Tectonics Corporation,
125 James Way, Southampton, PA 18966.

You can access Company information including press releases, earnings announcements, history, and other information through the Internet by visiting the ETC website at www.etcusa.com.

For further information, contact Mark Prudenti, Chief Financial Officer. Telephone: (215) 355-9100 x1531

Board of Directors

George K. Anderson, M.D., Chairman (2003)
Michael D. Malone, Vice Chairman (2012)
Linda J. Brent, Ed.D. (2010)
Roger Colley (2011)
Robert L. Laurent, Jr. (2014)
H.F. Lenfest, (2003)
Winston E. Scott (2010)

COMMITTEE COMPOSITION

	Audit Committee	Compensation Committee	Nominating and Governance Committee
George K. Anderson, M.D.	-	-	-
Michael D. Malone	Member	Member	-
Linda J. Brent Ed.D	Member	-	Chairperson
Roger Colley	Chairperson	Member	-
H.F. Lenfest	-	-	Member
Winston E. Scott	-	Chairperson	Member

OWNERSHIP TABLE

	Name/Address **	Title	Ownership Percentage
Directors and Executive Officers:	George K. Anderson, M.D.	Chairman of the Board of Directors	*
	Michael D. Malone	Vice Chairman of the Board of Directors	*
	Linda J. Brent, Ed.D.	Director	*
	Roger Colley	Director	*
	H.F. Lenfest c/o The Lenfest Group Five Tower Bridge-Suite 460 300 Barr Harbor Drive West Conshohocken, PA 19428	Director	*** 54.1%
	Winston E. Scott	Director	*
	Robert L. Laurent, Jr.	Chief Executive Officer, President, and Director	1.0%
	Mark Prudenti	Chief Financial Officer and Treasurer	*
	James D. Cashel	Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer	*
	Thomas G. Loughlin	Chief Operating Officer	*
Control Persons:	T. Todd Martin, III 50 Midtown Park East Mobile, AL 36606		11.0%
	3K Limited Partnership		6.9%
	Estate of Pete L. Stephens		6.3%

* less than 1%

** address listed for all persons beneficially owning more than ten percent (10%)

*** the denominator for this ownership percentage calculation includes all participating preferred shares

Information is accurate as of June 26, 2018, the date of issuance of our consolidated financial statements, based on information available to the Company. None of the foregoing Directors and Executive Officers in the last five (5) years has had a legal/disciplinary issue.

NEARLY FIVE DECADES ADVANCING AEROMEDICAL TECHNOLOGY

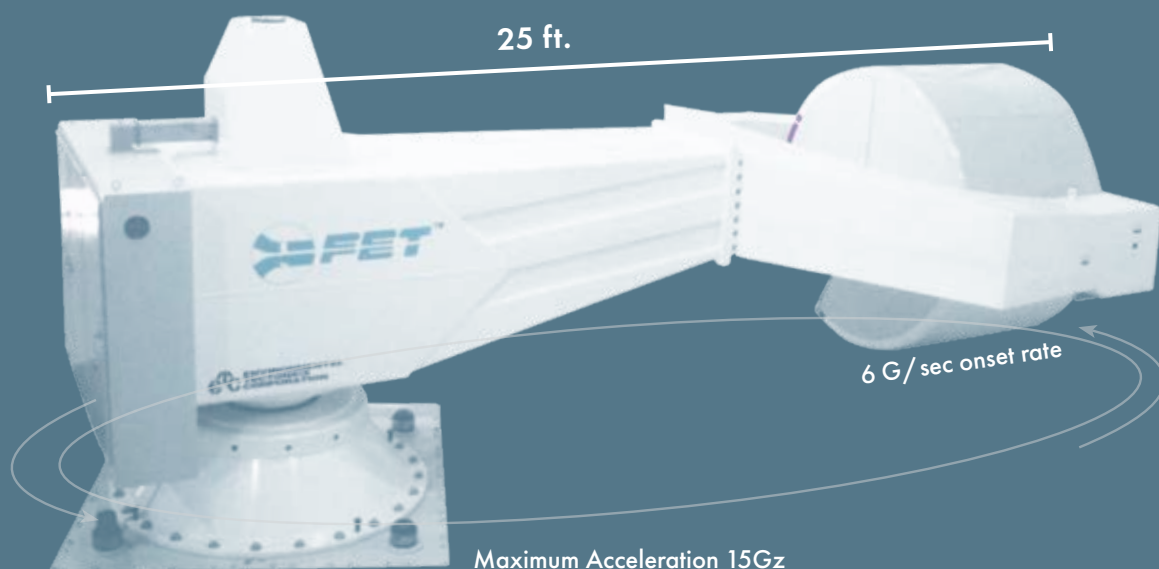
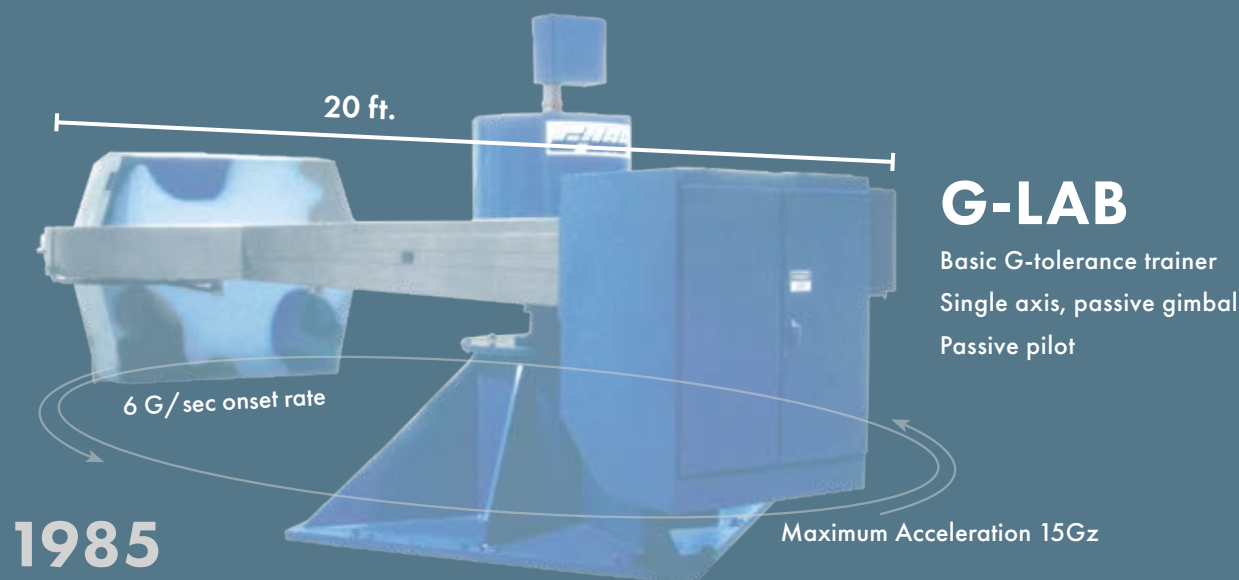
**2018 MARKS THE 100 YEAR ANNIVERSARY
OF AEROSPACE MEDICINE.**

For nearly half of that time, ETC has been at the forefront in the advancement of aeromedical technology, creating training solutions for humans engaged in activities in extreme environments in countries worldwide.

ETC, has been a corporate member of the Aerospace Medical Association ("AsMA") for 45 years and is proud to have been awarded the Aerospace Medical Association's first David M. Clark Award, presented to the corporate member who has made significant contributions to the advancement of Aerospace Medicine. ETC's innovation and dedication to human performance and safety have resulted in leading edge training equipment and courseware for high-G, spatial disorientation, altitude exposure, ejection and night flying operations.

KRAKEN Disorientation Research
and Training Device

THROUGHOUT 33 YEARS AND FOUR PRODUCT GENERATIONS, ETC HAS EVOLVED A PASSIVE G TRAINER INTO THE MOST ADVANCED, DYNAMIC HUMAN CENTRIFUGE WITH CUTTING-EDGE SIMULATION TECHNOLOGY.



ATFS-400-25

Authentic flight training

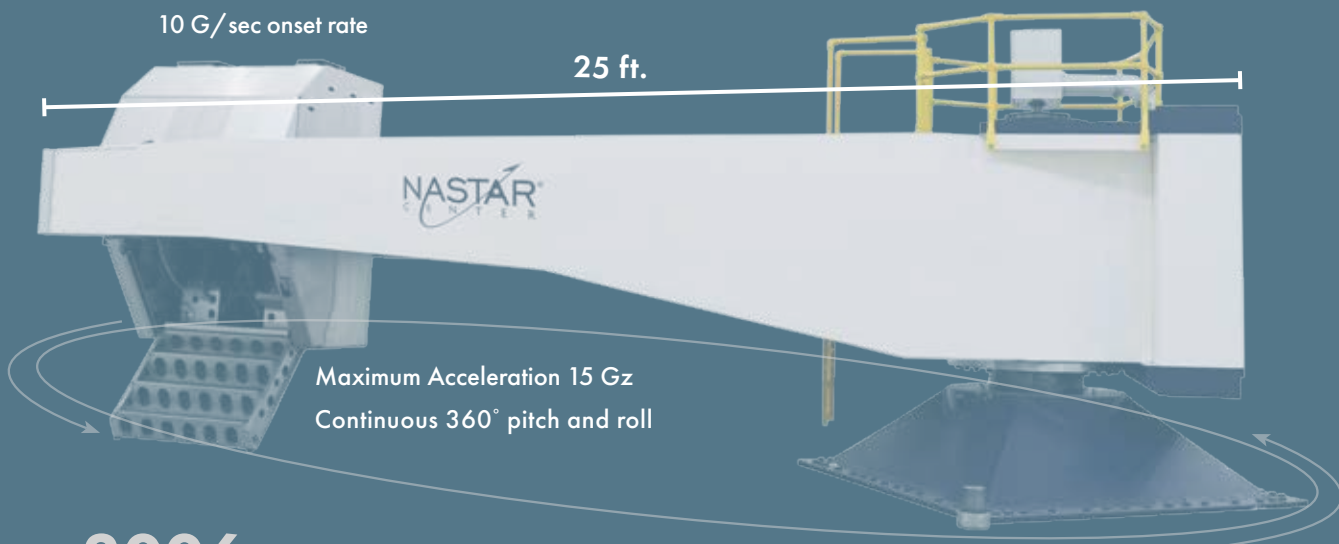
ETC's G-Pointing™ introduced, improving G accuracy

Training and Research Applications

Space training capabilities

First to use ETC's Signature Technology™ to replicate the motion signature of 4th and 5th gen fighters

Interchangeable, interoperable cockpits introduced



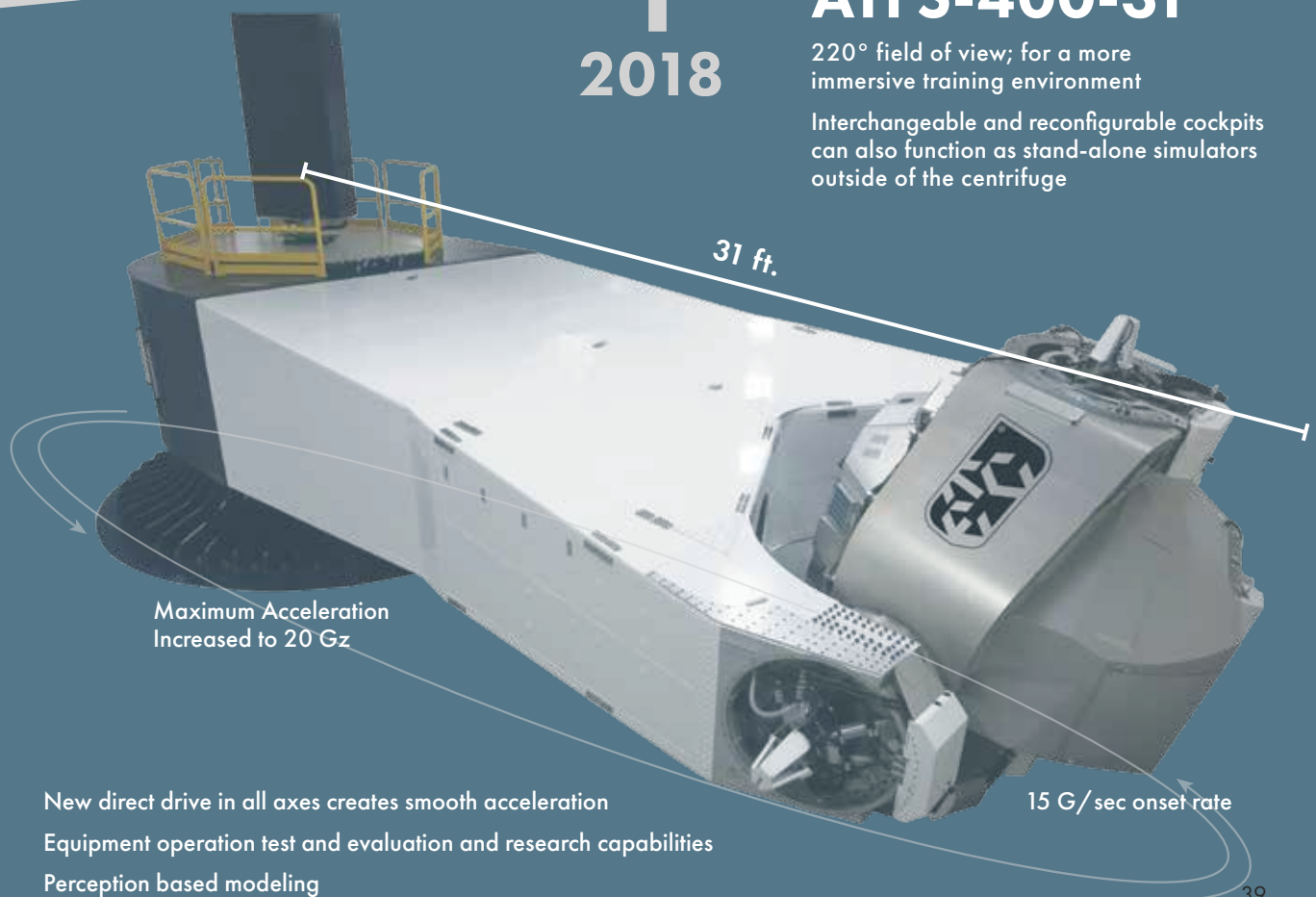
2006

2018

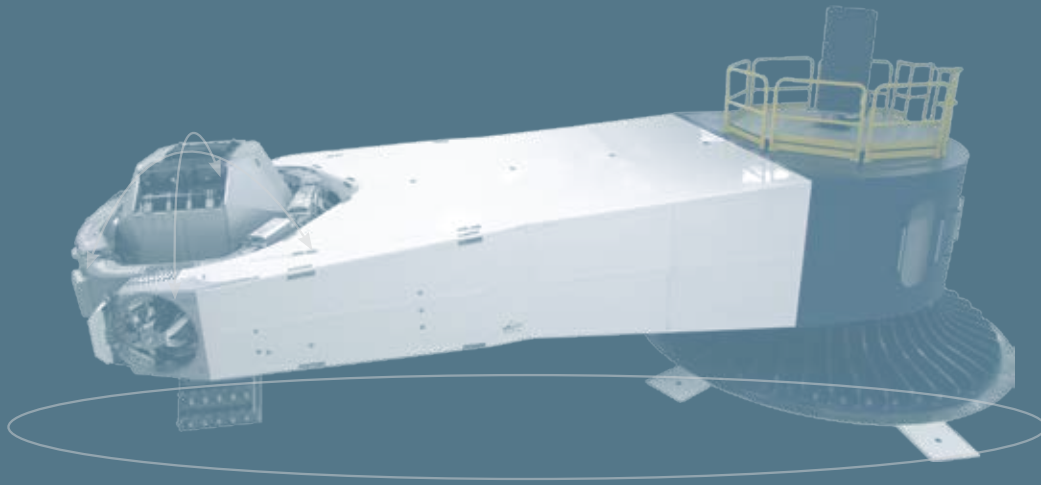
ATFS-400-31

220° field of view; for a more immersive training environment

Interchangeable and reconfigurable cockpits can also function as stand-alone simulators outside of the centrifuge



AEROSPACE SOLUTIONS



The National AeroSpace Training And Research (NASTAR) Center

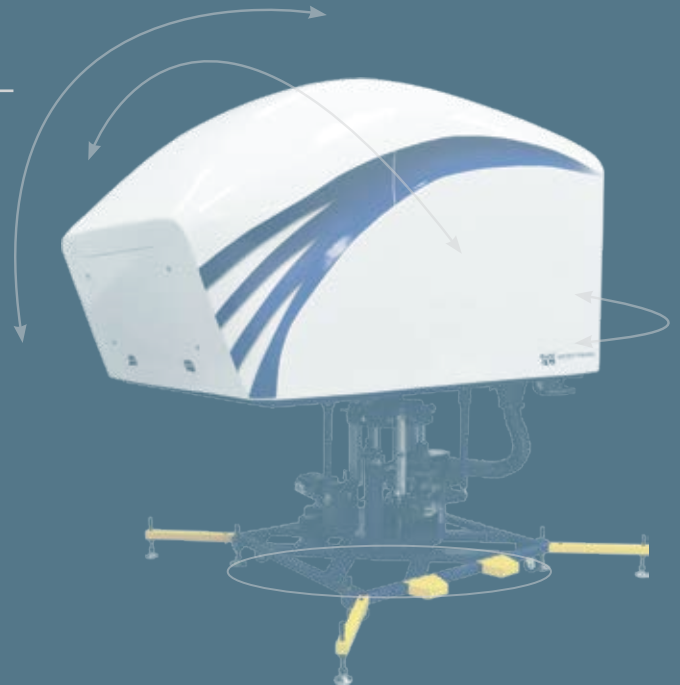
NASTARcenter.com

The NASTAR Center is the premier commercial air and space training, research, and development facility. It combines state-of-the-art flight simulators with physiology-based coursework to optimize human performance in extreme environments.

ETC Aircrew Training Systems

etcAircrewTraining.com

For nearly five decades, ATS has provided clients around the world with simulation systems designed for high-G, SD, SA, aircraft egress, night vision, hypoxic environments, tactical aviation, avionics maintenance, helicopter flight, water survival training, and research applications.



ETC Simulation

etcSimulation.com

ETC Simulation's flagship product is the Advanced Disaster Management Simulator (ADMS), a realistic, virtual emergency management simulation training system. Based in Orlando, Florida, ETC Simulation offers the most thorough training for incident command and disaster management teams.



ETC Integrated Logistics Support

SimulatorSupport.com

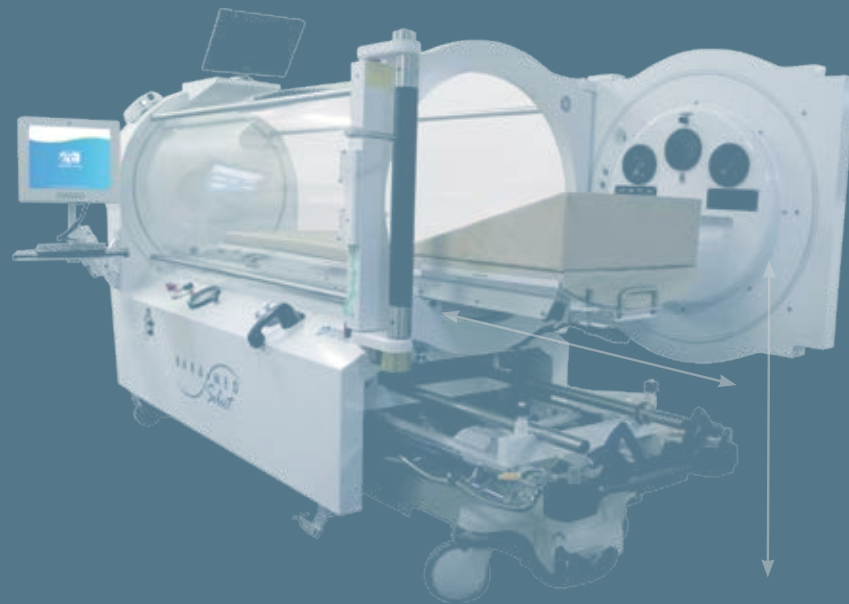
Equipment maintenance, training, and upgrades for domestic and foreign commercial accounts, civilian agencies, and militaries.

COMMERCIAL/ INDUSTRIAL SYSTEMS

ETC Sterilization Systems

etcSterilization.com

Specializing in medium to large (30 to 6000 cubic feet) EO and steam sterilizers. ETC Sterilization Systems serves the pharmaceutical, biotech, medical device, and life sciences markets with unique design solutions for any challenge.



ETC Hyperbaric Chambers

etcHyperbaricChambers.com

Founded in 1971, ETC Hyperbaric Chambers is the world's first provider of computer-driven HBOT chambers. Groundbreaking innovations include the O.S.C.A.R. computerized control system and our exclusive undercarriage gurney storage solution for optimized space.

ETC Service and Support

SterilizerSupport.com

ETC's Service and Support unit operates out of offices worldwide and provides service and support for all sterilizers, environmental systems, and chambers.

ETC Environmental Testing & Simulation Systems

TestingandSimulation.com

ETSS has designed, manufactured, and installed state-of-the-art environmental simulation systems for the automotive-testing and HVAC industries since 1969. Offering a complete line of industry-leading test equipment developed for clients' needs, ETSS offers the most customized equipment available for optimizing R&D, testing, and validation programs.



ENVIRONMENTAL
TECTONICS CORPORATION

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