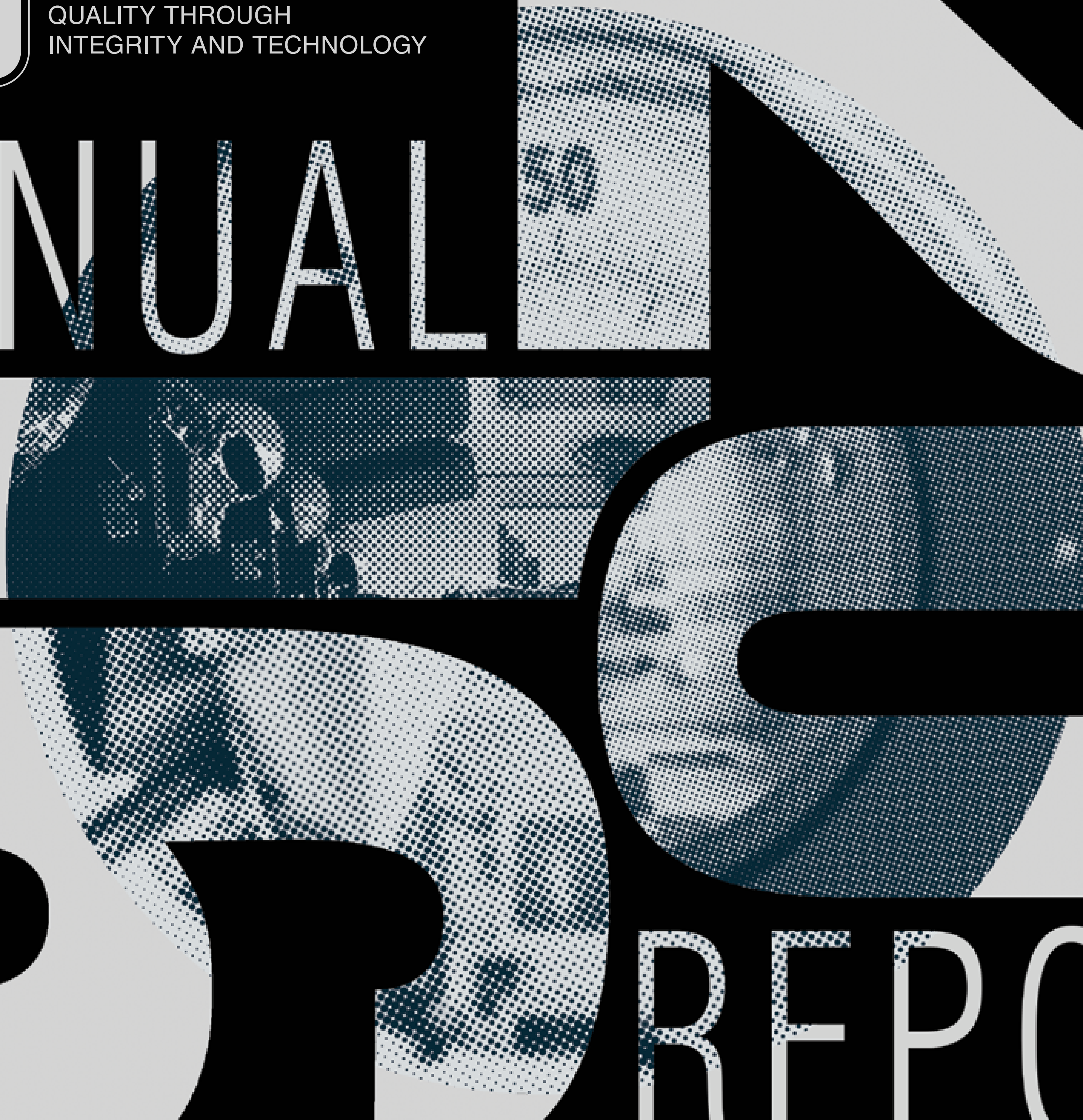
QUALITY THROUGH
INTEGRITY AND TECHNOLOGY

ANNUAL 2016 REPORT



LETTER TO THE SHAREHOLDERS

As a result of strong international orders from the Middle East and Asia for our Aircrew Training Systems products and a significant increase in orders for our monoplace hyperbaric chambers, fiscal 2016 showed another increase in orders booked, up 33% to $52.2 million from $39.3 million in fiscal 2015, which followed a fiscal 2015 increase of 28% over orders of $30.7 million in fiscal 2014. The fiscal 2016 increase was achieved despite a large reduction in sterilizer orders. This overall positive trend is reflected in a 6% increase in net sales in 2016 and a 39% increase in backlog which stands at $45.1 million at fiscal year-end and which bodes well entering fiscal 2017.

Gross profit margins rebounded nicely in fiscal 2016 to 29.2% from 21.0% in the prior year while we continue to create greater operational efficiencies that have allowed us to reduce the expense structure. Gross margins are also benefitting from progress made on three large U.S. Government contracts at Wright-Patterson Air Force Base. A ribbon cutting ceremony is scheduled in June 2016 for the U.S. Navy spatial disorientation device. The U.S. Air Force (USAF) centrifuge is in the latter stages of government testing and a suite of four USAF Research Altitude Chambers are installed and will soon begin testing. General and administrative expenses, excluding non-recurring items, have been reduced by nearly 30% over the last four years. As a result of this reduction, ETC will be in a better position to leverage profitability to the bottom-line as sales increase.

The combination of increased sales, higher margins, and an improving balance sheet resulted in cash flow generated from operations in fiscal 2016 of $6.5 million after two years of cash usage.

BOARD OF DIRECTORS

George K. Anderson, M.D. (2003)
Chairman

Michael D. Malone (2012)
Vice Chairman

Linda J. Brent, Ed.D (2010)

Roger Colley (2011)

Robert L. Laurent, Jr. (2014)

H.F. Lenfest (2003)

Winston E. Scott (2010)

CORPORATE OFFICERS

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

Mark Prudenti
Chief Financial Officer

James D. Cashel
Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer

Thomas G. Loughlin
Chief Operating Officer

ETC GLOBAL LOCATIONS

ETC Corporate Headquarters
125 James Way
Southampton, PA 18966 USA
+1.215.355.9100

ETC Simulation Training Systems
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ETC-PZL Aerospace Industries Sp. z o.o.
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ETC Turkey
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06531 ODTU Ankara, Turkey
(+90) 312.210.17.80

TRANSFER AGENT

American Stock Transfer
New York, New York

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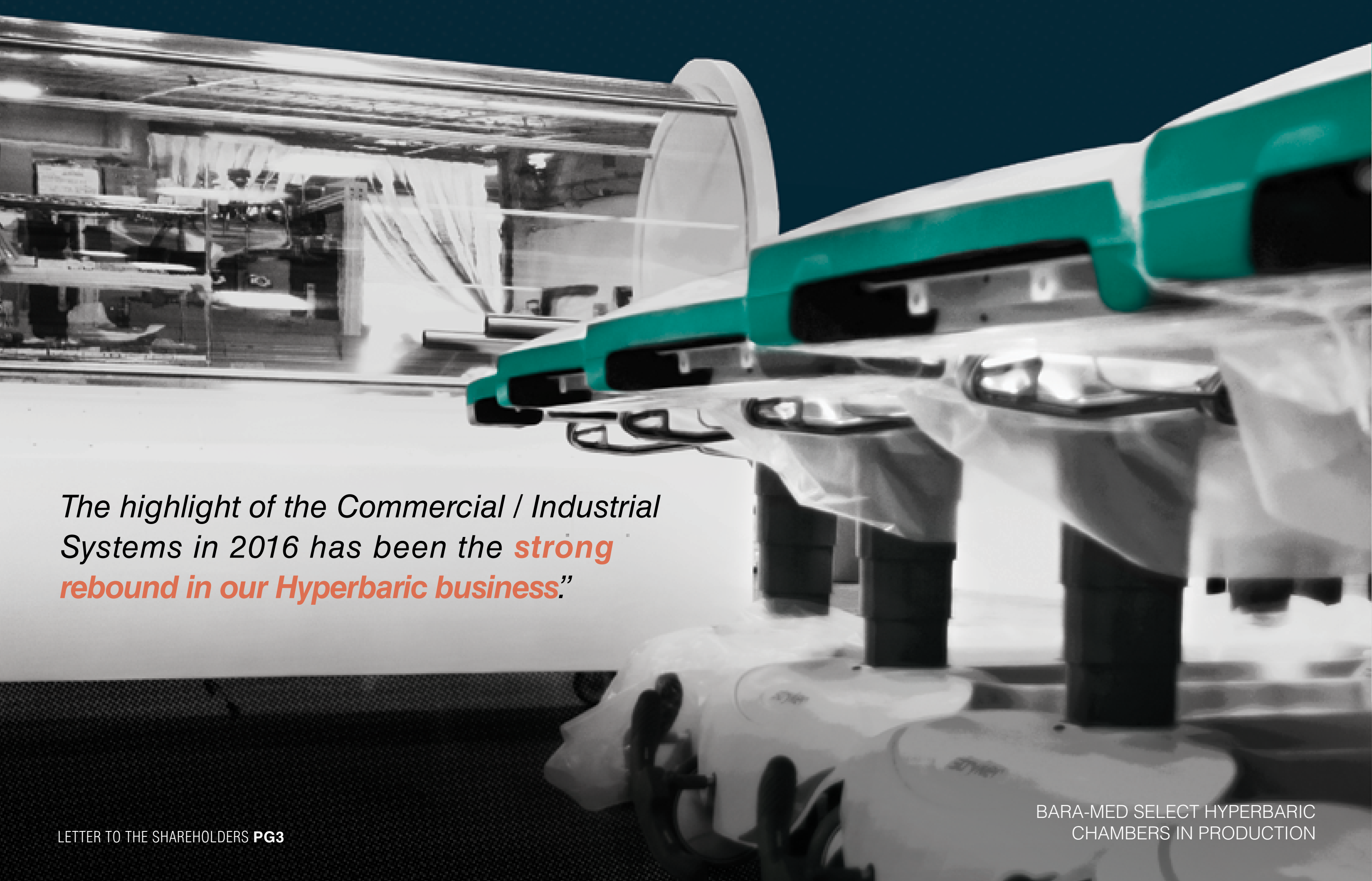
"This overall positive trend is reflected in a ***6% increase in net sales*** *in 2016 and a* ***39% increase in backlog,*** *which stands at $45.1 million at fiscal year-end."*

COMMERCIAL / INDUSTRIAL SYSTEMS

The highlight of the Commercial/Industrial Systems in 2016 has been the strong rebound in our Hyperbaric business, primarily related to increased orders of monoplace hyperbaric chambers, both domestically and internationally. The Hyperbaric business unit experienced increased bookings of 229% during fiscal 2016, following a decline in orders of 58% in the prior year. A number of dynamics are driving this sales increase: customers and industry professionals have embraced ETC's computer technology and advanced features like never before; aging equipment, both ETC's and that of our competitors, is being replaced; and our international distribution channel has been strengthened.

This positive development in the Hyperbaric business unit was more than offset by a 68% reduction in Sterilization System orders, which were affected in part by consolidation occurring in the end user market for sterilizers. Superior computer controls on ETC's ethylene oxide sterilizers, combined with its unique air jacket design, make this equipment extremely safe and reduce customer operating costs compared to competitors' products, making ETC the supplier of choice as the sterilizer market rebounds.

Although orders for our Environmental Testing and Simulation Systems ("ETSS") business unit were down 9% in fiscal 2016, there is a strong pipeline entering fiscal 2017. The ETSS business unit is currently completing testing on a state-of-the-art Compressor Calorimeter for use with volatile refrigerants, R-290 (propane) and R-32. This device will allow the customer to accurately rate compressor cooling capacity and operating efficiency of reciprocating residential and commercial air conditioner compressors for use with these up-and-coming environmentally friendly refrigerants. This project should position ETSS to be a preferred supplier for a wide range of test equipment utilizing these new refrigerants. ETSS also delivered high performance combustion air supply systems (CAS units) to Formula 1 racing teams this year. These systems provide precise temperature, humidity, and pressure control of the combustion air at the engine intake during extreme dynamic conditions. This allows racing teams to more accurately simulate the environmental conditions of an upcoming race location, providing a tuning and performance edge over the competition. These systems are now being marketed to racing teams in Europe.

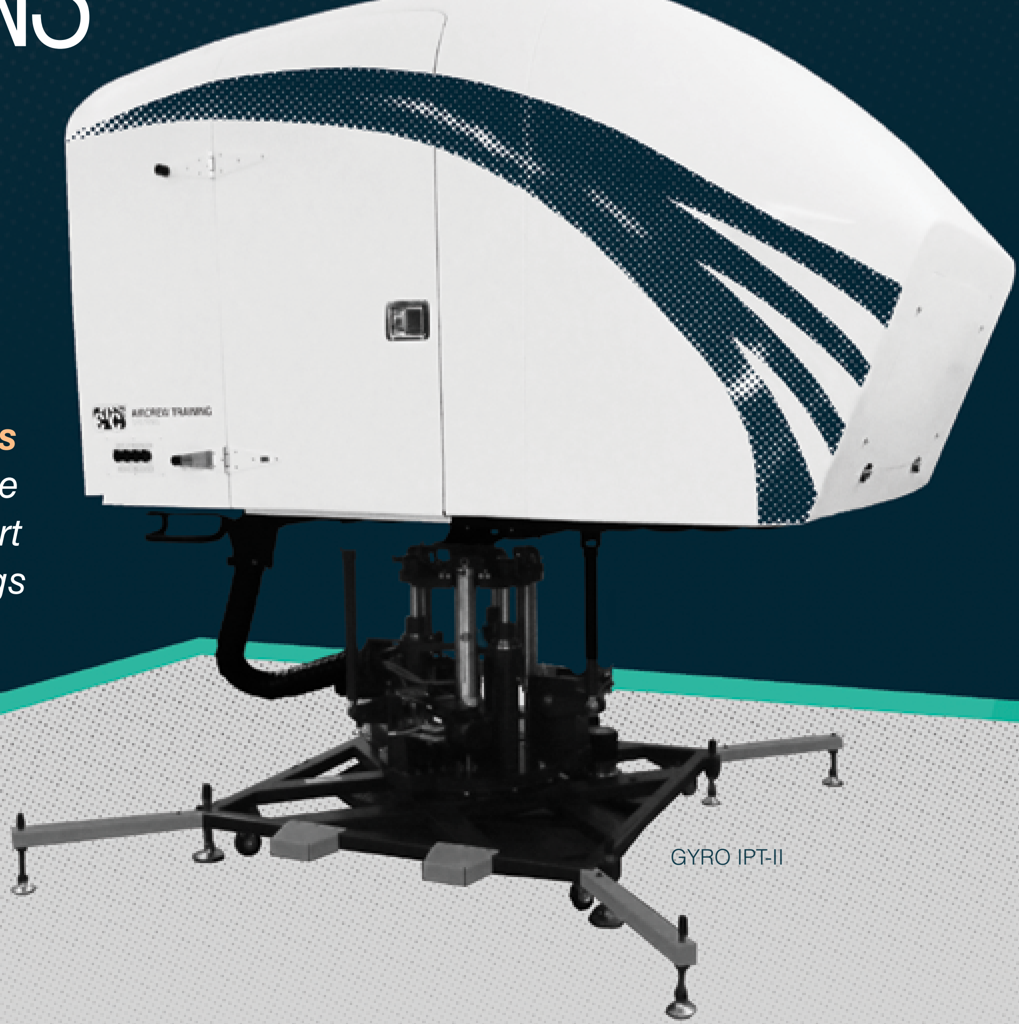


*The highlight of the Commercial / Industrial Systems in 2016 has been the **strong rebound in our Hyperbaric business**."*

BARA-MED SELECT HYPERBARIC CHAMBERS IN PRODUCTION

AEROSPACE SOLUTIONS

*"**Aerospace Solutions net sales increased by 35%** over the prior year, driven in large part by a 57% increase in bookings compared to fiscal 2015."*



GYRO IPT-II

Fiscal 2016 Aerospace Solutions net sales increased by 35% over the prior year. This was driven in large part by orders booked of approximately $42.8 million, an increase of 57% compared to fiscal 2015 (which was up 92% over fiscal 2014). This increase in bookings was due in large part to international contracts for Aircrew Training Systems products in the Middle East and Asia.

Domestically, we successfully fielded five GYRO IPT-II devices (Integrated Physiological Trainers) at five different USAF bases. These devices are ushering in the next generation of spatial disorientation training to the USAF Undergraduate Pilot Training program and save lives by helping pilots recognize when they are becoming disoriented in flight.

We continue to see significant international opportunities for our Aircrew Training Systems products, particularly in the Middle East and Asia, where the international community continues to invest in aircraft, which then requires an investment in aeromedical and other forms of training for pilots to fly safely.

ETC Simulation orders were down 73% in fiscal 2016; however, the business unit has a strong pipeline entering fiscal 2017. ETC Simulation delivered several additional ADMS Training Systems to U.S. DoD bases for Fire and Emergency Response Training Systems, as well as an Airfield Damage Repair Command and Control Training System for the USAF Civil Engineering Center. ETC Simulation also expanded its market with the airport fire truck industry with the delivery of additional ARFF vehicle simulators, and the Fire Hose and Fire Extinguisher Trainers have gained serious interest from various markets. ETC Simulation has continued expanding the capabilities of the ADMS software to remain a world-leader in advanced simulation of emergency response training systems and ARFF vehicle simulators.

Our NASTAR Center bookings were down 16% in fiscal 2016 following a 90% increase in the prior year, primarily due to less military training in fiscal 2016. The NASTAR Center has expanded its commercial aviation training program offerings and now includes a two-seat commercial jet cockpit for use in its centrifuge. The NASTAR Center's Crew Resource Management (CRM) academics course has now been integrated into its Upset Recovery Training program, to utilize full-motion, G-producing flight simulation that requires flight crew to work together as a team to recover an upset aircraft. ETC-PZL Aerospace Industries Sp. z o.o., our 95%-owned subsidiary in Warsaw, Poland, contributed to Aerospace Solutions with a 45% increase in net sales in fiscal 2016, and significant increase in gross profit margins.

With strong international interest in Aircrew Training Systems, a strong pipeline in Simulation and Environmental products, expected continued growth in Hyperbaric chambers, with ETC positioned well when demand returns for sterilizers, and with our expense structure streamlined, ***we are excited about prospects entering fiscal 2017 and beyond.*** *Let me finish by expressing my pride in ETC's team of hard working, dedicated employees and my gratitude to our shareholders for your support. I would also like to express my thanks to our loyal suppliers and customers.*

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

FINANCIAL REVIEW

(in thousands, except per share information)	Fiscal year ended February 26, 2016	Fiscal year ended February 27, 2015
Net sales	$ 39,632	$ 37,340
Gross profit	11,592	7,850
Operating loss	(2,375)	(4,837)
Net loss attributable to Environmental Tectonics Corporation	(10,783)	(3,715)
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed loss per share:		
Common	$ (0.74)	$ (0.28)
Preferred	$ (0.74)	$ (0.28)
Diluted loss per share	$ (0.74)	$ (0.27)
Working capital	$ 1,707	$ 6,731
Total long-term debt obligations	19,439	20,621
Total assets	44,292	51,650
Total shareholders' equity	9,111	20,253
Weighted average common and participating shares:		
Basic	15,248	15,248
Diluted	15,250	15,493

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 26, 2016, which totaled $1,461 thousand, remained unpaid as of June 14, 2016, 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." 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 2016 are references to the fifty-two week period ended February 26, 2016. References to fiscal 2015 are references to the fifty-two week period ended February 27, 2015. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2016.

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 devices; 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 PHOENIX High Performance Human Centrifuge
  - ATFS-400-25 PHOENIX High Performance Human Centrifuge
  - ATFS-300 Flight Simulator
- Cockpit Modules;
- Turnkey Aeromedical Centers;
- GYROLAB GL-6000 GRYPHON High-G 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 General 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;
- Night Vision Training System (“NVTS”);
- Night Vision Goggle Training System (“NVGTS”); 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;
- Suborbital and orbital commercial human spaceflight training;
- Upset prevention and recovery training (“UPRT”);
- Crew resource management (“CRM”) training;
- Aeromedical training;
- Advanced pilot training;
- Basic pilot training;
- Pilot selection;
- Emergency response training; and
- Integrated logistics support.

CIS encompasses the design, manufacture, and sale of:
- Steam and gas (ethylene oxide) sterilizers;
- Environmental testing and simulation devices;
- Hyperbaric (100% oxygen) chambers for one person (monoplace chambers); and
- Parts and service support.

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

We presently have two operating subsidiaries. ETC-PZL Aerospace Industries Sp. z o.o. (“ETC-PZL”), our 95%-owned subsidiary in Warsaw, Poland, manufactures certain simulators and provides software to support products manufactured domestically within our Aerospace segment. Environmental Tectonics Corporation (Europe) Limited (“ETC-Europe”), our 99%-owned subsidiary, functions as a sales office in the United Kingdom.

We utilize both employees and independent representatives to market our products and services. As of February 26, 2016, approximately twenty-seven (27) employees were committed to sales and marketing functions. In addition to our two operating subsidiaries, we have employees stationed in Spain, the Netherlands, Egypt, Turkey, 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 training services and products. Some of our products are customized using our proprietary software based on specifications provided by our customers. Some of our products take more than one year to manufacture and deliver to the customer.

In the 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 state and local governments, fire and emergency training schools, universities, and airports. We also provide integrated logistics support for customers who purchase these products or similar products manufactured by other parties.

In the CIS segment, we sell our sterilizers to pharmaceutical and medical device manufacturers. We sell our environmental testing and simulation devices primarily to commercial automobile 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.

Significant Impacts and Transactions during Fiscal 2016

The following items had a material impact on our financial performance, cash flow, and financial position during fiscal 2016:

Additional work required on several contracts

Although gross profit for fiscal 2016 increased by $3.7 million, or 47.7%, compared to fiscal 2015, additional work required on three contracts is still hindering our financial performance. The additional work, for some of which we are pursuing recoveries, lowered gross profits by $5.1 million in fiscal 2016, a decrease of $1.0 million compared to the $6.1 million effect in fiscal 2015. On April 24, 2014, we reached a settlement agreement on the first of these recoveries that partially offset the effects of the additional work during fiscal 2014. Although we expect to reach additional settlements, they are currently in the early stages of discussion, and under accounting principles generally accepted in the United States of America, there is a requirement that the settlement is probable before recovery is recorded. Further, the Company has completed testing on one of these contracts, is well into the testing phase with another contract, and will shortly be in the testing phase with the third contract, so we expect that any future impacts on our financial performance should decline in comparison to fiscal 2016.

Market for our ethylene oxide sterilizers

Our ethylene oxide sterilizers are sold primarily to pharmaceutical and medical device manufacturers, both of which we believe delayed purchases during fiscal 2016 as a result of consolidations within the industry. Sales of sterilizers decreased by $4.2 million, or 53.0%, during fiscal 2016 compared to fiscal 2015. Sales of our steam sterilizers and ethylene oxide computer controls continue to remain strong and comprise the majority of the $3.3 million Sterilizers sales backlog as of February 26, 2016.

Continued investments to enhance and market worldwide our ATFS, UPRT, and other technologies

During the past two fiscal years, we have spent $2.7 million (including $1.2 million in fiscal 2016) for capital improvements. Most of this investment has been related to the enhancement and promotion of our ATS products and related training and includes engineering costs to improve the technical abilities of our ATFS line of products and enhance upset prevention and recovery training ("UPRT"). This investment is in addition to several full-time employees and consultants whose main responsibilities are to support ATFS and UPRT business development. Going forward, we expect to continue to invest in new capabilities for our ATFS line of products and enhance our UPRT capabilities.

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 (in no 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. 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 liabilities and assets are offset and presented as a single non-current liability.

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 2016 versus Fiscal 2015

Summary Table of Results

(in thousands, except per share information)	Fiscal 2016	Fiscal 2015	Variance ($)	Variance (%)
Net sales:				
Domestic sales	$ 10,128	$ 16,771	$ (6,643)	(39.6)
U.S. Government sales	6,449	7,562	(1,113)	(14.7)
International sales	23,055	13,007	10,048	77.3
Net sales total	39,632	37,340	2,292	6.1
Gross profit	11,592	7,850	3,742	47.7
Gross profit margin %	*29.2%*	*21.0%*	*8.2%*	*39.0%*
Operating expenses:				
Selling and marketing expenses	5,258	4,696	562	12.0
General and administrative expenses	6,906	6,656	250	3.8
Research and development expenses	1,803	1,335	468	35.1
Operating expenses total	13,967	12,687	1,280	10.1
Operating loss	(2,375)	(4,837)	2,462	(50.9)
Operating margin %	*-6.0%*	*-13.0%*	*7.0%*	*-53.8%*
Interest expense, net	920	745	175	23.5
Other expense, net	845	439	406	92.5
Loss before income taxes	(4,140)	(6,021)	1,881	(31.2)
Pre-tax margin %	*-10.4%*	*-16.1%*	*5.7%*	*-35.4%*
Income tax provision (benefit)	6,620	(2,293)	8,913	(388.7)
Net loss	(10,760)	(3,728)	(7,032)	188.6
(Income) loss attributable to non-controlling interest	(23)	13	(36)	(276.9)
Net loss attributable to ETC	**$ (10,783)**	**$ (3,715)**	**$ (7,068)**	**190.3**
Per share information:				
Basic earnings (loss) per common and participating share:				
Distributed earnings per share:				
Common	$ -	$ -	$ -	
Preferred	$ 0.08	$ 0.08	$ -	0.0
Undistributed loss per share:				
Common	$ (0.74)	$ (0.28)	$ (0.46)	164.3
Preferred	$ (0.74)	$ (0.28)	$ (0.46)	164.3
Diluted loss per share	**$ (0.74)**	**$ (0.27)**	**$ (0.47)**	**174.1**

Net loss attributable to ETC

Net loss attributable to ETC was $10.8 million, or $0.74 diluted loss per share, in fiscal 2016, compared to a net loss attributable to ETC of $3.7 million during fiscal 2015, equating to $0.27 diluted loss per share. The $7.1 million variance reflects a decrease in loss before income taxes of $1.8 million due to the combined effect of a $3.7 million increase in gross profit, offset, in part, by a $1.3 million increase in operating expenses, a $0.4 million increase in other expense, and a $0.2 million increase in interest expense. The $1.8 million decrease in loss before income taxes was offset by an $8.9 million variance between the $6.6 million income tax provision recorded in fiscal 2016 compared to the $2.3 million income tax benefit recorded in fiscal 2015. The $8.9 million variance related to income taxes is almost entirely due to the establishment of an $8.2 million valuation allowance for such deferred tax assets that we do not expect to realize primarily due to uncertainties related to our ability to utilize them before they expire. 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. As of February 26, 2016, the Company had approximately $20.3 million of federal net operating loss carryforwards available to offset future income tax liabilities, which will begin to expire in 2025.

Net sales

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

	Fiscal 2016				Fiscal 2015			
	Domestic	**U.S. Gov't**	**International**	**Total**	**Domestic**	**U.S. Gov't**	**International**	**Total**
Aerospace Solutions								
ATS (including Chambers)	$ 376	$ 4,850	$ 17,994	$ 23,220	$ 412	$ 7,039	$ 9,174	$ 16,625
Simulation (ADMS)	828	1,574	1,351	3,753	1,485	511	1,539	3,535
ETC-PZL and other	214	-	2,550	2,764	185	-	1,756	1,941
Subtotal	1,418	6,424	21,895	29,737	2,082	7,550	12,469	22,101
Commercial/Industrial Systems								
Sterilizers	3,645	-	44	3,689	7,805	-	48	7,853
Environmental	2,231	25	-	2,256	4,062	12	43	4,117
Hyperbaric	1,341	-	1,038	2,379	936	-	447	1,383
Service and Spares	1,493	-	78	1,571	1,886	-	-	1,886
Subtotal	8,710	25	1,160	9,895	14,689	12	538	15,239
Net sales total	**$ 10,128**	**$ 6,449**	**$ 23,055**	**$ 39,632**	**$ 16,771**	**$ 7,562**	**$ 13,007**	**$ 37,340**

Net sales for fiscal 2016 were $39.6 million, an increase of $2.3 million, or 6.1%, from fiscal 2015. The increase reflects increased sales related to ATS products including Chambers and ETC-PZL and other sales within our Aerospace segment, to International customers; increased sales of our ADMS line of products to the U.S. Government; and overall increased sales of monoplace chambers, offset, in part, by decreased sales of Sterilization Systems, Environmental Testing and Simulation Systems, and our ADMS line of products to Domestic customers, as well as decreased sales related to ATS products, including Chambers within our Aerospace segment, to the U.S. Government. Given the current progress made on U.S. Government contracts in the Company's sales backlog, coupled with significant fiscal 2016 International bookings, the Company anticipates that the concentration of sales to the U.S. Government will decrease in fiscal 2017 as International sales increase.

In fiscal 2016, 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 $13.3 million, represented 33.5% of total net sales. In fiscal 2015, one customer, a U.S. defense agency in the Aerospace segment, represented 10.0% or more of total net sales, and sales to this customer, totaling $7.1 million, represented 19.0% of total net sales. Within the Company's February 26, 2016 sales backlog of $45.1 million for work to be performed and revenue to be recognized under written agreements after such date, one contract with an International customer represented at least 10% of the total sales backlog and constituted $29.1 million, or 64.6%, of the total sales backlog. ATS backlog was $33.2 million, or 73.7%, 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 2016 were $10.1 million, a decrease of $6.6 million, or 39.6%, compared to fiscal 2015, and represented 25.6% of total net sales compared to 44.9% in fiscal 2015. The decrease in Domestic sales is primarily a result of a $4.2 million, or 53.3%, decrease in sales of Sterilization Systems, a $1.8 million, or 45.1%, decrease in sales of Environmental Testing and Simulation Systems, and a $0.7 million, or 44.2%, decrease in sales of our ADMS line of products.

U.S. Government sales

U.S. Government sales in fiscal 2016 were $6.5 million, a decrease of $1.1 million, or 14.7%, from fiscal 2015, primarily as a result of our U.S. Government contracts entering into, nearing the end of, or completing the testing phase. The $1.1 million decrease was comprised of a $2.2 million decrease in sales related to ATS products, including Chambers, offset, in part, by a $1.1 million increase in sales of our ADMS line of products. U.S. Government sales represented 16.3% of total net sales in fiscal 2016 compared to 20.3% in fiscal 2015. Given the current progress made on U.S. Government contracts in the Company's backlog, coupled with a high concentration of International bookings during fiscal 2016, the Company anticipates that the concentration of sales to the U.S. Government will decrease in fiscal 2017 as International sales increase.

International sales

International sales in fiscal 2016, including those of the Company's foreign subsidiaries, were $23.0 million, an increase of $10.0 million, or 77.3%, from fiscal 2015. The increase in International sales is primarily a result of an $8.8 million, or 96.1%, increase in sales related to ATS products, including Chambers, and a $0.8 million, or 45.2%, increase in ETC-PZL and other sales within our Aerospace segment, and a $0.6 million, or 132.2%, increase in sales of monoplace chambers. In aggregate, International sales represented 58.1% of the Company's total net sales in fiscal 2016 compared to 34.8% in fiscal 2015. In fiscal 2016, International sales totaling at least $500 thousand were made to customers in seven (7) different countries; in fiscal 2015, International sales totaling at least $500 thousand were made to customers in ten (10) different countries.

Segment sales

Aerospace sales were $29.7 million in fiscal 2016, an increase of $7.6 million, or 34.6%, from sales of $22.1 million in fiscal 2015. This increase was primarily due to increased ATS sales within our Aerospace segment to International customers. Sales of Aerospace products accounted for 75.0% of our total net sales in fiscal 2016 versus 59.2% in fiscal 2015. Sales in our CIS segment decreased $5.3 million, or 35.1%, and constituted 25.0% of our total net sales in fiscal 2016 compared to 40.8% in fiscal 2015. The decrease was primarily due to decreased sales of Sterilization Systems to Domestic customers.

Given the Company's sales backlog as of February 26, 2016, it is anticipated that our Aerospace segment will generate the majority of its sales from International contracts, while the majority of sales within our CIS segment will be generated domestically.

Gross profit

Gross profit for fiscal 2016 was $11.6 million compared to $7.9 million in fiscal 2015, an increase of $3.7 million, or 47.7%. The significant increase in gross profit was a combination of both increased net sales and a higher gross profit margin percentage due primarily to the combination of a reduction in the amount of additional work required on several contracts and a higher concentration of net sales from more off-the-shelf type products requiring less initial design and engineering work. Gross profit margin as a percentage of net sales increased to 29.2% in fiscal 2016 compared to 21.0% in fiscal 2015.

Selling and marketing expenses

Selling and marketing expenses for fiscal 2016 of $5.3 million increased by $0.6 million, or 12.0%, compared to fiscal 2015. The increase is the combined result of an increase in commissions expense as the concentration of net sales shifts away from U.S. Government and an increase in International bid and proposal costs, offset, in part, by an on-going effort to reduce non-revenue generating expenses including a reduction in headcount, travel and entertainment, and tradeshow and advertising related expenses. As a percentage of net sales, selling and marketing expenses increased to 13.3% in fiscal 2016 from 12.6% in fiscal 2015 due primarily to a higher concentration of International sales in fiscal 2016.

General and administrative expenses

General and administrative expenses for fiscal 2016 of $6.9 million increased by $0.2 million, or 3.8%, from fiscal 2015. The increase is the combined result of a one-time severance charge and the write-off of a receivable deemed to be uncollectable; offset, in part, by an on-going effort to reduce non-revenue generating expenses including a reduction in headcount and legal expenses. As a percentage of net sales, general and administrative expenses decreased to 17.4% in fiscal 2016 compared to 17.8% in fiscal 2015 due primarily to higher net sales in fiscal 2016.

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 $1.8 million for fiscal 2016 compared to $1.3 million in fiscal 2015, an increase of $0.5 million, or 35.1%. The increase is primarily the result of less research and development employees being assigned to specific contracts; thus, expenses related to these employees were excluded from cost of sales in fiscal 2016. 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 increased to 4.5% in fiscal 2016 compared to 3.6% in fiscal 2015 due primarily to on-going research projects within the Simulation (ADMS), Hyperbaric, and Sterilizers business units.

Operating loss

Operating loss in fiscal 2016 was $2.4 million compared to operating loss in fiscal 2015 of $4.8 million. The $2.4 million decrease is due primarily to a $3.7 million increase in gross profit, resulting from a combination of both increased net sales and a higher gross profit margin percentage, offset, in part, by a $1.3 million increase in operating expenses.

On a segment basis, Aerospace posted an operating loss of $0.7 million for fiscal 2016, a $3.4 million, or 83.6%, improvement compared to an operating loss of $4.1 million in fiscal 2015. CIS posted an operating loss of $0.5 million for fiscal 2016, a $1.0 million, or 195.8%, decrease compared to operating income of $0.5 million in fiscal 2015. These segment operating results were offset, in part, by unallocated corporate expenses.

Interest expense, net

Interest expense, net, for fiscal 2016 was $0.9 million compared to $0.7 million in fiscal 2015, an increase of $0.2 million, or 23.5%, due to the combination of a higher level of bank borrowing throughout fiscal 2016 as a whole compared to fiscal 2015 and an increased interest rate.

Other expense, net

Other expense, net, for fiscal 2016 was $0.8 million compared to $0.4 million in fiscal 2015, an increase of $0.4 million, or 92.5%, due to an increase in letter of credit fees associated with the increase in International sales and an increase in realized foreign currency exchange net losses.

Income taxes

As of February 26, 2016, 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 net operating loss carryforwards will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established an $8.2 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 provision of $6.6 million was recorded in fiscal 2016 compared to an income tax benefit of $2.3 million recorded in fiscal 2015. Effective tax rates were 159.9% and 38.1% for fiscal 2016 and fiscal 2015, respectively. Our effective fiscal 2016 tax rate was significantly higher than fiscal 2015 primarily due to the $7.6 million increase in the aforementioned valuation allowance.

Liquidity and Capital Resources

On June 2, 2014, the Company received a waiver as of the fiscal quarter ended February 28, 2014 for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. The waiver also temporarily replaced the Fixed Charge Coverage Ratio with a required minimum EBITDA, as adjusted by the addition of an EBITDA Addback, on a rolling four quarters basis for the fiscal quarter ended May 30, 2014.

On November 5, 2014, 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) An $11.7 million Committed Line of Credit (the “Committed Line of Credit”) under which the Company covered the majority of its $10.3 million in standby letters of credit, outstanding as of February 26, 2016. Total outstanding standby letters of credit decreased to approximately $9.0 million as of June 14, 2016, the date of issuance of our consolidated financial statements.

(ii) The Committed Line of Credit is and will continue to be collateralized by H.F. Lenfest (“Mr. Lenfest”), a major shareholder and member of the Board of Directors, until such time the Company is in position to pledge its own cash collateral.

(iii) The Company’s existing Line of Credit with PNC Bank (“PNC Line of Credit”) was decreased from $15.5 million to $13.5 million; however, $2.1 million of funds deemed to have been restricted as of August 29, 2014 are now considered unrestricted and are being used as working capital.

(iv) No monthly principal payments were to be due and payable on the existing Term Loan from September 29, 2014 through October 27, 2015. Monthly principal payments were to commence on October 28, 2015 and continue for each succeeding month thereafter. Interest was and shall still be payable on a monthly basis, regardless of whether or not any principal payment is due. Any outstanding principal and accrued interest is due and payable in full on September 28, 2017, which is the current maturity date.

(v) The Company received a waiver, as of the fiscal quarter ended August 29, 2014, for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. Going forward, ETC was to maintain at all times a minimum Consolidated Tangible Net Worth of $20.0 million; further, commencing with the fiscal quarter ending August 28, 2015, ETC was to maintain, as of the end of each fiscal quarter, an Operating Leverage Ratio not greater than 3.00 to 1 and a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio was to increase to 1.10 to 1 on November 27, 2015, and was to remain at that level at all times thereafter.

(vi) Effective as of the date of this amendment, the interest rate on all PNC Lines of Credit, as well as the Term Loan Note, was based on the PNC Daily LIBOR Rate (0.469% as of June 1, 2016, the date of our most current PNC Line of Credit statement) plus a margin of 4.00%.

On July 9, 2015, 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 was extended from October 31, 2015 to June 10, 2016.

(ii) The Company must have maintained a minimum Consolidated Tangible Net Worth of $19.0 million for the fiscal quarter ended May 29, 2015. Going forward, ETC was to maintain at all times a minimum Consolidated Tangible Net Worth of $18.5 million; further, commencing with the fiscal quarter ending May 27, 2016, ETC was to maintain, as of the end of each fiscal quarter, an Operating Leverage Ratio not greater than 3.00 to 1 and a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio was to increase to 1.10 to 1 on August 26, 2016, and was to remain at that level at all times thereafter.

(iii) No monthly principal payments were to be due and payable on the existing Term Loan from September 29, 2014 through May 27, 2016. Monthly principal payments commenced on May 28, 2016, and were to continue for each succeeding month thereafter. Interest was and shall still be payable on a monthly basis, regardless of whether or not any principal payment is due. Any outstanding principal and accrued interest is due and payable in full on September 28, 2017, which is still the current maturity date.

On November 25, 2015, the Company entered into an amendment to the September 28, 2012 Loan Agreement with PNC Bank that provided for, among other things, a modification that temporarily reduced the required value of the collateral under the accompanying Pledge Agreement until such time funds related to a significant open receivable as of November 27, 2015 were collected or February 29, 2016, whichever occurred first, and allowed PNC Bank to transfer $2.0 million of restricted cash to the Company's operating account on December 1, 2015. The significant open receivable as of November 27, 2015 was collected on February 18, 2016 and the $2.0 million of restricted cash was transferred back on February 19, 2016.

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 ending May 26, 2017, ETC must maintain as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio will increase to 1.10 to 1 on August 25, 2017, and will remain at that level at all times thereafter. The waiver also extends the maturity date of the existing PNC Line of Credit to August 10, 2016, during which time the Company expects to enter into a new loan agreement with PNC Bank that is expected to provide for, among other things, terms similar or slightly more favorable than the existing terms provided under the September 28, 2012 Loan Agreement with PNC Bank through December 31, 2017.

As of February 26, 2016, the Company's availability under the PNC Line of Credit was $1.4 million. This reflected cash borrowings of $11.6 million and net outstanding standby letters of credit not covered by the Committed Line of Credit of approximately $0.5 million. As of June 1, 2016, the date of our most current PNC Line of Credit statement, the Company's availability under the PNC Line of Credit was approximately $10.5 million. Working capital was $1.7 million and $6.7 million as of February 26, 2016 and February 27, 2015, respectively. The decrease in working capital was primarily the result of a decrease in costs and estimated earnings in excess of billings on uncompleted long-term contracts and an increase in billings in excess of costs and estimated earning on uncompleted long-term contracts. Under POC revenue recognition, these accounts represent the timing differences of spending on production activities versus the billing of customer payments.

With unused availability under the Company's various current and expected 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 2017 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 2017.

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 2016, despite the significant net loss, and due primarily to the increase in billings in excess of costs and estimated earnings on uncompleted long-term contracts and a decrease in both costs and estimated earnings in excess of billings on uncompleted long-term contracts and accounts receivable, the Company generated $6.5 million of cash from operating activities compared to $0.5 million of cash used in operating activities in fiscal 2015.

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 2016 investing activities used $1.2 million, which consisted primarily of equipment and software enhancements for our ATFS and ADMS technologies and UPRT capabilities, and costs to upgrade existing information technology systems. This is a decrease of $0.3 million from cash used in investing activities in fiscal 2015.

Cash flows from financing activities

During fiscal 2016, the Company's financing activities used $4.8 million of cash, which primarily reflected a $3.6 million increase in restricted cash and $1.2 million increase in borrowings under the PNC Line of Credit. During fiscal 2015, a $2.4 million reduction in restricted cash and $0.9 million of repayments under the Company's various lines of credit, offset in part, by $1.7 million in Term Loan payments, generated $1.6 million of 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 potential acquisition of businesses; 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, 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 2017 bookings, should continue to provide us sufficient funds for fiscal 2017. At this time, however, we cannot accurately predict the effect of certain developments on our anticipated results in fiscal 2018 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 2016 or fiscal 2015 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.

Board of Directors Actions

On May 28, 2014, the Board of Directors unanimously approved a resolution to amend and restate the Company's bylaws to, among other things, amend certain governance provisions to reflect recent changes at the Company (e.g., bifurcation of the roles of Chief Executive Officer and President and no longer being an SEC reporting company), to update the bylaws under the Pennsylvania Business Corporation Law, and to make certain other conforming and technical changes. Some of these amendments relate to the composition of the Board of Directors and its committees, advance notice provisions for shareholder meetings, indemnification, and action by written consent. The Board of Directors also approved an amendment to Section 8(b) of the Statement With Respect to Shares of the Series E Preferred Stock of the Company, clarifying the composition of the Board of Directors. These amendments were also approved by the written consent of the holder of all of the Series E Preferred Stock and holders of Common Stock.

On September 18, 2014, the Company announced that it made a management transition. Mr. Lenfest was named Chairman of the Board of Directors, and Robert L. Laurent, Jr. was named Chief Executive Officer, while continuing as President. The Chairman and Chief Executive Officer positions were formerly held by William F. Mitchell, Sr., who retired and resigned from the Board of Directors effective September 19, 2014. Also as part of the management transition, Mr. Laurent was appointed to the Board of Directors and George K. Anderson, M.D., a member of the Board of Directors since 2003, was appointed as Vice Chairman of the Board of Directors. Subsequently, the Company announced that Dr. Anderson was promoted to Chairman of the Board of Directors and Michael Malone, Vice Admiral, U.S. Navy (Ret.) and member of ETC's Board of Directors since 2012, was elected as Vice Chairman of the Company's Board of Directors, replacing Mr. Lenfest who stepped down for personal reasons. Mr. Lenfest continues to serve on the Company's Board of Directors.

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

Independent Auditor's Report

RSM US LLP

To the Board of Directors
Environmental Tectonics Corporation
Southampton, Pennsylvania

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 26, 2016 and February 27, 2015 and the related consolidated statements of operations and comprehensive (loss) income, changes in shareholders' equity, and cash flows for the years then ended and the related notes to the financial statements (collectively, financial statements).

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these 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 these financial statements based on our audits. We conducted our audits as of and for the years ended February 26, 2016 and February 27, 2015, 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 of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated 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 26, 2016 and February 27, 2015, and the results of its operations and its 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 14, 2016

CONSOLIDATED BALANCE SHEETS

(in thousands, except share information)	February 26, 2016	February 27, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 976	$ 611
Restricted cash	6,162	2,516
Accounts receivable, net	4,222	5,812
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	14,973	17,698
Inventories, net	2,600	3,610
Prepaid expenses and other current assets	1,441	809
Total current assets	30,374	31,056
Property, plant and equipment, at cost, net	13,726	14,174
Capitalized software development costs, net	172	125
Deferred tax assets, non-current, net	-	6,251
Other assets	20	44
Total assets	**$ 44,292**	**$ 51,650**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt obligations	$ 13,870	$ 14,052
Accounts payable, trade	3,224	2,605
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	6,148	3,014
Customer deposits	1,061	1,073
Accrued taxes	410	175
Accrued interest and dividends	1,533	1,044
Other accrued liabilities, current	2,424	2,362
Total current liabilities	28,670	24,325
Long-term debt obligations, less current portion:		
Term loan	5,569	6,569
Total long-term debt obligations, less current portion	5,569	6,569
Deferred tax liabilities, non-current, net	200	-
Other accrued liabilities, non-current	742	503
Total liabilities	35,181	31,397
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 26, 2016 and February 27, 2015	12,127	12,127
Common Stock, $0.05 par value, 50,000,000 shares authorized; 9,185,161 share issued and outstanding as of February 26, 2016 and February 27, 2015	459	459
Additional paid-in capital	9,169	9,506
Accumulated deficit	(12,141)	(1,358)
Accumulated other comprehensive loss	(571)	(526)
Total shareholders' equity before non-controlling interest	9,043	20,208
Non-controlling interest	68	45
Total shareholders' equity	9,111	20,253
Total liabilities and shareholders' equity	**$ 44,292**	**$ 51,650**

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	Fiscal year ended	
(in thousands, except per share information)	February 26, 2016	February 27, 2015
Net sales	$ 39,632	$ 37,340
Cost of goods sold	28,040	29,490
Gross profit	11,592	7,850
Operating expenses:		
Selling and marketing	5,258	4,696
General and administrative	6,906	6,656
Research and development	1,803	1,335
Operating expenses total	13,967	12,687
Operating loss	(2,375)	(4,837)
Other expenses:		
Interest expense, net	920	745
Other expense, net	845	439
Other expenses total	1,765	1,184
Loss before income taxes	(4,140)	(6,021)
Income tax provision (benefit)	6,620	(2,293)
Net loss	(10,760)	(3,728)
(Income) loss attributable to non-controlling interest	(23)	13
Net loss attributable to Environmental Tectonics Corporation	**(10,783)**	**(3,715)**
Foreign currency translation adjustment and unrealized gain on cash flow hedge	(45)	103
Comprehensive loss	$ (10,828)	$ (3,612)
Preferred Stock dividends	(484)	(484)
Loss attributable to common and participating shareholders	$ (11,267)	$ (4,199)
Per share information:		
Basic earnings (loss) per common and participating share:		
Distributed earnings per share:		
Common	$ -	$ -
Preferred	$ 0.08	$ 0.08
Undistributed loss per share:		
Common	$ (0.74)	$ (0.28)
Preferred	$ (0.74)	$ (0.28)
Diluted loss per share	**$ (0.74)**	**$ (0.27)**
Basic weighted average common and participating shares:		
Common weighted average number of shares	9,185	9,185
Participating preferred shares	6,063	6,063
Total basic weighted average common and participating shares	15,248	15,248
Diluted weighted average shares:		
Basic weighted average common and participating shares	15,248	15,248
Dilutive effect of stock warrants and options	2	245
Total diluted weighted average shares	15,250	15,493

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

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands, except share information)	Preferred Stock	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings / (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, February 28, 2014	$ 12,127	9,185,161	$ 459	$ 9,954	$ 2,357	$ (629)	$ 24,326
Less: Prior year non-controlling interest	-	-	-	-	-	-	(58)
Net loss attributable to Environmental Tectonics Corporation	-	-	-	-	(3,715)	-	(3,715)
Foreign currency translation adjustment	-	-	-	-	-	93	93
Unrealized gain on cash flow hedge	-	-	-	-	-	10	10
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	36	-	-	36
Balance before non-controlling interest, February 27, 2015	12,127	9,185,161	459	9,506	(1,358)	(526)	20,208
Non-controlling interest	-	-	-	-	-	-	45
Balance, February 27, 2015	**12,127**	**9,185,161**	**459**	**9,506**	**(1,358)**	**(526)**	**20,253**
Less: Prior year non-controlling interest	-	-	-	-	-	-	(45)
Net loss attributable to Environmental Tectonics Corporation	-	-	-	-	(10,783)	-	(10,783)
Foreign currency translation adjustment	-	-	-	-	-	(45)	(45)
Preferred Stock dividends	-	-	-	(484)	-	-	(484)
Stock compensation expense	-	-	-	147	-	-	147
Balance before non-controlling interest, February 26, 2016	12,127	9,185,161	459	9,169	(12,141)	(571)	9,043
Non-controlling interest	-	-	-	-	-	-	68
Balance, February 26, 2016	**$ 12,127**	**9,185,161**	**$ 459**	**$ 9,169**	**$ (12,141)**	**$ (571)**	**$ 9,111**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Fiscal year ended February 26, 2016	Fiscal year ended February 27, 2015
Cash flows from operating activities:		
Net loss	$ (10,760)	$ (3,728)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,645	1,809
Deferred income taxes	(1,135)	(2,469)
Increase in valuation allowance for deferred tax assets	7,586	59
Increase (decrease) in allowance for doubtful accounts and inventory obsolescence	305	(5)
Accretion of loan origination deferred charge and deferred financing costs	50	38
Stock compensation expense	147	36
Gain on sale of assets	-	(6)
Changes in operating assets and liabilities:		
Accounts receivable	1,382	167
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	2,725	3,939
Inventories	913	35
Prepaid expenses and other assets	(641)	(283)
Accounts payable, trade	619	(164)
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	3,134	92
Customer deposits	(12)	(716)
Accrued taxes	235	51
Accrued interest and dividends	5	8
Other accrued liabilities	301	648
Net cash provided by (used in) operating activities	**6,499**	**(489)**
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(1,079)	(1,497)
Proceeds from sale of assets	-	19
Capitalized software development costs	(165)	(8)
Net cash used in investing activities	**(1,244)**	**(1,486)**
Cash flows from financing activities:		
Borrowings under lines of credit	(1,182)	888
Decrease in restricted cash	(3,646)	2,438
Payments on the Term Loan and of other debt obligations	-	(1,750)
Payments of deferred financing costs	(17)	(18)
Net cash (used in) provided by financing activities	**(4,845)**	**1,558**
Effect of exchange rate changes on cash	(45)	93
Net decrease in cash and cash equivalents	365	(324)
Cash and cash equivalents at beginning of period	611	935
Cash and cash equivalents at end of period	**$ 976**	**$ 611**
Supplemental schedule of cash flow information:		
Interest paid	$ 874	$ 761
Income taxes paid	$ 4	$ 45
Supplemental information on non-cash operating and investing activities:		
Preferred Stock dividends accrued during each respective fiscal year	$ 484	$ 484
Unrealized gain on cash flow hedge	$ -	$ 10

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

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 devices; 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 (loss) income, 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 state and local governments, fire and emergency training schools, universities, and airports. We also provide integrated logistics support 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) environmental testing and simulation devices; 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 pharmaceutical and medical device manufacturers. We sell our environmental testing and simulation devices primarily to commercial automobile 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.

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 2016 are references to the fifty-two week period ended February 26, 2016. References to fiscal 2015 are references to the fifty-two week period ended February 27, 2015. Certain amounts from prior consolidated financial statements have been reclassified to conform to the presentation in fiscal 2016.

Sales Backlog

Below is a breakdown of the Company's February 26, 2016 sales backlog (amounts in thousands, except percentages):

	Business segment			
Geographic area	**Aerospace**	**CIS**	**Total**	**%**
Domestic	$ 320	$ 5,113	$ 5,433	12.1%
U.S. Government	3,170	43	3,213	7.1
International	35,998	415	36,413	80.8
Total	**$ 39,488**	**$ 5,571**	**$ 45,059**	**100.0%**
% of Total	87.6%	12.4%	100.0%	

Our sales backlog as of February 26, 2016, for work to be performed and revenue to be recognized under written agreements after such dates, was $45,059. Of the February 26, 2016 sales backlog, one product line, ATS, represented at least 10% of the total backlog. ATS sales backlog as of February 26, 2016 was $33,191, or 73.7%, of the total sales backlog. Of the February 26, 2016 sales backlog, $29,127, or 64.6%, represents one International contract.

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 Environmental Tectonics Corporation (Europe) Limited ("ETC-Europe"), our 99%-owned subsidiary in the United Kingdom. "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 the 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 $6,162 as of February 26, 2016 compared to $2,516 as of February 27, 2015. 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 $2,155 or 51.1%, of total net accounts receivable as of February 26, 2016. Subsequent to fiscal year end and prior to June 14, 2016, the date of issuance of our consolidated financial statements, 91.6% 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 $15,807 and $15,281 as of February 26, 2016 and February 27, 2015, respectively. The net book value of demonstration equipment was $9,059 and $9,520 as of February 26, 2016 and February 27, 2015, 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 2016 and fiscal 2015, $79 and $981, respectively, of machinery and equipment, all of which was fully depreciated, was retired. In fiscal 2015, $25 of machinery and equipment, with a net book value of $13, was sold. No such sales occurred in fiscal 2016.

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 $118 and $157 in fiscal 2016 and fiscal 2015, respectively. Estimated software amortization, which is based on existing capitalized software, for each of the next five (5) fiscal years is as follows: $94 in fiscal 2017; $56 in fiscal 2018; $22 in fiscal 2019; and $0 in fiscal 2019, fiscal 2020, and beyond.

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 2016 and fiscal 2015, the Company was involved with two (2) and one (1) such grants, respectively. Payments received under these grants are recorded as a reduction of research and development costs. Such payments totaled \$478 in fiscal 2016 and \$872 in fiscal 2015. Research and development expenses, which totaled \$2,281 in fiscal 2016 and \$2,207 in fiscal 2015, 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 \$1,803 for fiscal 2016 compared to \$1,335 for fiscal 2015.

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. 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 liabilities and assets are offset and presented as a single non-current liability.

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 2016 or fiscal 2015.

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 402,000 options granted in fiscal 2016; there were 23,000 options granted in fiscal 2015.

Advertising Costs

The Company expenses advertising costs, which include trade shows, as incurred. Advertising costs were \$288 and \$389 in fiscal 2016 and fiscal 2015, 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 26, 2016 and February 27, 2015, there was $12,127 of cumulative convertible participating Series E Preferred Stock convertible at an exercise price of $2.00 per share, equating to 6,063,321 shares of Common Stock, issued in July 2009.

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. 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. On January 4, 2011, the Company entered into amendments to these warrants to remove a provision in each of the warrants which provided anti-dilution protection in the event the Company issued securities at a price below the exercise price set forth in the warrants.

As of February 26, 2016 and February 27, 2015, there were outstanding options to purchase the Company's Common Stock totaling 637,917 and 254,798 shares at an average price of $1.25 and $3.18 per share, respectively. Due to the conversion price of certain Common Stock options, 637,917 and 113,298 shares were excluded from the calculation of diluted earnings per share as of February 26, 2016 and February 27, 2015, respectively, because the effect of their conversion would be anti-dilutive; further, all 143,885 shares of the Company's Common Stock pertaining to the 200,000 warrants issued on February 20, 2009 were excluded from the calculation of diluted earnings per share as of February 26, 2016 because the effect of their conversion would also be anti-dilutive.

Recent Accounting Pronouncements

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 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. As amended by ASU 2015-14 in August 2015, ASU 2014-09 will be effective for our fiscal 2019, which will begin on February 24, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. We anticipate this standard will have a material impact, and we are currently evaluating the impact this standard will have on our consolidated financial statements.

In April 2015, as part of its initiative to reduce complexity in accounting standards, the FASB issued ASU No. 2015-03, Interest–Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs, however, are not affected. Given the absence of authoritative guidance within ASU No. 2015-03 for debt issuance costs related to line of credit arrangements, it was amended by ASU 2015-15 in August 2015 to allow an entity to defer and present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line of credit arrangement, regardless of whether there are any outstanding borrowings on the line of credit arrangement. ASU 2015-03 will be effective for our fiscal 2017, which began on February 27, 2016. We do not expect it to have a significant impact on our consolidated financial statements.

In November 2015, as part of its initiative to reduce complexity in accounting standards and align the presentation of deferred income tax assets and liabilities with IFRS, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes, which requires that deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount remains unaffected. We have chosen to early adopt ASU No. 2015-17 and have applied the amendments within this update retrospectively to all periods presented within the accompanying consolidated financial statements.

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.

2. Accounts Receivable

The components of accounts receivable are as follows:

	February 26, 2016	February 27, 2015
U.S. Commercial ("Domestic")	$ 1,553	$ 1,677
U.S. Government	637	1,627
International	2,635	2,903
	4,825	6,207
Less: allowance for doubtful accounts	(603)	(395)
Accounts receivable, net	**$ 4,222**	**$ 5,812**

3. Costs and Estimated Earnings on Uncompleted Contracts

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

	February 26, 2016	February 27, 2015
Cost incurred on uncompleted long-term contracts	$ 123,952	$ 135,158
Estimated earnings	32,253	56,173
	156,205	191,331
Less: billings to date	(147,380)	(176,647)
	$ 8,825	**$ 14,684**

Included in accompanying balance sheets under the following captions:

	February 26, 2016	February 27, 2015
Costs and estimated earnings in excess of billings on uncompleted long-term contracts	$ 14,973	$ 17,698
Billings in excess of costs and estimated earnings on uncompleted long-term contracts	(6,148)	(3,014)
	$ 8,825	**$ 14,684**

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 2016 and fiscal 2015.

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:

	February 26, 2016	February 27, 2015
Raw materials	$ 132	$ 160
Work in process	2,372	3,315
Finished goods	96	135
Inventories, net	**$ 2,600**	**$ 3,610**

Inventory is presented net of an allowance for obsolescence of $311 (raw material $54 and work in process $257), and $214 (raw material $55 and work in process $159) as of February 26, 2016 and February 27, 2015, 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

	February 26, 2016	February 27, 2015
Land	$ 100	$ 100
Buildings and building additions	3,851	3,851
Machinery and equipment	10,835	10,833
Demonstration equipment	15,807	15,281
Office furniture and equipment	1,324	1,323
Building improvements	3,144	3,126
Construction in process	1,020	567
	36,081	35,081
Less: accumulated depreciation	(22,355)	(20,907)
Property, plant, and equipment, at cost, net	**$ 13,726**	**$ 14,174**

Depreciation expenses for fiscal 2016 and fiscal 2015 were $1,527 and $1,652, respectively.

As of both February 26, 2016 and February 27, 2015, 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 26, 2016 and February 27, 2015, no interest has been accrued for under the Lenfest Pledge.

(iii) The PNC Line of Credit is no longer guaranteed by Mr. Lenfest. Instead, the PNC Line of Credit is 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 shareholders 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 will be available for working capital and other general business purposes, and for issuances of letters of credit. Amounts borrowed under the PNC Line of Credit may be borrowed, repaid, and re-borrowed from time to time until August 10, 2016, the extended maturity date based upon the waiver that the Company received on June 10, 2016; see "New Loan Agreement with PNC Bank" below for details. The Company's obligation to repay the advances under the PNC 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 PNC Line of Credit. As of February 26, 2016, the Company's availability under the PNC Line of Credit was $1,345. This reflected cash borrowing under the PNC Line of Credit of $11,620 and outstanding standby letters of credit of approximately $535. As of June 1, 2016, the date of our most current PNC Line of Credit statement, the Company's availability under the PNC Line of Credit was approximately $10,510. 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; however, a subsequent amendment to the September 28, 2012 Loan Agreement requires Mr. Lenfest to collateralize the Term Loan until it is paid in full (September 28, 2017 is the current maturity date) or the Company's Operating Leverage Ratio using all Senior Funded Debt in place of Adjusted Senior Funded Debt is less than 3.00 to 1, whichever occurs first. Adjusted Senior Funded Debt is defined as the sum of Senior Funded Debt minus the then outstanding principal amount of the Term Loan, and will be used for calculating Operating Leverage Ratio while the collateral is in place. The Company's obligation to repay the principal on the Term Loan, including interest, on a monthly basis is set forth in a Term Loan Note (the "Term Loan Note").

As security for repayment of the Line of Credit Note and the Term Loan Note, as noted above, 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, 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 "New Loan Agreement with PNC Bank" 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 is scheduled to expire on September 28, 2017. The notional amount of $5,000 will decrease ratably over the duration of the interest rate swap agreement. The interest rate swap effectively fixes our LIBOR interest rate on the notional amount at a rate of 0.74% in excess of the margin. We have recorded an unrealized gain of $10 in fiscal 2015 related to the fair value of our interest rate swap, with the corresponding entry to other accrued liabilities, non-current. No such unrealized gain was recorded in fiscal 2016. We have designated our current interest rate swap as a cash flow hedge instrument. As of February 26, 2016, we have determined the hedge to be effective. 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 26, 2016 and February 27, 2015. Following the execution of the Preferred Stock Repurchase and Financial Restructuring Agreement, and as approved by the Company's Common Stock shareholders 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 2015 Amendments to the September 28, 2012 Loan Agreement

On June 2, 2014, the Company received a waiver as of the fiscal quarter ended February 28, 2014 for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. The waiver also temporarily replaced the Fixed Charge Coverage Ratio with a required minimum EBITDA, as adjusted by the addition of an EBITDA Addback, on a rolling four quarters basis for the fiscal quarter ended May 30, 2014.

On November 5, 2014, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the following:

(i) An $11,700 Committed Line of Credit (the Committed Line of Credit") under which the Company covered the majority of its $10,340 in standby letters of credit outstanding as of February 26, 2016. Total outstanding standby letters of credit decreased to approximately $8,983 as of June 14, 2016, the date of issuance of our consolidated financial statements.

(ii) The Committed Line of Credit is and will continue to be collateralized by Mr. Lenfest until such time the Company is in position to pledge its own cash collateral.

(iii) The PNC Line of Credit was decreased from $15,500 to $13,500; however, $2,110 of funds deemed to have been restricted as of August 29, 2014 is now considered unrestricted and is being used as working capital.

(iv) No monthly principal payments were to be due and payable on the existing Term Loan from September 29, 2014 through October 27, 2015. Monthly principal payments were to commence on October 28, 2015, and continue for each succeeding month thereafter. Interest was and shall still be payable on a monthly basis, regardless of whether or not any principal payment is due. Any outstanding principal and accrued interest is due and payable in full on September 28, 2017, which is the current maturity date.

(v) The Company received a waiver as of the fiscal quarter ended August 29, 2014 for exceeding the permitted maximum Operating Leverage Ratio and for failing to exceed the permitted minimum Fixed Charge Coverage Ratio. Going forward, ETC was to maintain at all times a minimum Consolidated Tangible Net Worth of $20,000; further, commencing with the fiscal quarter ending August 28, 2015, ETC was to maintain, as of the end of each fiscal quarter, an Operating Leverage Ratio not greater than 3.00 to 1 and a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio was to increase to 1.10 to 1 on November 27, 2015 and was to remain at that level at all times thereafter.

(vi) Effective as of the date of this amendment, the interest rate on all PNC Lines of Credit, as well as the Term Loan Note, was based on the PNC Daily LIBOR Rate (0.469% as of June 1, 2016, the date of our most current PNC Line of Credit statement) plus a margin of 4.00%.

Fiscal 2016 Amendments to the September 28, 2012 Loan Agreement

On July 9, 2015, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, the following:

(i) The PNC Line of Credit was extended from October 31, 2015 to June 10, 2016.

(ii) The Company must have maintained a minimum Consolidated Tangible Net Worth of $19,000 for the fiscal quarter ended May 29, 2015. Going forward, ETC was to maintain at all times a minimum Consolidated Tangible Net Worth of $18,500; further, commencing with the fiscal quarter ending May 27, 2016, ETC was to maintain, as of the end of each fiscal quarter, an Operating Leverage Ratio not greater than 3.00 to 1 and a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio was to increase to 1.10 to 1 on August 26, 2016 and was to remain at that level at all times thereafter.

(iii) No monthly principal payments were to be due and payable on the existing Term Loan from September 29, 2014 through May 27, 2016. Monthly principal payments commenced on May 28, 2016, and were to continue for each succeeding month thereafter. Interest was and shall still be payable on a monthly basis, regardless of whether or not any principal payment is due. Any outstanding principal and accrued interest is due and payable in full on September 28, 2017, which is still the current maturity date.

On November 25, 2015, the Company entered into an amendment to the September 28, 2012 Loan Agreement that provided for, among other things, a modification that temporarily reduced the required value of the collateral under the accompanying Pledge Agreement until such time funds related to a significant open receivable as of November 27, 2015 were collected or February 29, 2016, whichever occurred first, and allowed PNC Bank to transfer $2,000 of restricted cash to the Company's operating account on December 1, 2015. The significant open receivable as of November 27, 2015 was collected on February 18, 2016 and the $2,000 of restricted cash was transferred back on February 19, 2016.

New Loan Agreement with PNC Bank

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 must maintain as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio will increase to 1.10 to 1 on August 25, 2017, and will remain at that level at all times thereafter. The waiver also extends the maturity date of the existing PNC Line of Credit to August 10, 2016, during which time the Company expects to enter into a new loan agreement with PNC Bank (the "New Loan Agreement") that is expected to provide for, among other things, terms similar or slightly more favorable than the existing terms provided under the September 28, 2012 Loan Agreement with PNC Bank through December 31, 2017.

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 with PNC Bank. 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 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 net losses incurred in fiscal 2016 and fiscal 2015, all $484 of dividends recorded during each fiscal year 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 February 26, 2016.

As of both February 26, 2016 and February 27, 2015, the Series E Preferred Stock totaled $12,127 and was convertible into 6,063,321 shares of the Company's 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 26, 2016, which totaled $1,461, remained unpaid as of June 14, 2016, 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 are exercisable for seven years following issuance at an exercise price of $1.39, which price equaled the average closing price of ETC Common Stock during the 120 days prior to the issuance of the warrant.

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 are exercisable for seven 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.

On January 4, 2011, the Company entered into amendments to each of the warrants issued to Mr. Lenfest pursuant to which Mr. Lenfest agreed to remove a provision in each of the warrants which provided anti-dilution protection in the event the Company issued securities at a price below the exercise price set forth in the warrants.

Export Import Line of Credit Agreement with PNC Bank

On December 19, 2012, the Company entered into an Export Import Loan Agreement through PNC Bank, whereby the Company has an Ex-Im Line of Credit through which it may borrow against eligible export inventory and eligible export accounts receivable up to a maximum of $2,000. The agreement expired on October 31, 2015. Interest on advances under the agreement were based on the PNC Daily LIBOR Rate (0.469% as of June 1, 2016, the date of our most current PNC Line of Credit statement) plus a margin of 4.00%. The agreement included covenants that are generally consistent with the PNC Line of Credit. The amount borrowed under the Ex-Im Line of Credit was $200 as of February 27, 2015.

ETC-PZL Line of Credit Agreement

On December 9, 2015, ETC-PZL entered into a loan agreement with a bank in Warsaw, Poland, whereby ETC-PZL has line of credit ("ETC-PZL Line of Credit") to fund current activity. As of February 26, 2016, availability under the ETC-PZL Line of Credit was approximately $150. Amounts may be borrowed, repaid, and re-borrowed, subject to availability, from time to time until December 9, 2016. As of both February 26, 2016 and February 27, 2015, there were no outstanding borrowings under the ETC-PZL Line of Credit.

Summary of Long-Term Debt Obligations

Long-term debt obligations consist of the following:

	February 26, 2016	February 27, 2015
Credit facility payable to bank	$ 11,620	$ 12,602
Term Loan	7,819	7,819
Borrowed under Ex-Im Line of Credit	-	200
Total long-term debt obligations	19,439	20,621
Less: current portion of long-term debt obligations	(13,870)	(14,052)
Total long-term debt obligations, less current portion	**$ 5,569**	**$ 6,569**

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 2017	$ 13,870
Fiscal 2018	5,569
Fiscal 2019	-
Fiscal 2020	-
Fiscal 2021	-
Total future long-term debt obligations	**$ 19,439**

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. 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 liabilities and assets are offset and presented as a single non-current liability.

As of February 26, 2016, 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 net operating loss carryforwards will not be realized primarily due to uncertainties related to our ability to utilize them before they expire. Accordingly, we have established an $8,203 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 provision of $6,620 was recorded in fiscal 2016 compared to an income tax benefit of $2,293 recorded in fiscal 2015. Our income tax provision (benefit) consists of the following.

	Fiscal year ended	
	February 26, 2016	February 27, 2015
Current tax expense:		
U.S. Federal	$ 28	$ 22
U.S. State	46	9
Foreign	95	86
Total current tax expense	**169**	**117**
Deferred tax expense (benefit):		
U.S. Federal	$ 5,952	$ (2,054)
U.S. State	434	(209)
Foreign	65	(147)
Total deferred tax expense (benefit)	**6,451**	**(2,410)**
Income tax provision (benefit)	**$ 6,620**	**$ (2,293)**

Effective tax rates were 159.9% and 38.1% for fiscal 2016 and fiscal 2015, respectively. Our effective fiscal 2016 tax rate was significantly higher than fiscal 2015 primarily due to the $7,586 increase in the aforementioned valuation allowance.

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 26, 2016, the Company had approximately $20,362 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 2013. ETC-PZL is no longer subject to tax examinations in Poland for tax periods prior to December 31, 2010; ETC-Europe is no longer subject to tax examinations in the United Kingdom for tax periods prior to fiscal 2014. We are, however, subject to examination in various other foreign and state jurisdictions for fiscal years 2006-2016. We believe appropriate provisions for all outstanding tax issues have been made for all jurisdictions and all open years.

As of February 26, 2016, the Company has a net deferred tax liability of $200 compared to a net deferred tax asset of $6,251 as of February 27, 2015. Significant components of our net deferred tax (liability) asset are as follows:

	February 26, 2016	February 27, 2015
Deferred tax assets:		
Net operating loss carryforwards	$ 8,203	$ 7,308
U.S. R&D tax credits	1,322	1,187
U.S. AMT credits	584	584
Foreign	292	334
Vacation accrual	264	215
Inventory reserve	111	75
Receivable reserve	214	138
Other, net	246	198
	11,236	10,039
Valuation allowance	(8,203)	(617)
Total deferred tax assets	**3,033**	**9,422**
Deferred tax liabilities:		
Depreciation	(2,854)	(3,025)
Amortization of capitalized software	(97)	(79)
Foreign	(94)	(48)
APB 23 liability	(188)	(19)
Total deferred tax liabilities	**(3,233)**	**(3,171)**
Total net deferred tax (liability) asset	**$ (200)**	**$ 6,251**

As of February 26, 2016 and February 27, 2015, we have provided for U.S. deferred income taxes and foreign withholding tax in the amount of $187 and $19, respectively, for all undistributed earnings not considered permanently reinvested in our non-U.S. subsidiaries.

As of February 26, 2016, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $43 and penalties of $64. As of February 27, 2015, the amounts accrued for the payment of income tax-related interest and penalties included in the consolidated financial statements were as follows: interest of $27 and penalties of $40. The interest and penalties recorded during both fiscal 2016 and fiscal 2015 primarily related to domestic state tax and foreign tax issues.

As of February 26, 2016 and February 27, 2015, the total amount of unrecognized tax benefits was $604 and $499, respectively, of which $211 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 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. CIS encompasses the design, manufacture, and sale of: (i) steam and gas (ethylene oxide) sterilizers; (ii) environmental testing and simulation devices; 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 (loss) income 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 the Company's 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 2016, 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 $13,264, represented 33.5% of total net sales. In fiscal 2015, one customer, a U.S. defense agency in the Aerospace segment, represented 10.0% or more of total net sales, and sales to this customer, totaling $7,080, represented 19.0% of total net sales.

Included in the segment information for fiscal 2016 and fiscal 2015 are export sales of $23,055 and $13,007, respectively. In fiscal 2016, International sales totaling at least $500 were made to customers in seven (7) different countries; in fiscal 2015, International sales totaling at least $500 were made to customers in ten (10) different countries. Sales to the U.S. Government and its agencies aggregated to $6,449 and $7,562 for fiscal 2016 and fiscal 2015, respectively.

The following segment information reflects the accrual basis of accounting:

	Aerospace	CIS	Corporate	Company Total
Fiscal 2016:				
Net sales	$ 29,737	$ 9,895	$ -	$ 39,632
Interest expense, net	690	230	-	920
Depreciation and amortization	1,144	437	64	1,645
Operating loss	(677)	(458)	(1,240)	(2,375)
Income tax provision	-	-	6,620	6,620
Identifiable assets	30,874	3,866	9,552	44,292
Expenditures for segment assets	1,192	38	14	1,244
Fiscal 2015:				
Net sales	$ 22,101	$ 15,239	$ -	$ 37,340
Interest expense, net	441	304	-	745
Depreciation and amortization	1,263	482	64	1,809
Operating (loss) income	(4,114)	478	(1,201)	(4,837)
Income tax benefit	-	-	(2,293)	(2,293)
Identifiable assets	35,189	5,253	11,208	51,650
Expenditures for segment assets	992	498	15	1,505

Reconciliation to consolidated net loss attributable to Environmental Tectonics Corporation:

	Fiscal 2016	Fiscal 2015
Operating loss	$ (2,375)	$ (4,837)
Interest expense, net	(920)	(745)
Other expense, net	(845)	(439)
Income tax (provision) benefit	(6,620)	2,293
(Income) loss attributable to non-controlling interest	(23)	13
Net loss attributable to Environmental Tectonics Corporation	**$ (10,783)**	**$ (3,715)**

9. Stock Option Plans

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

	Fiscal year ended			
	February 26, 2016		February 27, 2015	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of year	254,798	$ 3.18	354,406	$ 3.34
Granted	402,000	$ 1.25	23,000	$ 2.00
Exercised	-	$ -	-	$ -
Forfeited	(18,881)	$ 1.76	(122,608)	$ 3.41
Outstanding at end of year	637,917	$ 1.25	254,798	$ 3.18
Options exercisable at fiscal year end	195,417		159,465	
Weighted average fair value of options granted during the fiscal year		$ 0.78		$ 0.79

The following information applies to options outstanding as of February 26, 2016:

	Options outstanding			Options exercisable	
Exercise price	Number outstanding as of February, 26 2016	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at February 26, 2016	Weighted average exercise price
$1.25	637,917	7.41	$1.25	195,417	$1.25

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 2016 and fiscal 2015) is no less than the award vesting period and is based on the Company's historical experience. The expected stock price volatility (54.1% and 30.0% for options granted in fiscal 2016 and fiscal 2015, respectively) is based on the Company's historical stock prices. The risk-free interest rate (0.9% for options granted in both fiscal 2016 and fiscal 2015) 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 402,000 options granted in fiscal 2016; there were 23,000 options granted in fiscal 2015.

The cost for stock option compensation was $147 and $36 in fiscal 2016 and fiscal 2015, respectively. The increase in stock option compensation expense was due primarily to the repricing of all shares outstanding as of April 22, 2015, the same day on which all 402,000 options in fiscal 2016 were granted. As of February 26, 2016, there were 28,917 options outstanding under the 1998 Incentive Stock Option Plan, which expired in August 2008.

As of February 26, 2016, 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 26, 2016, there were 601,000 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 26, 2016, there were 390,000 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 28, 2016, are $565 in fiscal 2017; $363 in fiscal 2018; $344 in fiscal 2019; $324 in fiscal 2020; and $302 in fiscal 2021. Total rental expense for all operating leases for fiscal 2016 and fiscal 2015 was $592 and $617, respectively.

Retirement and Consulting Agreement Obligations

Although William F. Mitchell, Sr., who founded the Company in 1969, has retired and resigned from the Board of Directors, effective September 19, 2014, he is currently engaged as a senior technical consultant to the Company. Mr. Mitchell`s consulting engagement is for a period of up to thirty-six (36) months, and during this time, he will be eligible to receive consulting fees comparable to, but less than, his cash compensation as Chief Executive Officer, along with continuing to receive certain benefits.

Separation Agreements

In February 2016, the Company entered into separation agreements with a small number of employees that resulted in a one-time severance charge of $415 being reflected in fiscal 2016 general and administrative expenses. This amount will be paid out on a weekly basis for a period of up to twenty-four (24) months.

Legal Proceedings

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 is 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. Earlier this 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, which included additional counterclaims for Fraudulent Misrepresentation and Fraudulent Inducement based on alleged false representations made by Orbit regarding its certification with the American Society of Mechanical Engineers, was subsequently filed and Orbit has replied to ETC’s Amended Answer. We believe that we have valid defenses to the claims asserted by Orbit and we are contesting the matter vigorously. At this time, we are not able to predict the outcome of the Orbit Litigation.

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 $503 and $486 in fiscal 2016 and fiscal 2015, respectively.

The Company had an Employee Stock Purchase Plan, which was originally adopted by the Board of Directors on November 3, 1987 but was subsequently terminated by the Board of Directors effective January 1, 2013. The Company originally reserved 270,000 shares for issuance under this plan, of which 163,406 shares were still remaining as of the effective termination date of January 1, 2013.

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 both February 26, 2016 and February 27, 2015, we had one interest rate swap contract in place to reduce our exposure to fluctuations in interest rates on our Term Loan. The swap converts 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, and it is scheduled to expire on September 28, 2017. The notional amount of $5,000 will decrease ratably over the duration of the interest rate swap agreement. The interest rate swap effectively fixes our LIBOR interest rate on the notional amount at a rate of 0.74% in excess of the margin. We have recorded an unrealized gain of $10 in fiscal 2015 related to the fair value of our interest rate swap, with the corresponding entry to other accrued liabilities, non-current. No such unrealized gain was recorded in fiscal 2016.

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. In this case, we would still be obligated to pay the variable interest payments underlying the Term Loan. 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 14, 2016, 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 26, 2016.

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 must maintain as of the end of each fiscal quarter a Fixed Charge Coverage Ratio of at least 1.00 to 1. This ratio will increase to 1.10 to 1 on August 25, 2017, and will remain at that level at all times thereafter. The waiver also extends the maturity date of the existing PNC Line of Credit to August 10, 2016, during which time the Company expects to enter into a New Loan Agreement that is expected to provide for, among other things, terms similar or slightly more favorable than the existing terms provided under the September 28, 2012 Loan Agreement with PNC Bank through December 31, 2017. See Note 6 – Long-Term Obligations and Related Equity Arrangements for further details regarding the Company's loan agreements with PNC Bank.

OWNERSHIP TABLE

DIRECTORS AND EXECUTIVE OFFICERS

NAME / ADDRESS**	TITLE	OWNERSHIP PERCENTAGE
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	*
Robert L. Laurent, Jr.	Chief Executive Officer, President, and Director	*
H.F. Lenfest *c/o The Lenfest Group* *Five Tower Bridge, Suite 460* *300 Barr Harbor Drive* *West Conshohocken, PA 19428*	Director	*** 56.0%
Winston E. Scott	Director	*
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

NAME / ADDRESS**	OWNERSHIP PERCENTAGE
William F. Mitchell, Sr. *2355 Fairway Road* *Huntingdon Valley, PA 19006*	14.5%
T. Todd Martin, III *50 Midtown Park East* *Mobile, AL 36606*	11.3%
3K Limited Partnership	7.1%
Pete L. Stephens	6.4%

* 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 February 26, 2016. None of the foregoing Directors and Executive Officers in the last five years has had a legal/disciplinary issue.

FIVE YEAR SUMMARY

(in thousands, except per share information)	Fiscal 2012	Fiscal 2013	Fiscal 2014	Fiscal 2015	Fiscal 2016
Net sales	$ 66,294	$ 62,773	$ 48,274	$ 37,340	$ 39,632
Gross profit	23,531	24,869	14,559	7,850	11,592
Gross profit margin %	*35.5%*	*39.6%*	*30.2%*	*21.0%*	*29.2%*
Operating income (loss)	8,137	9,944	2,461	(4,837)	(2,375)
Operating margin %	*12.3%*	*15.8%*	*5.1%*	*-13.0%*	*-6.0%*
Income (loss) before income taxes	7,488	8,821	1,272	(6,021)	(4,140)
Pre-tax margin %	*11.3%*	*14.1%*	*2.6%*	*-16.1%*	*-10.4%*
Income tax provision (benefit)	2,620	3,859	670	(2,293)	6,620
Net income (loss)	4,868	4,962	602	(3,728)	(10,760)
(Income) loss attributable to non-controlling interest	5	(14)	(3)	13	(23)
Net income (loss) attributable to ETC	4,873	4,948	599	(3,715)	(10,783)
Preferred Stock dividends	(2,208)	(1,511)	(493)	(484)	(484)
Income (loss) attributable to common and participating shareholders	$ 2,665	$ 3,437	$ 106	$ (4,199)	$ (11,267)
Diluted earnings (loss) per share	$ 0.13	$ 0.19	$ 0.01	$ (0.27)	$ (0.74)
Working capital	$ 27,786	$ 25,135	$ 26,536	$ 6,731	$ 1,707
Total long-term debt obligations	16,724	22,185	21,483	20,621	19,439
Total assets	67,786	60,568	56,192	51,650	44,292
Total shareholders' equity	30,825	24,219	24,326	20,253	9,111
Capital expenditures	2,144	1,304	1,432	1,505	1,244
Depreciation and amortization	1,760	1,843	1,803	1,809	1,645
Interest expense, net	734	1,005	808	745	920
EBITDA *	**$ 9,982**	**$ 11,669**	**$ 3,913**	**$ (3,431)**	**$ (1,428)**

* 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.

By utilizing a full-motion, sustained G-producing simulator, our unique and cost-effective ***upset prevention and recovery training program with integrated CRM*** *challenges flight crews to work together to recover the aircraft while under the real physiological stresses incurred during an upset.*

TWO-SEAT COMMERCIAL COCKPIT MODULE
IN THE NASTAR CENTER'S ATFS-400

Corporate Governance

The Board of Directors is comprised of seven (7) members, four (4) 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.

	AUDIT COMMITTEE	COMPENSATION COMMITTEE	NOMINATING AND GOVERNANCE COMMITTEE
George K. Anderson, M.D.	-	-	-
Michael D. Malone	Member	Member	-
Linda J. Brent Ed.D	-	-	Chairperson
Roger Colley	Chairperson	Member	-
H.F. Lenfest	-	-	Member
Winston E. Scott	Member	Chairperson	Member

Company Affiliates and Locations

The consolidated financial statements include the accounts of ETC, our 95%-owned subsidiary ETC-PZL, and our 99%-owned subsidiary ETC-Europe. 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 26, 2016, we had 279 full-time employees, compared to 295 full-time employees as of February 27, 2015, of which 4 were employed in executive positions, 121 were engineers, engineering designers, or draftspersons, 48 were administrative (sales, sales support, accounting, or general administrative) or clerical personnel, and 106 were engaged principally in production, operations, or field support. A total of 124 employees were stationed 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:

Southampton, Pennsylvania
83,800 (approx.) sq. ft | Manufacturing (36,000 sq. ft), NASTAR Center (22,100 sq. ft.), and Corporate Headquarters (25,700 sq. ft.) | Owned | Aerospace & CIS Segment

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

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

Orlando, Florida
8,700 (approx.) sq. ft | Product development and administration | Leased | Aerospace Segment

Warsaw, Poland
28,000 (approx.) sq. ft | Manufacturing, product development and administration | Leased | Aerospace Segment

Ankara, Turkey
5,700 (approx.) sq. ft | Software Development | Leased | Aerospace & CIS Segment

Reporting Requirements

The Company is not currently required to register with the 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 2016. 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.amstock.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.otcmarkets.com.

Annual Meeting

The Company's Annual Meeting of Shareholders is scheduled for 10:00 a.m. on Wednesday, July 13, 2016, to be held at The Fuge located at 780 Falcon Circle, Warminster, PA, 18974, USA.

Corporate Data

Environmental Tectonics Corporation, 125 James Way, Southampton, PA 18966. For further information, contact Mark Prudenti, Chief Financial Officer. Telephone: (215) 355-9100 x1531

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.

COMMERCIAL / INDUSTRIAL SYSTEMS

MULTIPLACE HYPERBARIC CHAMBER IN PRODUCTION

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.

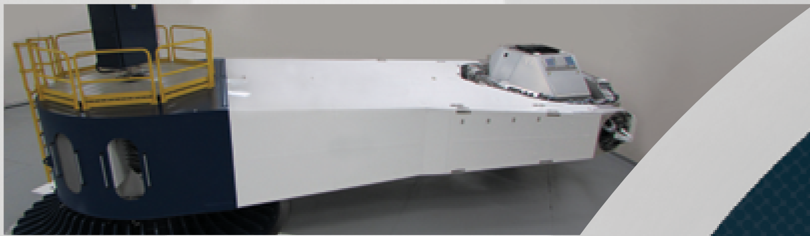
ETC Sterilization Systems | *etcSterilization.com*
Specializing in medium to large (30 to 6000 cubic feet) EO and steam sterilizers, ETC Sterilization Systems serves the pharmaceutical, biotech, medical device and life sciences market with unique design solutions for any challenge.

ETC Service and Support | *SterilizerSupport.com*
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, test and validation programs.

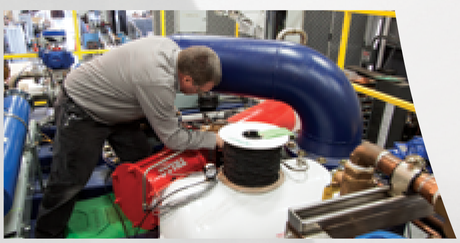
F-15 COCKPIT MODULE IN
THE NASTAR CENTER'S ATFS-400

AEROSPACE SOLUTIONS



ETC Aircrew Training Systems | *etcAircrewTraining.com*
For over four decades, ATS has provided clients in over eighty countries with simulation systems designed for high–G, SD, SA, aircraft egress, night vision, hypoxic environments, tactical aviation, avionics maintenance, helicopter flight and 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, FL, 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.

The National Aerospace Training And Research (NASTAR) Center | *NASTARcenter.com*
The National AeroSpace Training And Research (NASTAR) Center is the premier commercial air and space training, research and educational facility. It combines state-of-the-art flight simulation with physiology-based courseware to optimize human performance in extreme environments.

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