



2008 Financial Statements

TSX.V: AMA





Management's Report

To the Shareholders of
AeroMechanical Services Ltd.

The accompanying consolidated financial statements of AeroMechanical Services Ltd. and all of the information in its annual report are the responsibility of Management and have been approved by the Board of Directors.

Management has prepared the consolidated financial statements in accordance with Canadian generally accepted accounting principles and where alternative accounting methods exist, Management has chosen those that it deems most appropriate.

Financial statements are not precise since they include amounts based on estimates and judgments. Such amounts have been determined on a reasonable basis to ensure the financial statements are presented fairly in all material aspects. Management has prepared the financial information in this annual report and has ensured it is consistent with the consolidated statements.

The Company maintains internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable, and accurate and that the Company's assets are appropriately accounted for and adequately safeguarded.

The AeroMechanical Board of Directors is responsible for ensuring Management fulfills its responsibilities for financial reporting and for reviewing and approving the financial statements. This is carried out principally through the Audit Committee. AeroMechanical's auditors have access to the audit committee.

The Audit Committee of the Board of Directors, consisting of a majority of independent members, meets regularly with management, as well as external auditors, to discuss auditing, internal controls, accounting policy and financial reporting matters. The Committee reviews the financial statements with both management and the independent auditors and reports its finding to the Board of Directors before such statements are approved by the Board.

A handwritten signature in black ink, appearing to be 'W. Tempany', written over a horizontal line.

William Tempany
Chief Executive Officer
April 8, 2009

A handwritten signature in black ink, appearing to be 'T. R. French', written over a horizontal line.

Thomas R. French, CGA
Chief Financial Officer
April 8, 2009

Auditors' Report

To the Shareholders of
AeroMechanical Services Ltd.

We have audited the consolidated balance sheets of AeroMechanical Services Ltd. as at December 31, 2008 and 2007 and the consolidated statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
April 8, 2009



Consolidated Balance Sheets

December 31, 2008 & 2007

	2008	2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 801,404	\$ 1,945,687
Restricted cash (note 8)	250,000	284,500
Accounts receivable	1,163,420	621,726
Prepaid expenses	312,379	349,924
Inventory (note 3)	1,787,811	1,810,483
	4,315,014	5,012,320
Property and equipment (note 4)	262,331	252,826
Rental assets (note 5)	1,347,508	981,414
Intangible asset	34,992	34,992
	\$ 5,959,845	\$ 6,281,552
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,558,594	\$ 1,219,977
Current portion unearned revenue	1,289,466	232,805
Current portion of deferred leasehold inducements (note 6)	2,281	13,687
Current portion of loans payable (note 7)	105,068	52,810
Current portion of obligation under capital lease (note 9)	24,291	23,681
	2,979,700	1,542,960
Unearned revenue	812,608	689,861
Deferred leasehold inducements (note 6)	-	2,281
Loans payable (note 7)	287,443	382,679
Obligation under capital lease (note 9)	31,134	18,150
Warranty	-	13,842
	4,110,885	2,649,773
Shareholders' equity:		
Share capital (note 10)	28,982,059	23,992,644
Warrants (note 10)	1,717,678	493,589
Contributed surplus (note 10)	1,467,350	940,445
Deficit	(30,318,127)	(21,794,899)
	1,848,960	3,631,779
Going concern (note 1)		
Commitments (note 11)		
Subsequent event (note 17)		
Contingencies (note 18)		
	\$ 5,959,845	\$ 6,281,552

See accompanying notes to the consolidated financial statements.

On behalf of the board

Director – William Tempany

Director – Paul Takalo

Consolidated Statements of Loss and Deficit

Years ended December 31, 2008 and 2007

	2008	2007
Revenue:		
afirs UpTime revenue	\$ 2,015,810	\$ 709,191
Product sales revenue	595,161	386,363
Services revenue and interest	566,024	893,850
	<u>3,176,995</u>	<u>1,989,404</u>
Cost of sales	2,159,846	1,351,395
Gross margin	<u>1,017,149</u>	<u>638,009</u>
Expenses:		
Salaries and benefits	5,160,967	4,098,886
General and administrative	1,502,596	1,400,126
Marketing	1,009,963	1,079,353
Research and development	745,308	253,236
Stock based compensation	704,859	525,252
Bad debts	175,334	-
Amortization	174,693	89,038
Interest and bank charges	41,563	24,094
Foreign exchange loss	15,546	36,338
Loss (gain) on asset disposal	9,548	-
	<u>9,540,377</u>	<u>7,506,323</u>
Net loss and comprehensive loss	(8,523,228)	(6,868,314)
Deficit, beginning of year	<u>(21,794,899)</u>	<u>(14,926,585)</u>
Deficit, end of year	<u>\$ (30,318,127)</u>	<u>\$ (21,794,899)</u>
Net loss per share:		
Basic and diluted (note 2 (m))	\$ (0.11)	\$ (0.11)

See accompanying notes to the consolidated financial statement



Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

	2008	2007
Cash provided by (used in):		
Operating activities:		
Net loss	\$ (8,523,228)	\$(6,868,314)
Add items not affecting cash		
Amortization	174,693	89,038
Amortization of rental assets	124,219	82,749
Stock based compensation	704,859	525,252
Loss on asset disposal	9,548	-
Write down of rental assets	75,117	122,400
Warranty expense	(13,842)	1,825
Unrealized foreign exchange loss	30,215	26,232
	(7,418,419)	(6,020,818)
Net change in non-cash working capital balances (note 16)	992,646	(591,873)
	(6,425,773)	(6,612,691)
Financing:		
Issuance of common shares	6,522,641	6,583,616
Repayment on capital leases	(33,756)	(18,444)
Share issue costs	(487,089)	(122,884)
Loan repayment	(42,978)	(37,213)
	5,958,818	6,405,075
Investments:		
Restricted cash	34,500	-
Purchase of property and equipment	(147,898)	(117,220)
Proceeds on disposal of property and equipment	1,500	-
Purchase of rental assets	(565,430)	(417,866)
	(677,328)	(535,086)
Change in cash and cash equivalents	(1,144,283)	(742,702)
Cash and cash equivalents, beginning of year	1,945,687	2,688,389
Cash and cash equivalents, end of year	\$ 801,404	\$ 1,945,687

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 2008 and 2007

AeroMechanical Services Ltd. (the "Company") is a public company incorporated under the Canada Business Corporations Act. The Company is listed on the Toronto Venture Stock Exchange, trading under the symbol "AMA".

The Company is a designer, developer and service provider to the global aerospace industry. The major products are the Automated Flight Information Reporting System ("afirs™"), UpTime™, AeroQ™ FIRST, Fuel MI and Underfloor Stowage Units.

1. Going concern:

These consolidated financial statements have been prepared on the basis that the Company will continue to realize its assets and meet its obligations in the ordinary course of business. At December 31, 2008, the Company had working capital of \$1,335,314 (2007 – \$3,469,360), a deficit of \$30,318,127 (2007 - \$21,794,899), a net loss of \$8,523,228 (2007 - \$6,868,314) and negative cash flow from operations of \$6,425,773 (2007 - \$6,612,692).

The Company's ability to continue as a going concern is dependent upon attaining and sustaining profitable operations and/or obtaining additional financing in order to fund its on-going operations (note 15). The Company's ability to attain profitable operations and positive cash flow in the future is dependent upon various factors including its ability to acquire new customer contracts, the success of management's continued cost containments and general economic conditions.

There is no assurance that the Company will be successful in attaining and sustaining profitable operations and cash flows or raising additional capital to meet its working capital requirements. If the Company is unable to satisfy its working capital requirements from these sources, the Company's ability to continue as a going concern and to achieve its intended business objectives will be adversely affected. These financial statements do not reflect adjustments that would otherwise be necessary if the going concern assumption was not valid such as revaluation to liquidation values and reclassification of balance sheet items.

2. Significant accounting policies:

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles within the framework of the accounting policies as summarized below.

(a) Basis of presentation:

These financial statements consolidate the accounts of the Company and its wholly-owned subsidiaries, Flyht Inc, AeroMechanical Services USA Inc, Flyht Corp. and Flyht India Corp. The latter three subsidiaries were inactive for the reporting period and currently remain inactive. All inter-company transactions have been eliminated upon consolidation.



2. Significant accounting policies (continued):

(b) Measurement uncertainty:

The preparation of the financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from and affect the results reported in these consolidated financial statements as future confirming events occur.

Amounts recorded for stock-based compensation are based on management's estimates of share price volatility and the expected life of the options. By their nature, these estimates are subject to uncertainty and the impact on the consolidated financial statements of future periods could be material.

Amounts recorded for warranty are based on management's estimates of the costs associated with afirs™ UpTime™. Costs of replacing components that are not functioning plus associated costs of travel and staff time have been included in the estimates. By their nature, these estimates are subject to uncertainty and the impact on the consolidated financial statements of future periods could be material.

Amounts recorded for provisions for obsolete inventory are based on management's estimates which consider a variety of factors that may affect the carrying values of inventories. These factors include, but are not limited to, market demand, technology changes and design changes.

(c) Revenue recognition:

The Company's main revenue sources are derived from the rental and sale of afirs™ units and related UpTime™ usage fees and the sale of under floor storage boxes. The Company has developed a new service agreement for agreements executed after January 1, 2008 which pass title of the equipment to the purchaser. This has resulted in two types of revenue streams, leases and sales, in 2008 depending on the type of service agreement. Under the terms of lease type agreements, revenue from afirs™ is derived from an upfront fee which is recorded as unearned revenue and recognized into revenue over the term of the lease agreement. For sales type service agreements, afirs™ fees are deferred as unearned revenue and corresponding expenses are recorded as work in progress. When the system is fully functional and customer acceptance has been obtained, the full deferred amount is recognized in revenue along with the work in progress as cost of sales. Under both forms of agreement, revenue from UpTime™ usage fees is recognized at the end of each month and is based on actual usage during that month.

Revenue from the sale of under floor storage boxes is recognized when the unit is shipped, title is transferred and collection is reasonably assured. Certain customers have prepaid for product services not yet delivered. These amounts are recorded as accounts payable and accrued liabilities on the balance sheet and are recorded as revenue in the period in which such product or services are delivered.

2. Significant accounting policies (continued):

(d) Property and equipment:

Property and equipment is recorded at cost. Amortization is provided annually at rates calculated to write-off assets over their estimated useful lives as follows:

Computers	30% declining balance
Computer Software	12 months straight-line
Equipment	20% declining balance
Leasehold improvements	Term of lease

(e) Rental assets:

Rental assets are recorded at cost and consist of afirs™ units that are in use in customer aircraft, spare units held by airlines and units available for sale or lease. The Company classifies afirs™ units as rental assets until it is determined that the unit is leased or sold. Amortization is provided for units that are leased on a straight line basis over 6 years and for sold units the carrying value is recorded as cost of good sold. For units leased, no amortization is recorded until the unit is leased to a customer.

(f) Future income taxes:

The Company uses the asset and liability method to account for income taxes. Future income taxes are calculated based on temporary differences arising between the financial statement carrying values and tax bases of assets and liabilities. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. Changes in income tax rates that are substantively enacted are reflected in the accumulated future tax balances in the period the change occurs. To the extent that future income taxes are not considered more likely than not to be realized, a valuation allowance is provided.

(g) Foreign currency translation:

Transactions denominated in US dollars have been translated into Canadian dollars at the approximate rate of exchange prevailing at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the year end exchange rates. The operations of the Company's foreign subsidiary are considered self sustaining and therefore its accounts are translated into Canadian dollars under the current method of accounting whereby the assets and liabilities are translated into Canadian dollars using the exchange rate in effect and the consolidated balance sheet date. Revenues and expenses are translated at rates in effect at the time of the transactions. Exchange gains or losses on translation of the Company's net investment in the foreign operation are deferred in the cumulative adjustment component of shareholders' equity. Due to the timing and limited nature of the activities in the subsidiary in the current year, there was no exchange gains or losses on translation of the Company's net investment in the foreign operation. Other exchange gains and losses are included in the consolidated statement of loss and deficit.



2. Significant accounting policies (continued):

(h) Research and development costs:

Research costs are expensed as incurred. Development costs incurred in the design and development of new products are capitalized if certain defined criteria are met. The criteria for capitalization of development costs is met when the product is clearly identified, the technical feasibility has been established, management has indicated its intention to market the product, the future market is identified and adequate resources exist or are expected to be available to complete the project. Upon commercial production or use of the product, deferred costs will be amortized over the estimated useful life of the product. If the criteria are no longer met, costs for a specific product are charged against earnings. To date, all development costs have been expensed as incurred.

(i) Financial instruments:

Financial instruments are initially classified into one of five categories: (i) held-for-trading, (ii) held-to-maturity, (iii) loans and receivables, (iv) available-for-sale, and (v) other financial liabilities. All financial instruments including all derivative instruments are recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities – except those in the held-for-trading and available-for-sale categories – must be determined at amortized cost using the effective interest rate method. Held-for-trading financial instruments are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial instruments are measured at fair value with changes in fair value recognized in comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net earnings.

The Company classifies its cash, cash equivalents and restricted cash as held-for-trading, accounts receivable are classified as loans and receivables. Accounts payable and certain accrued liabilities are classified as other liabilities all of which are measured at amortized cost. Carrying values approximate the fair values due to the short term nature of the instruments.

(j) Inventory:

Inventory is stated at the lower of cost and net realizable value. Management evaluates inventory for obsolescence and charges obsolescence to cost of goods sold. Cost is determined using the first in first out method. Inventories include under floor storage units and general parts which are held pending installation and sale to the customer.

(k) Cash and cash equivalents:

Cash and cash equivalents consists of deposits in banks, redeemable deposits, Guaranteed Investment Certificates, and short-term investments with initial maturities of three months or less.

2. Significant accounting policies (continued):

(l) Warranty:

Provisions for estimated expenses related to product warranties are made at the time products are leased or sold. These estimates are established using historical information relating to the nature, frequency, and average cost of warranty claims.

(m) Per share amounts:

The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. The treasury stock method assumes that proceeds received from the exercise of in-the-money instruments are used to repurchase common shares at the average market price for the period.

The weighted average number of shares outstanding during the year was 81,201,148 (2007 – 64,304,464).

(n) Stock-based compensation:

The Company has a stock option plan for directors, officers, employees and consultants of the Company. The executive stock compensation plan provides for direct grants of stock to the Company's officers. Under the terms of the stock option plan, the options shall be granted at an exercise price not less than market price of the stock on the date of issuance, less a discount up to a percentage permitted by the rules and policies of the stock exchange.

The Company records compensation expense in the consolidated statement of loss and deficit for stock options using the fair value method. Compensation costs are recognized over the vesting period, and are determined using the Black-Scholes option pricing model.

(o) Intangible asset:

Intangible asset is stated at cost and is comprised of a license. The license has an indefinite life. Intangible asset is subject to an annual impairment test or more frequent if events or changes in circumstances indicate that the carrying value may not be recoverable.

(p) Deferred leasehold inducements:

Leasehold inducements are deferred and amortized against rent expense on a straight-line basis over the term of the lease. When a lease interest is abandoned, the balance of the leasehold inducement is offset against the lease buyout cost or rent expense during the applicable period.



2. Significant accounting policies (continued):

(q) Adoption of new accounting standards:

As of January 1, 2008, the Company adopted CICA Handbook Section 1535, "Capital Disclosures", Section 3862, "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments – Presentation". The new standards have been adopted on a prospective basis with no restatement of prior periods. Section 1535 requires additional disclosures regarding the Company's capital management (note 15), while section 3862 addresses financial instruments and the nature, extent and management of risks arising from financial instruments to which the Company may be exposed (note 14). The adoption of Section 3863 had no effect on the presentation of the Company's financial instruments.

The CICA issued new accounting standard Section 3064 "Goodwill and Intangible Assets" which is applicable for fiscal years beginning on or after October 1, 2008. The Company does not expect any significant effect on its financial statements due to the application of this standard.

The Canadian Accounting Standards Board's recently announced that as of January 1, 2011 International Financial Reporting Standards (IFRS) will replace current Canadian GAAP for publicly accountable enterprises. The Company has been carefully evaluating its own implementation plan and assessing the impact the changes will have on the organization. As the final implementation date approaches, the Company will continue to monitor developments.

As of January 1, 2008, the company has adopted newly issued accounting standards for inventories, relating to the method of accounting for inventory and related disclosures. The adoption had no effect on the amounts recorded or presentation contained within the financial statements.

3. Inventory:

	2008	2007
Raw material	\$ 1,374,771	\$ 1,810,483
Work in progress	413,040	-
	<u>\$ 1,787,811</u>	<u>\$ 1,810,483</u>

4. Property and equipment:

2008	Cost	Accumulated amortization	Net book value
Computer	\$ 420,211	\$ 261,702	\$ 158,509
Software	101,088	74,563	26,525
Equipment	144,658	72,065	72,593
Leasehold improvements	79,369	74,665	4,704
	\$ 745,326	\$ 482,995	\$ 262,331
2007			
Computer	\$ 331,950	\$ 197,578	\$ 134,372
Equipment	153,376	57,469	95,907
Leasehold improvements	79,369	56,822	22,547
	\$ 564,695	\$ 311,869	\$ 252,826

Included in computer and equipment are capital leases with a cost of \$98,418 (2007 - \$60,568), accumulated amortization of \$41,065 (2007 - 20,941) and a net book value of \$57,352 (2007 - \$39,627).

5. Rental assets:

2008	Cost	Accumulated amortization	Net book value
Leased assets	\$ 724,871	\$ 248,772	\$ 476,099
Assets available for sale or lease	1,089,926	218,517	871,409
	\$ 1,814,797	\$ 467,289	\$ 1,347,508
2007			
Leased assets	\$ 705,942	\$ 172,246	\$ 533,696
Assets available for sale or lease	591,118	143,400	447,718
	\$ 1,297,060	\$ 315,646	\$ 981,414

In 2008, it was determined that certain rental assets in the amount of \$75,117 (2007 - \$122,400) were obsolete. This obsolescence was recorded in cost of sales.



6. Deferred leasehold inducements:

	2008	2007
Balance, beginning of year	\$ 15,968	\$ 29,655
Amortization	(13,687)	(13,687)
Balance, end of year	2,281	15,968
Less: current portion	(2,281)	(13,687)
	\$ -	\$ 2,281

7. Loans payable:

	2008	2007
The Industrial Research Assistance Program "IRAP" loan is non-interest bearing and is repaid annually, based on 1.11% of gross revenues, commencing October 2005 and is unsecured. The current portion is calculated based on the actual gross revenues in the previous quarter plus the Company's revenue projections for the next nine months.	\$ 307,101	\$ 330,966
The Technology Partnerships Canada "TPC" loan is non-interest bearing and unsecured. The loan is repayable annually, based on 15% of the initial contribution when the Company has achieved more than 10% growth in gross revenues above the previous year's gross revenue and the gross revenue for the year is greater than the base amount. The base amount is defined as the Company's gross revenue in fiscal 2004, which was at \$556,127.	85,410	104,523
	392,511	435,489
Less: current portion	(105,068)	(52,810)
	\$ 287,443	\$ 382,679

8. Bank loan:

Operating demand loan is available to the Company up to a maximum of \$250,000 (2007 – \$284,500). The operating demand loan bears interest at Canadian chartered bank prime plus 1.0%. The operating demand loan and other revolving credit facilities are secured by an assignment of cash collateral in the amount of \$250,000 and a general security agreement including a first ranking security interest in all personal property. The amount of the cash collateral has been disclosed as restricted cash. As at December 31, 2008 and 2007, the facility has not been drawn.

9. Obligations under capital lease:

The Company is party to various capital leases for computer hardware and software that expire in 2011. Future minimum lease payments under the capital leases are as follows:

	2008	2007
2008	\$ -	\$ 29,400
2009	34,263	16,275
2010	22,107	4,003
2011	16,630	-
	73,000	49,678
Less: imputed interest	(17,575)	(7,847)
Less: current portion	(24,291)	(23,681)
	\$ 31,134	\$ 18,150

10. Share capital:

(a) Authorized:

Unlimited numbers of:
Common shares
Classes A, B and C preferred shares, issuable in series

The preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions, and conditions attached to the shares in each series.

(b) Issued and outstanding:

	Number of shares	Value
Common shares:		
Balance December 31, 2006	58,488,823	\$ 17,052,282
Issued for cash	6,519,467	2,929,180
Exercise of employee options	1,259,993	430,966
Contributed surplus from exercise of employee options		290,632
Exercise of warrants	6,452,339	3,223,470
Contributed surplus from exercise of warrants		179,908
Share subscription receivable		9,090
Share issue costs		(122,884)
Balance December 31, 2007	72,720,622	23,992,644
Issued for cash	4,500,000	4,500,000
Bifurcation of warrants issued to contributed surplus		(1,353,218)
Exercise of employee options	528,000	169,230
Contributed surplus from exercise of employee options		177,955
Exercise of warrants	4,751,597	1,853,411
Contributed surplus from exercise of warrants		398,515
Share issue costs		(756,478)
Balance December 31, 2008	82,500,219	\$ 28,982,059



10. Share capital (continued):

(c) Stock option plan:

The Company grants stock options to its directors, officers and consultants. The Company has a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. As at December 31, 2008, there were 8,250,022 (2007 – 7,272,062) common shares reserved for this purpose. All options vest immediately at the grant date with the exception of 33,333 (2007 – 116,666) options granted to employees during 2006 which have not yet vested. The options are granted at an exercise price not less than fair market value of the stock on the date of issuance. A summary of the Company's outstanding and exercisable stock option grants, as at December 31, 2008 and 2007 and changes during these years is presented below:

	2008		2007	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Outstanding, beginning of year	2,235,668	\$ 0.50	2,426,995	\$ 0.33
Granted	1,752,000	0.54	1,139,000	0.65
Exercised	(528,000)	0.32	(1,259,993)	0.34
Cancelled/expired	(1,150,670)	0.57	(70,334)	0.57
Outstanding, end of year	2,308,998	\$ 0.52	2,235,668	\$ 0.50
Exercisable, end of year	2,275,665	\$ 0.52	2,119,002	\$ 0.48

Weighted average life remaining for the options outstanding and exercisable is 2.8 years for both.

The weighted average fair market value of the options granted during the year was \$0.54 (2007 - \$0.65) per option. The fair value of the options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2008	2007
Risk-free interest rate	2.73%	4.69%
Expected life (years)	2.4	2.6
Volatility in the price of the Company's common shares	163%	190%
Dividend yield rate	0.00%	0.00%

10. Share capital (continued):

(d) Contributed surplus:

	2008	2007
Balance, beginning of year	\$ 940,445	\$ 705,825
Employee stock options exercised	(177,955)	(290,632)
Stock based compensation	704,859	525,252
Balance, end of year	\$ 1,467,350	\$ 940,445

(e) Warrants:

A summary of the Company's outstanding warrants and changes during the years are presented below:

	2008	2007
Balance, beginning of year	\$ 493,589	\$ 673,497
Finder fee warrants exercised	(398,515)	(179,908)
Warrants issued on private placement	1,353,218	-
Agent options issued	269,387	-
Balance, end of year	\$ 1,717,678	\$ 493,589

	2008		2007	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Outstanding, beginning of year	9,535,960	\$ 0.52	17,136,376	\$ 0.51
Granted	2,722,500	1.27	-	
Exercised	(4,751,597)	0.44	(6,452,339)	0.49
Expired	(4,934,363)	0.75	(1,148,077)	0.45
Outstanding, end of year	2,572,500	\$ 1.31	9,535,960	\$ 0.52



10. Share capital (continued):

During 2008 the Company issued 4,500,000 units at \$1.00 per unit with each unit consisted of one common share and one-half of one purchase warrant. In connection with this private placement 2,250,000 warrants were issued entitling the holder to acquire one common share of the Company at \$1.30 until March 13, 2010.

The estimated fair value of these warrants is \$1,353,218 or \$0.56 per warrant. The fair value of these warrants was estimated using the Black-Scholes option pricing model with average risk-free interest rate of 2.6%, expected life of 2.0 years, volatility in the price of the Company's common shares of 140% and dividend yield of 0.00%.

The remaining 472,500 warrants were issued in connection with the private placement completed in 2008 and consisted of 315,000 agent option units which consisted of one common share and one-half warrant at a price of \$1.00 expiring September 13, 2009. These agent options are accounted for as a charge to share issuance costs of \$170,233 or \$0.54 per warrant. The fair value of the agent options were estimated using the Black-Scholes option pricing model with a weighted average risk-free interest rate of 2.6%, expected life of 1.5 years, volatility in the price of the Company's common shares of 129%, and a dividend yield rate of 0.00%.

The 157,500 warrants associated with the agent options entitle the holder to acquire one common share of the Company at \$1.30 until March 13, 2010. These warrants are accounted for as a charge to share issuance costs of \$99,154 or \$0.63 per warrant. The fair value of these agent options were estimated using the Black-Scholes option pricing model with a weighted average risk-free interest rate of 2.6%, expected life of 2.0 years, volatility in the price of the Company's common shares of 147%, and a dividend yield rate of 0.00%.

11. Commitments:

The Company is party to various leases for its operating premises and equipment. Future minimum annual payments under these operating leases are as follows:

2009	\$	426,598
2010		441,726
2011		449,282
2012		445,685
2013		458,718
2014		76,815
	\$	2,298,824

12. Related party transactions:

During the year, the Company contracted with a company owned by a director to supply consulting services totaling \$73,694. All of the transactions were measured at the exchange amounts, that being the amount of consideration established and agreed upon by the related parties and approximates fair market value.

13. Income taxes:

(a) The income tax expense differs from the amounts which would be obtained by applying the expected Federal and provincial income tax rate of 29.50% (2007 – 32.12%) as follows:

	2008	2007
Computed "expected" tax (recovery)	\$ (2,514,352)	\$ (2,206,102)
Non-deductible expenses	22,512	20,676
Stock-based compensation	207,933	168,711
Rate change and other	363,322	823,123
Valuation allowance and other	1,920,585	1,193,592
	\$ -	\$ -

(b) The components of the Company's future income tax assets are as follows:

	2008	2007
Capital assets	\$ 19,652	\$ 148,108
Intangibles	(857)	51
Warranty liability	-	3,607
Non-capital loss carry-forwards	6,239,744	4,709,586
Share issue costs	215,546	192,018
Scientific research and experimental development expenditures	1,138,337	648,953
Other	14,643	4,161
Valuation allowance	(7,627,065)	(5,706,484)
	\$ -	\$ -



13. Income taxes (continued):

(c) The Company has non-capital losses for income tax purposes of approximately \$24,589,703 which are available to be applied against future year's taxable income. The benefit of these non-capital losses has not been recognized in the consolidated financial statements. These losses will expire as follows:

2009	561,577
2010	1,715,370
2014	2,570,288
2015	2,461,959
2026	3,390,309
2027	5,596,948
2028	8,293,252

\$ 24,589,703

14. Financial instruments and financial risk management:

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their fair value due to the relatively short periods to maturity of these instruments. The fair value of the loans payable could not be determined as the timing of repayment is difficult to estimate since they are dependant on future revenues.

The nature of these instruments and the Company's operations expose the Company to the following risks:

(a) Credit risk:

Credit risk reflects that the Company may be unable to collect amounts due to the Company from customers for its services, products, or other transactions that may be entered into by the Company. The extent of risk depends on the credit quality of the party from which the amount is due.

The Company employs established credit approval and monitoring practices to mitigate this risk, including evaluating the creditworthiness of new customers and monitoring customer payment performance. The Company also includes the ability to receive payments in advance for both services and products in its agreements with customers as well as the ability to suspend services and ongoing support. The Company establishes an allowance for doubtful accounts that corresponds to the credit risk of its customers, historical trends, and economic circumstances.

14. Financial instruments and financial risk management (continued):

The aging of the accounts receivable as at year end is as follows:

	2008
Current, 1 – 30 days	\$ 711,294
31 – 60 days	136,908
61 – 90 days	171,540
Greater than 90 days	160,623
	\$ 1,180,365

The movement in the allowance for doubtful accounts as at year end is as follows:

	Provision
Balance, December 31, 2007	\$ -
Provision	175,333
Accounts receivable written off	(175,333)
	\$ -

(b) Interest risk:

The Company is exposed to interest rate risk on cash balances earning interest income and to the extent that it may draw on its operating line of credit which calculates interest as a function of variable interest rates. As at December 31, 2008, the Company does not carry material liabilities that are exposed to variable interest rates.

(c) Liquidity risk:

The Company is exposed to liquidity risk to the extent it is unable to collect its trade receivable balances on a timely basis and generate additional services revenue, which in turn could impact the Company's ability to meet commitments to creditors. The Company manages its liquidity risks by carrying cash on its balance sheet, by maintaining a conservative capital structure, by prudently managing its credit risks, and by maintaining its relationship with the capital markets to meet any near-term liquidity requirements.



14. Financial instruments and financial risk management (continued):

(d) Foreign exchange risk:

The Company is exposed to foreign exchange risk primarily in the following ways:

- (i) Cash flow – a significant portion of the Company's revenues and a portion of its expenses are denominated in US dollars. Management estimates that a 1% weakening of the Canadian dollar will increase net earnings by approximately \$30,342 and a strengthening of the Canadian dollar will decrease net earnings by approximately \$30,342.
- (ii) Working capital – the Company has exposure to foreign exchange risk for working capital items denominated in US dollars. At December 31, 2008, working capital denominated in US dollars was approximately \$760,506. As a result a 1% weakening of the Canadian dollar will increase net earnings by approximately \$7,606 and a strengthening of the Canadian dollar will decrease net earnings by approximately \$7,606.

The Company mitigates its exposure to foreign exchange risk in the following ways:

- (iii) Cash flow – the Company mitigates its cash flow exposures by the international nature of the business where a significant portion of its marketing costs are in currencies that naturally hedge a portion of US dollar revenue. The Company has not engaged in activities to manage its cash flow foreign currency exposure through the use of financial instruments.
- (iv) Working capital – the Company mitigates its working capital exposure by managing its US dollar denominated working capital items to limit the requirement to convert either to or from US dollars to fulfill working capital payment requirements.

15. Capital management:

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern (note 1) so that it can continue to seek to provide returns for shareholders and benefits for other stakeholders, to maintain optimal structure to reduce the cost of capital, and to facilitate the growth strategy of the Company.

The Company monitors its capital management through analysis of cash flow expectations to ensure an adequate amount of liquidity and through the monthly review of financial results and business expectations. The Company considers the shareholders equity to be the capital of the Company.

Based upon the dynamic nature of the aviation and technology markets that the Company engages in, and the low level of tangible assets required, the capital strategy is to carry a low level of debt, including capital leases. Although a formal debt to equity ratio has not been established by the Company, the ratio of debt to equity at December 31, 2008 was 24.2% (2007 - 13.1%)

16. Supplemental cash flow information:

Change in non-cash working capital:

	2008	2007
Changes in non-cash working capital:		
Accounts receivable	\$ (571,909)	\$ (330,123)
Prepaid expenses	37,545	(116,884)
Inventory	22,672	(1,381,597)
Accounts payable and accrued liabilities	338,617	722,446
Unearned revenue	1,179,408	527,972
Deferred lease inducement	(13,687)	(13,687)
	\$ 992,646	\$ (591,873)
Interest earned	\$ 67,378	\$ 85,132
Cash and cash equivalents:		
	2008	2007
Cash in bank	\$ 386,404	\$ 430,187
Guaranteed investment certificates	415,000	1,515,500
	\$ 801,404	\$ 1,945,687

17. Subsequent event:

On March 3, 2009, the Company signed a License and Manufacturing Agreement with Sierra Nevada Corporation ("SNC"). Under the agreement, SNC will pay an upfront license fee, a royalty on future sales by SNC of afirs™ to the military market and contribute funding, personnel, and expertise to the future design of afirs™. As well, SNC will manufacture the Company's afirs products under license.

18. Contingencies:

In September 2007, the Company, among others, were served with a counterclaim alleging that the Company induced a breach of contract and interfered with economic relationships. The Company maintains that the claims are without merit. Management intends to vigorously defend the matter and believes the outcome will be in its favour. On November 7, 2007, the Company file a statement of defense and a counterclaim against three parties for interference with legally binding contracts, disrupted business, attacks on the Company's reputation, and costs. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable.



Corporate Information

Directors

Bill Tempany	CEO of the Company
Richard Hayden	President of the Company
Doug Marlin	President of Marlin Ventures Ltd.
Mike Brown	Partner, Geselbracht Brown
Paul Takalo, CA	Vice-President, Standen's Limited
Jack Olcott	President, General Aviation Company

Officers

Bill Tempany	CEO
Richard Hayden	President
Thomas French, CGA	CFO
Matt Bradley	VP Operations

Auditor

KPMG LLP	Calgary, Alberta
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Legal Counsel

Chris Croteau	Tingle Merrett LLP
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Offices

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