

PROGRESS IN THE INDUSTRY

2010 ANNUAL REPORT



F L **Y** H T™

AeroMechanical Services Ltd.

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COMPANY PROFILE

AeroMechanical Services Ltd. was founded in 1998 to design and develop products and services for the international aerospace industry. The company's patented technologies, marketed under the FLYHT™ brand name, enhance safety, efficiency and profitability by providing real-time data communications to airline customers worldwide. AeroMechanical Services is based in Calgary, Canada and has service locations in the United States, China, Ireland, England, Switzerland, Dubai, India and Argentina. The company is listed on the Toronto Venture Exchange under the symbol AMA.

2010 Snapshot: Progress in the Industry

- Largest product sale in AMA history to major European Dash-8 aircraft operator
- Expanded gross margin as percent of sales to 60.8% from 56.0% in 2009
- Hawker Beechcraft announced installation of AFIRS™ product on new aircraft; first OEM acceptance
- Established Operations Command Centre for the Nigerian Civil Aviation Authority
- Strengthened balance sheet with share issue, convertible debenture financing of \$6.4 million
- Member of the international OPTIMI group, demonstrated real-time data streaming capabilities

2011 FLYHT Plan: Further Growth & Development

- Complete development of next generation product: AFIRS 228
- Continue to deliver AFIRS 220 units, from order book, to customers worldwide
- Enhance service and support to current customers with installed AFIRS 220 base
- Commence installation of the AFIRS 228 for minimum of 3 clients
- Increase deliveries in growing regions of China, Africa, South America and Middle East
- Continue expanding range of Supplemental Type Certificates for our products

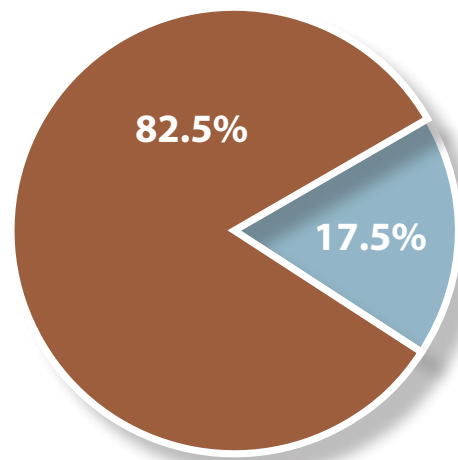


INVESTMENT HIGHLIGHTS

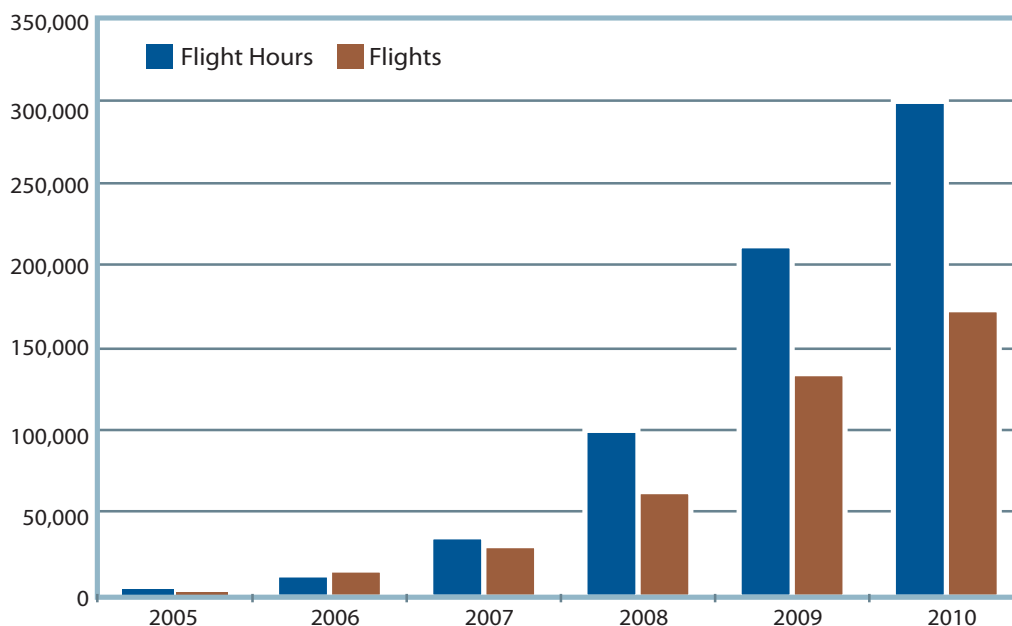
- Unique line of patented products and services
- AFIRS key industry differentiator moving to next generation
- Strategic alliances with industry sector leaders
- Increasing customer growth in flights, hours and aircraft types
- Recurring long term revenue stream from installed base
- High regulatory barriers to entry

REVENUE BREAKDOWN

82.5% of revenue was AFIRS sales and UpTime services revenue, 17.5% Other Revenue (Underfloor Stowage Unit, and Consulting)



CUSTOMER GROWTH IN FLIGHT HOURS AND FLIGHTS



AeroMechanical Services' customers logged more than 300,000 hours in 2010 with AFIRS providing real-time communications for more than 200 aircraft in service

MAJOR ANNOUNCEMENTS



FEBRUARY 5

TSX Venture Exchange named AeroMechanical Services Ltd. (AMA) the number one ranked company, out of 10, within the diversified industries sector of the TSX Venture 50, comprised of 50 emerging companies in five industry sectors that the Exchange described as “outstanding companies” that are “proven leaders” in Canada’s public venture market.

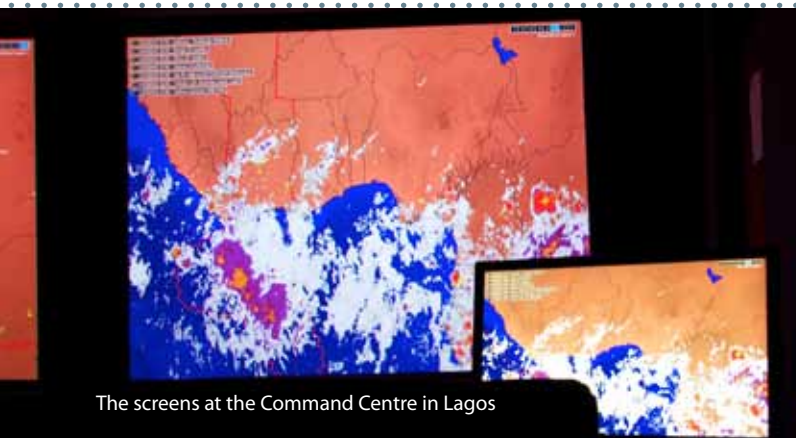
(from left to right: Tom French, CFO and Bill Tempany, CEO receive award from the TSX in Toronto)

FEBRUARY 8

AMA was selected to participate in OPTIMI, the European Oceanic Position Tracking Improvement and Monitoring Initiative. OPTIMI’s goal is to improve air traffic capacity and efficiency and reduce fuel burn and emissions in all European airspace.

“I’m sure the involvement of AeroMechanical in the OPTIMI project will make a valuable contribution to identifying potential improvements to flight monitoring over remote oceanic regions as we endeavor to improve safety and rescue efforts should an event such as the tragic loss of AF447 be repeated,”

Mark Watson, CEDAR (Critical Event Detection and Reporting) consortium Program Manager.



The screens at the Command Centre in Lagos

MARCH 30

AMA signed an agreement with the Nigerian Civil Aviation Authority (NCAA) to provide services and equipment to establish a state-of-the-art Operations Command Center in Lagos, Nigeria.

“The solutions being provided by AMA will allow us to improve safety and efficiency around our aviation infrastructure,”

Dr. Harold Demuren, Director General of the NCAA.

MARCH 31

AMA signed a contract with a Nigerian based airline to install AFIRS UpTime on their fleet of Boeing 737, Dash 8, Embraer Legacy 600 and Hawker Beech aircraft.

JULY 16

AMA signed a contract to install AFIRS UpTime with an African aircraft lease and charter company.



JULY 28

AMA announced a contract to install AFIRS UpTime on 34 turboprop aircraft, the entire fleet of a regional Scandinavian airline. The operator has been in business for over 75 years and is one of the region's largest carriers, with over 300 daily departures to national and international locations.



Photo taken of scenic Scandinavia by an AMA employee

OCTOBER 19

In an interim report on the feasibility of implementing improved aircraft tracking services and real-time data streaming across the Atlantic Ocean, the European Oceanic Position Tracking Improvement & Monitoring ("OPTIMI") program cited AMA's technology as a readily available solution for the airline industry (see February 8 above).

OCTOBER 19

Hawker Beechcraft Services Offers Satellite Monitoring System on Hawker 125 Series Aircraft

ATLANTA (Oct. 19, 2010) – Hawker Beechcraft Services (HBS) today announced it is offering automated flight information reporting on fielded Hawker 125 series business jets (900XP, 850XP, 800XP and 750) through an agreement with AeroMechanical Services, Ltd. (which markets products and services under the FLYHT brand name).

"By installing the afirs/UpTime system, our operators can be proactive about troubleshooting maintenance issues and taking necessary actions to reduce unscheduled downtime," said Christi Tannahill, HBC vice president, Global Customer Support. "Our customers will have real-time access to experts with no gaps in coverage and we'll be able to deliver a new dimension of customer service and safety."



DECEMBER 3

AeroMechanical Services Ltd. appointed Jacques Kavafian, President and CEO of 7546220 Canada Inc. to the Board of Directors.

DECEMBER 23

AMA announced the completion of two concurrent private placements:

- An aggregate of 3,159 debenture units were issued at a price of \$1,000 per debenture unit for aggregate gross proceeds of \$3.2 million.
- An aggregate of 14,985,080 share units were issued at a price of \$0.25 per share unit for aggregate gross proceeds of \$3.7 million.

INTRODUCING AFIRS 228



The AFIRS 220 has been AMA's signature product since its introduction in 2004. This unit has received regulatory certification for installation in approximately 30 widely used commercial aircraft brands and models and expects to apply for certification for approximately 15 additional during 2011. In 2010, the total number of in service hours for all aircraft with AFIRS 220 on board reached 700,000 hours.

Over the past several years, AMA has been designing the next generation of this technology – the AFIRS 228. It was developed to meet future industry regulations, while remaining fully compatible with existing technology.

The AFIRS 228 incorporates improvements in several important areas: processing capacity, data transmission characteristics and programmability. For customers the upgrades are significant because the new unit can process and analyze more data at a faster rate. It offers more inputs and outputs, which means air carriers will be able to obtain more data from their aircraft. Going forward, the AFIRS 228 is designed as a very versatile platform that can cater to the changing needs and demands of airlines. It offers more flexibility for customers wishing to add features, request specific data at predetermined times, and interface with other aircraft systems. In addition, the new unit will be a premier product for the changing air traffic control regimes in North America and Europe.

The next generation AFIRS box is intelligent, programmable and bufferable. Not only does it deliver the data to the location it needs to go, it has the ability to process, read, analyze and interpret that data for the customer.

The AFIRS 220 will continue to serve our current and future customers for years to come. The AFIRS 228 is the company's answer to the industry's need and part of our strategy to succeed in a competitive world market.

(Image above: left: AFIRS 220, right: AFIRS 228)

TO OUR SHAREHOLDERS

For AeroMechanical Services (“AMA” or the “Company”), 2010 was a period of development, achievement and growth. Over the year, the FLYHT™ brand name has been gaining recognition at international events and conferences.

Our highest priority during the year was the accelerated development of the newest version of our Automated Flight Information Reporting System (AFIRS) program – the AFIRS 228. Since the launch of our first-generation AFIRS 220 in 2004, this patented technology has won widespread market acceptance as more than 30 commercial and military aircraft operators on all continents benefit from its advantages.

AFIRS 228: THE NEXT GENERATION

AMA’s current product centerpiece is the AFIRS 220, which we continue to sell and which we will be supporting for many years. As we do so, we are preparing the next generation – AFIRS 228.

This new version is being developed to meet future industry regulations, while remaining fully compatible with existing technology. It incorporates improvements in processing capacity, data transmission characteristics and programmability. In addition, the new unit will be compatible with changing air traffic control regimes in North America and Europe.

AMA initiated the AFIRS 228 program in 2007 and work continues to gain momentum. In 2010, \$5.0 million was devoted to the project. Testing and certification are scheduled for completion during the first four months of 2011 and we expect to install the first unit in May 2011, with commercial availability by July. We are excited to have AFIRS 228 ready for commercial installation in time to compete in this critical market.

LANDMARK SALES CONTRACTS

During 2010 AMA signed four new groundbreaking sales contracts and laid the foundation for additional revenues by reaching an agreement with Hawker Beechcraft Corporation (HBC) for factory installation of AFIRS as standard equipment on their aircraft.

Aviation products such as ours are commonly sold via two main channels: retrofitting into existing aircraft already in service, and installation on new aircraft at the factory. All our sales had been retrofits until fall 2010, when AMA and HBC announced the adoption of AFIRS UpTime for factory installation on their aircraft, beginning in 2011. This agreement is an important milestone for AMA because HBC is the first original equipment manufacturer (OEM) to adopt our technology as standard equipment. Installing AFIRS on aircraft at the factory is a significant accomplishment for AMA as it provides the market with assurance of OEM support for the equipment and data produced, relief from the cost and delay of the retrofit process, easy access to OEM information for our engineering teams, ongoing demand for product and a growing base of recurring revenue-producing installations. Signing contracts with more OEMs is part of our strategy to strengthen equipment sales and recurring revenues from our installed base.

Another noteworthy contract was the largest sale in AMA’s history. The deal is with a major European operator of Dash 8 aircraft* and provides installation and service of AFIRS UpTime on board the carrier’s fleet of 35 turboprop aircraft. Currently, the system that has been installed is not turned on as training of pilots and changes in standard operating procedures must be completed by the airline before AFIRS can be made operational on the aircraft. Those efforts are being pursued by the customer, who is looking for significant fleet operational savings with adoption of the real-time data provided by AFIRS.

Three additional contracts represent sales “breakthroughs” for AMA in Africa. The first was with the Nigerian Civil Aviation Authority, to provide services and equipment for a state-of-the-art operations command centre. We installed the equipment in late 2010 and have been paid in full. The successful launch of the centre has sparked interest from several other countries interested in our technology. Many of the AFIRS sales expected in Africa in 2011 will be driven by the need for our customers to comply with regulations associated with reporting to this new facility.

The second contract is a five-year agreement to provide AFIRS UpTime to a Nigerian air carrier* for their fleet of aircraft. The third deal, also for a five-year term, will see AMA install and service equipment on aircraft operated by an African lease and charter company*.

Other contracts proceeded during 2010 as expected. Early in the year, a Middle East military organization* began installing AFIRS UpTime in its fleet of 23 C-130 Hercules aircraft. In the final quarter of 2010, four of these aircraft had completed the conversion and been placed into UpTime revenue service, and the schedule calls for the program to be completed by late 2012. The upgrade is taking place as part of a cockpit upgrade and our partnership with CMC Electronics on this program is strong. We designed the contract as a phased upgrade that provides for improvements over time to keep the client in sync with changing technologies. The current program calls for installation of AFIRS 220 units, and in the future these aircraft will convert to AFIRS 228 to comply with new air traffic rules as they come into force.

RECOGNITION FROM AVIATION INDUSTRY, TSX VENTURE EXCHANGE

During 2010 AMA gained recognition in several ways from the international aviation community and Canada’s capital markets.

First, AMA was awarded a subcontract as a member of the Critical Event Detection and Reporting consortium to support the European industry team developing the Oceanic Position Tracking Improvement Monitoring Initiative (“OPTIMI”). AMA’s role, as the sole consortium member providing data linking services was to integrate FLYHTStream in continuous reporting of aircraft position and streaming of black box data to the ground over the Iridium satellite system. Opportunities such as this increase AMA’s visibility and credibility with manufacturers and operators alike, and provide us with a unique overseas platform to showcase our technologies.

During this past year, we also broadened our relationship with the Chinese aviation community by deploying FLYHTStream on several aircraft operating in China. Over the past several years we have maintained an ongoing dialogue with Chinese aviation officials as part of an initiative to penetrate one of Asia’s largest markets. AMA has a technological advantage in that AFIRS is the only voice and data service utilizing Iridium satellite technology approved for aircraft use in China.

Last year, the largest operator of business aircraft in the world* completed a successful in-service evaluation of AFIRS UpTime. This project demonstrated the product’s outstanding performance and high reliability, which provides the basis for a solid return on investment for the airline operator. We are expecting publication of the results soon, and we continue to work with the operator toward a contract.

AMA submitted final patent applications covering many aspects of data streaming technology, in addition to separate patent applications related to the AFIRS 228 and system concepts under development.

During 2010 we were recognized by the TSX Venture Exchange, which named AMA the top-ranked issuer out of

10 rising stars within the Diversified Industries Sector of the TSX Venture 50. This is a compendium of 50 strong performers listed on the Exchange – 10 drawn from each of five industry sectors -- and identified as “outstanding companies” that are “proven leaders” in their respective fields.

FINANCIAL POSITION STRENGTHENED

During 2010, worldwide aviation markets continued to exhibit weakness as their host economies struggled to emerge from recession. Amid this uncertain economic environment, airlines were generally reluctant to commit to capital projects.

As a result, AMA product shipments totaled 27 in 2010, compared to 44 during 2009. While there was a decrease in product revenue, AMA also derives revenue from recurring fees generated by ongoing usage of AFIRS UpTime and associated applications. This installed revenue base expands every year and the increase during 2010 effectively offset part of the decline in product revenues. The Company also benefited from markedly higher consulting fees. The net result was a year-over-year reduction of only 1.9% in revenues, to \$5.0 million in 2010.

The installed base of revenue-generating equipment and consulting-fee revenues both involve low cost of sales and therefore offer strong profitability. This has had a measurable impact on AMA’s income statement; gross margin as a percent of sales in 2010 was 60.8%, up from 56.0% in 2009 and 32.0% in 2008.

AMA’s expenses increased significantly during 2010 as development activity ramped up on the AFIRS 228 project. Outlays in this category totaled \$5.0 million, compared to \$0.6 million in 2009. Costs are expensed as they are incurred.

If R&D expenses are removed for both years, the loss for 2010 would be \$4.2 million, versus a \$4.0 million loss in 2009. Including R&D, the bottom line for 2010 was a net loss of \$9.3 million or \$0.09 per share, compared to a net loss of \$4.5 million or \$0.05 per share the previous year.

AMA ended 2010 with a strong balance sheet. In December, the Company closed a private placement of common shares and issued convertible debentures for net cash proceeds totaling \$6.4 million. Some of the proceeds were deployed to reduce payables, leaving AMA with working capital of \$4.2 million at December 31, 2010. We also have access to a bank credit facility of \$250,000 that was undrawn at year end.

Subsequent to 2010, the federal government awarded AMA with \$1.96 million in funding to complete the AFIRS 228 program. The total amounts to approximately 30% of costs related to product development and certification. The funds, which are repayable over the next 15 years, were provided by Industry Canada in February 2011 under the Strategic Aerospace and Defence Initiative program. The detailed review of our plans, technology and patents by the federal government lend credence to the promising future of the company.

GOING FORWARD

AMA enters 2011 amid an improving industry environment, solid sales prospects, a favorable revenue structure and a strong financial position.

In the first quarter of 2011 a particularly compelling driver for new business emerged in the form of rapidly rising fuel prices. Margins are thin in the airline business, and with fuel costs accounting for more than 25% of operating expenses in many cases, AMA's productivity-enhancing fuel management technologies become increasingly attractive as fuel prices increase.

AMA's long-term investment in marketing and relationship building has generated a strong pipeline of new business around the world. In the early part of 2011 there have been some inquiries from the main global airlines, plus a stronger surge of interest from growing markets such as Africa, South America and the Middle East. Air carriers in these markets have not undergone the recession-induced decline of business seen by the majors, and they have capital budgets available for investment.

After 10 years of product development, sales and service, AMA is gaining profile, recognition and stature in the aviation technology industry. The combination of marketing initiatives and solid reputation have firmly positioned AFIRS UpTime and related services in the marketplace.

There is an order book of AFIRS 220 units, which will drive installations in 2011. Our recurring revenues grow with new sales each year as airlines and military operators expand, and the Company's top line increases in tandem. Strong margins that accompany this revenue segment will progressively improve profitability over time.

The Company is well positioned financially to complete development, certification and launch of AFIRS 228 in 2011. This has been AMA's top priority and largest single expense, and R&D outlays are expected to be substantially lower in 2011. That being said, the Company will continue to be challenged by the strong Canadian dollar because most sales are denominated in U.S. currency.

During 2010 we welcomed Jacques Kavañian to the Board of Directors. His 26 years of experience as a Bay Street equity analyst covering airlines and aerospace companies will add considerable breadth and depth to AMA's board.

Management is mindful that AMA's share value is not where we would like it to be. We have made it a priority to broaden awareness of our technologies to investors in the coming year. We are also shareholders of AMA and we continue to work very hard to improve shareholder value.

In closing, I would like to extend my appreciation to our customers for their business, our employees for their skills and dedication, our managers for their diligence and leadership, our board members for their guidance and counsel, and most of all to our shareholders for their faith in the people of AeroMechanical Services.



Bill Tempany
Chairman and Chief Executive Officer

* For competitive and confidentiality reasons AMA does not disclose the identities of certain customers

MANAGEMENT DISCUSSION & ANALYSIS

This management discussion and analysis ("MD&A") should be read in conjunction with the audited annual consolidated financial statements of AeroMechanical Services Ltd. ("AMA" or the "Company") as at and for the years ended December 31, 2010 and 2009. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Additional information with respect to AMA can be found on SEDAR at www.sedar.com.

This MD&A is dated April 6, 2011.

Non-GAAP Financial Measures

The Company reports its financial results in accordance with generally accepted accounting principles ("GAAP"). It also occasionally uses certain non-GAAP financial measures, such as working capital, modified working capital, loss before research and development ("R&D") and cash revenue. AMA defines working capital as current assets less current liabilities. The Company defines modified working capital as current assets less current liabilities, not including customer deposits or the current portion of unearned revenue because those customer deposits are non-refundable. AMA defines cash revenue as financial statement revenue plus arrangement consideration received during the period that has not yet been recognized as revenue in the period due to the required revenue recognition criteria not yet being satisfied. Loss before R&D is defined as the net loss minus the direct costs associated with research and development but does not include internal labour costs. These non-GAAP financial measures are always clearly indicated. The Company believes that these non-GAAP financial measures provide investors and analysts with useful information so they can better understand the financial results and perform a better analysis of the Company's growth and profitability potential. Since non-GAAP financial measures do not have a standardized definition, they may differ from the non-GAAP financial measures used by other companies. The Company strongly encourages investors to review its financial statements and other publicly filed reports in their entirety and not rely on a single non-GAAP measure.

Forward-Looking Statements

This discussion includes certain statements that may be deemed "forward-looking statements" that are subject to risks and uncertainty. All statements, other than statements of historical facts included in this discussion, including, without limitation, those regarding the Company's financial position, business strategy, projected costs, future plans, projected revenues, objectives of management for future operations, the Company's ability to meet any repayment obligations, the use of non-GAAP financial measures, trends in the airline industry, the global financial outlook, expanding markets, research and development of next generation products and any government assistance in financing such developments, foreign exchange rate outlooks, new revenue streams and sales projections, cost increases as related to marketing, research and development (including AFIRS™ 228), administration expenses, and litigation matters, may be or include forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on a number of reasonable assumptions regarding the Canadian, U.S., and global economic environments, local and foreign government policies/regulations and actions and assumptions made based upon discussions to date with the Company's customers and advisers, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those in the forward-looking statements include production rates, timing for product deliveries and installations, Canadian, U.S., and foreign government activities,

volatility of the aviation market for the Company's products and services, factors that result in significant and prolonged disruption of air travel worldwide, U.S. military activity, market prices, foreign exchange rates, continued availability of capital and financing and general economic, market, or business conditions in the aviation industry, worldwide political stability or any effect those may have on our customer base. Investors are cautioned that any such statements are not guarantees of future performance and that actual results or developments may differ materially from those projected in the forward-looking statements.

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to have been correct. The Company cannot assure investors that actual results will be consistent with any forward-looking statements; accordingly, readers should not place undue reliance on forward-looking statements. The forward-looking statements contained herein are current only as of the date of this document. The Company disclaims any intentions or obligation to update or revise any forward-looking statements or comments as a result of any new information, future event or otherwise, unless such disclosure is required by law.

Overview

AMA is a designer, developer, and service provider of innovative solutions to the global aerospace industry and markets and sells under the brand name FLYHT™. The Company's solutions are designed to improve the productivity and profitability of our customers and to ensure that the communications between terrestrial and airborne staff and assets is to the highest possible standard. Our tools also provide the ability to deliver large amounts of data if an aircraft is in distress through our patent pending FLYHTStream™ product.

AFIRST™ UpTime™

AMA's automated flight information reporting system ("AFIRS") is installed on aircraft and monitors hundreds of essential functions from the plane and the black box. AFIRS sends that information to the UpTime Server on the ground, which stores and transfers the data to the airline in real-time. Airlines can use this information to increase passenger safety, improve productivity, maximize efficiency and enhance profitability. In addition to its data monitoring functions, AFIRS provides voice and text messaging capabilities that give pilots the ability to communicate with ground support. AMA offers global satellite coverage, providing service to whoever needs it, when they need it, anywhere on the planet.

FLYHTStream

For the first time in history, AMA has developed and has patent pending technology to stream data off an aircraft in real-time. If an airplane encounters an emergency, AMA's proven technology can automatically stream vital data, normally secured in the black box, and provide position information to designated sites on the ground in real-time. This technology opens new doors for increased awareness and safety in the industry.

FLYHT Fuel Management System

The FLYHT Fuel Management System is a powerful way to focus attention on the areas of greatest savings potential automatically, and to provide the information necessary to make decisions about the operation. Most airlines currently rely on a system of reports, manually generated and analyzed to make fuel savings decisions within the operation. This is

time consuming and relies on the user to calculate areas of potential by cross-referencing a great number of queries. The FLYHT Fuel Management System is not just a report generation tool, it is a dynamic, interactive application that answers key questions by generating alerts and providing the user with the ability to quickly identify trends. AMA teamed up with an award winning user experience development team to design this unique application that highlights exceptions to best practices, provides quick drill downs to spot the root cause, and identifies trends. It is an intuitive tool that enables fuel managers to act on information instead of compiling and analyzing data.

The Fuel Management System is ideally suited for large commercial airlines and is designed to receive inputs from AFIRS, ACARS, Flight Planning Systems, Load Planning Systems, and Electronic Flight Bags (EFBs). The system can also operate independently of AFIRS.

FIRST

The Fuel Initiative Reporting System Tracker (“FIRST”) is a tool that eliminates uncertainty about the effectiveness of an airline’s fuel savings initiatives. FIRST can be purchased separately, as a standalone module from the FLYHT Fuel Management System. It uses real-time flight data acquired from the aircraft’s onboard systems, and presents the data to operations personnel in an easy to read dashboard. The dashboard compares how the pilots are operating the aircraft to how they could be flying in order to maximize efficiency and fuel savings. Where compliance has not been met, costs are shown. This tool is de-identified to meet pilot union requirements, but can be filtered to display performance by pilot if desired.

The Underfloor Storage Unit

The Underfloor Stowage Unit offers the flight crew additional stowage space in the cockpit. With this addition, the manuals will always be within reach of the seated crew. When in use, the manuals are kept safe, dry and clean inside the Stowage Unit. In addition, safety equipment and other items required by the flight crew can be accessed any time throughout the flight without leaving the cockpit. The Stowage Unit is certified to be installed in the Bombardier CRJ series, Challenger and DHC-8’s and can also be installed in other aircraft types.

AMA’s products are marketed globally by a team of several employees and agents based in Canada, the United States, the United Kingdom, France, Switzerland, Abu Dhabi, Ireland, and Argentina. A Calgary employee is currently spending more than 95% of his time in China working on opportunities there.

In 2010 AMA continued on the progress made in 2009 through an increase in recurring revenues of AFIRS UpTime and services revenue. This progress with these two revenue streams continues to further define AMA as an aviation solutions company. While the rate of increase slowed in 2010 from previous years the number of total flight hours since 2005 passed through the 700,000 hour mark with approximately 300,000 hours of those being in 2010 versus 211,000 in 2009. Our continued research and development of our leading edge technology and services and the continued development of value added products such as FIRST, FLYHT Fuel Management System, and FLYHTStream is being transformed into a continuous telecommunications revenue stream. To further this initiative, AMA continues to add Supplemental Type Certificates (“STCs”), which broadens the aircraft types, models, and jurisdictions in which the AFIRS UpTime solution can be implemented. The process is a requirement that cannot be shortcut by any potential competitors and therefore, as the list of STCs grows, the barrier to entry for competitive products increases.

As in previous years, customer installation schedules continue to be a challenge. Customer installation schedules are determined by “C Check” schedules. “C Checks” are the regular inspections made on all commercial aircraft after a set number of hours of operation of the aircraft or a time limit, allowing for the installation of AMA’s products. The Company obtains this schedule from a customer upon the signing of a contract, and manages the planned versus actual installations.

Trends and Economic Factors

The Company continues to capitalize on the need for timely flight and sensor data from the aircraft to ground operations and maintenance facilities. Airlines are increasingly looking for methods to reduce costs and operate their aircraft more efficiently. Margins are extremely thin in the airline industry. Fuel and labour compete as the largest operating expenses for airlines, with fuel making up to approximately 25% of some airline’s annual operating costs. The slightest decrease in fuel consumption can turn into big savings. Some of the fuel saving methods currently used by airlines include: using one engine instead of two while taxiing, tankering extra fuel, operating the Auxiliary Power Unit (“APU”), configuring the aircraft for most efficient flight profiles, and removing unnecessary equipment. The Company’s AFIRS, UpTime, FIRST, and FLYHT Fuel Management System solutions are valuable tools that provide airlines with the data to reduce fuel costs and to improve operational efficiency and effectively manage aircraft operations. AMA customers are showing significant return on investment over the costs of AFIRS and UpTime.

In 2010 the Company continued to witness weakness across a variety of financial markets, resulting in continued volatility and uncertainty leading to the reluctance for airlines to commit to capital projects. While the aviation industry has seen the slowdown in the demand reverse for air travel, both business and vacation, it has been minor and remains far from the pre-recession levels. The industry continued to see reduced fuel costs which lead to a reduction in operating costs. The Company remains optimistic about its business outlook for 2011 as the global aviation industry continues to move out of the recessionary period that started in 2008 and continues to adopt technology that will help it monitor flight operations, and maintenance issues to reduce costs. The Company has seen an interest from legacy airlines for its technology as they strive to improve operational efficiency and reduce costs, as capital budgets return to pre-2008 levels.

As well, there has been a surge in interest from growing markets such as Africa, South America and the Middle East. Airlines in these markets have not seen the load factor declines of the legacy carriers and possess the capital budgets to improve the technology they are using to create efficient, low cost, technology driven operations.

The acquisition of the assets of a competitor, Wingspeed Corporation (“Wingspeed”), in October 2009 and the assumption of customer contracts and the restoration of service in December 2009 had the desired effect of increasing monthly recurring revenue in 2010. The Company did not expect to see monthly recurring revenues at the same levels as existing AMA customers since the Wingspeed serviced customers contracted for a considerably lower level of deliverables. The Company has capitalized the opportunity to sell value-added services to Wingspeed customers as well as pursue the opportunity to upgrade them to a full AFIRS UpTime solution over time.

During 2010 AMA signed four contracts, including the largest single contract in its history. For competitive and confidentiality reasons the Company is not able to disclose the customers’ names publicly. In March AMA signed two contracts in Nigeria. The first was with the Nigerian Civil Aviation Authority (“NCAA”) to provide services and equipment to establish a state-of-the-art Operations Command Centre in Lagos, Nigeria. The initial order for the equipment, training and commissioning of the centre was \$281,000. The second was a five-year contract to provide a Nigerian based operator

with patented AFIRS UpTime technology for their fleet of aircraft. If AMA is able to install on all contracted aircraft and provide services for the full term of the contract the gross revenues will be approximately \$2,514,000 USD. The third contract of 2010 was signed in July 2010 with an African air carrier for a five-year term with a potential gross revenue of \$205,000 USD, if AMA is able to install on all contracted aircraft and provide services for the full term of the contract. The final contract of 2010 was signed with a Scandinavian airline in July 2010 with a potential gross revenue of \$4,353,360 USD, if AMA is able to install on all contracted aircraft and provide services for the full five-year term of the contract.

The continued strength of the Canadian dollar relative to the U.S. dollar during 2010 continues to negatively impact the Company's revenues and income. As a result of these movements, the Company's Canadian dollar revenues, which are substantially all denominated in U.S. dollars, were lower than they would have been had the foreign exchange rates not changed. While a significant amount of the Company's costs are denominated in Canadian dollars, a significant portion of marketing and parts costs are U.S. dollar denominated, and therefore create a natural hedge against the fluctuations of the Canadian dollar.

System Approvals

A supplemental type certificate ("STC") is an airworthiness certification required to modify an aircraft from its original design and is issued by an aviation regulator. AMA's AFIRS equipment is an addition to an aircraft and therefore an STC is required prior to installation. AMA has received or applied for AFIRS product approvals from Transport Canada ("TC"), the Federal Aviation Administration ("FAA") in the United States, the European Aviation Safety Agency ("EASA") in Europe, and the General Administration of Civil Aviation of China ("CAAC") for various aircraft models, depending on customer requirements.

The process to receive a STC takes some time to complete, but in all cases it starts with an application for the STC through any one of TC, FAA or EASA. Generally, AMA starts the process with TC by opening an application with the regulator and then an STC data package is created. This data package consists of the engineering documents that outline how the AFIRS equipment will be installed on the aircraft. This data package is submitted to TC for approval and once that stage of approval is received, ground and flight testing takes place. To fulfil the flight test requirement, AMA must have access to the appropriate type and model of aircraft. This is done with the cooperation of either an existing or potential customer. Once these tests are completed, AMA submits an activation data package to TC that enables the AFIRS unit to be integrated into the aircraft systems. If TC approves the submission an STC is issued. To obtain an STC from another regulator AMA prepares an application which is sent through TC to the regulator such as FAA, EASA or CAAC along with the STC package previously approved by TC. The regulator reviews the package and issues their STC based on that review and approval.

The time required for the approval process through TC will vary depending on the aircraft and workloads but a general rule of thumb is about three months with a further minimum of three months if an STC is required from another regulator such as FAA, EASA or CAAC.

AMA has received STC approvals for AFIRS 220 on the following aircraft:

- ✓ Airbus A319, A320, A321
- ✓ Airbus A330
- ✓ Boeing B737-200, 300, 400, 500
- ✓ Boeing B737-500, 600, 700, 800

- ✓ Boeing B757-200
- ✓ Boeing B767-200, 300
- ✓ Bombardier DHC-8-100, 200, 300, 400
- ✓ Bombardier CRJ100, 200, 400
- ✓ DC-10
- ✓ Fokker F100
- ✓ Hawker Beech 750, 850XP, 900XP, 950XP
- ✓ Viking Air DHC-7 (LSTC)

AMA has received STC approvals for AFIRS 228 on the following aircraft:

- ✓ Hawker Beech 750, 850XP, 900XP, 950XP

AMA has STC applications in process for AFIRS 220 or 228, expected to be submitted in 2011, depending on market requirements, for the following aircraft:

- ATR-42, 72
- Boeing 747-200,400
- Boeing B777
- Bombardier CRJ-700, 900
- Dassault Falcon 2000
- Embraer EMB – 135/145 (includes Legacy)
- McDonnell Douglas MD-81/82/83/87/88

In addition, the Company will be filing the necessary documents to obtain approval for the AFIRS 228 for a majority of currently approved 220 STCs, depending on market requirements, over the next several years. Portions of those costs, including salaries and salary burden, will be covered by funding provided by Industry Canada in February 2011 under the Strategic Aerospace Defence Initiative program (see “Subsequent Event”).

RESULTS OF OPERATIONS – YEAR ENDED DECEMBER 31, 2010

Revenues

The following table shows AFIRS and UpTime revenue as well as other revenue, which consists of consulting services, license fees and interest revenue. The Company’s long-term investment in marketing, research and development, and building relationships has resulted in a strong pipeline of prospective customers around the world. While 2010 has been a challenging year in the aviation industry, the Company believes that the ongoing revenue streams from our existing customer base will continue to expand through future years with the addition of services and fleet expansions. Recurring revenue continued to increase in 2010 despite a reduction in customers due to bankruptcies. During 2010 shipments totaled 27 compared to 44 during 2009.

The Company has two types of revenue streams relating to AFIRS equipment depending on the type of service agreement: sales and rental. In accordance with the Company’s revenue recognition policy for rental type agreements, the arrangement consideration is deferred as unearned revenue and revenue is recognized over the initial term of the contracts. For sales type agreements, AFIRS fees are deferred as unearned revenue and corresponding expenses are recorded as work in progress. When the system is fully functional and the customer has accepted the system, the deferred amount is fully recognized in revenue along with the work in progress as cost of sales. Under both forms of agreement,

the UpTime usage fees are recognized as the service is provided based on actual customer usage each month. For the Sierra Nevada Corporation ("SNC") license fee, the amount received is deferred as unearned revenue and revenue is recognized over the initial five year term of the agreement. The amounts recorded in unearned revenue are non-refundable.

The effect in 2010 is that AMA received \$6,050,023 (2009: - \$7,471,777) in cash revenue, which is calculated as \$4,967,861 (2009: - \$5,106,494) reported as financial statement revenue plus \$1,072,378 (2009: - \$3,756,846) being cash received for arrangement consideration less the portion of cash received during the year that is recognized in financial statement revenue of \$1,082,161 (2009 - \$1,391,563).

Total revenues were \$4,967,861 and \$5,106,494 for fiscal 2010 and 2009, respectively.

	2010			2009			2008		
	AFIRS UpTime	Other	Total	AFIRS UpTime	Other	Total	AFIRS UpTime	Other	Total
Q1	\$1,015,181	\$97,695	\$1,112,876	\$ 918,410	\$335,522	\$1,253,932	\$349,893	\$48,175	\$ 398,068
Q2	1,169,311	111,836	1,281,147	1,225,574	98,430	1,324,004	475,675	120,588	596,263
Q3	924,042	157,887	1,081,929	1,386,093	135,801	1,521,894	502,966	287,027	789,993
Q4	1,023,616	468,293	1,491,909	887,236	119,428	1,006,664	1,027,491	365,180	1,392,671
Total	\$4,132,150	\$835,711	\$4,967,861	\$4,417,313	\$689,181	\$5,106,494	\$2,356,025	\$820,970	\$3,176,995

Other revenue is derived from the sale of Underfloor Stowage units, the sale of consulting services, licensing fees, commissions and interest. During 2010, Underfloor Stowage Unit revenue was \$46,346 (2009 - \$228,465), consulting revenue was \$506,625 (2009 - \$196,454), licensing fees were \$257,520 (2009 - \$257,520), commissions were \$8,607 (2009 - \$Nil) and interest revenue was \$16,613 (2009 - \$6,742).

Gross Margin and Cost of Sales

Gross margin before general and administrative expenses was \$3,006,116 for 2010 (2009 - \$2,861,893). This increase was the result of the continued increase in recurring revenue as a percentage of total revenue and increased technical services and licensing revenue which have significantly higher margins than the margins associated with the shipment of installation kits.

Cost of sales for AFIRS UpTime was \$1,925,672 on revenues of \$4,132,150 representing a gross margin of \$2,206,478 or 53.4% in 2010. This compares to 2009's \$2,092,831 cost of sales on revenues of \$4,417,313, representing a gross margin of \$2,324,482 or 52.6% on AFIRS UpTime revenue. The increase in the 2010 gross margin over 2009 on AFIRS UpTime is primarily due to the higher level of recurring revenue as a percentage of the total at the higher gross margin associated with the recurring revenue stream. Cost of sales on other revenue was \$36,073 on revenues of \$835,711, resulting in a gross margin of \$799,638 or 95.7%. In 2009 other revenue cost of sales was \$151,770 on revenues of \$689,181, resulting in a gross margin of \$537,411 or 78.0%.

The increase in other revenue in 2010 is the result of an increase in interest revenue and consulting services which is partially offset by a decrease in revenue from Underfloor Stowage Units.

2010				
	Revenue	Cost of Sales	Gross Margin - \$	Gross Margin - %
AFIRS UpTime	\$ 4,132,150	\$ 1,925,672	\$ 2,206,478	53.4%
Other	835,711	36,073	799,638	95.7%
Total	\$ 4,967,861	\$ 1,961,745	\$ 3,006,116	60.5%

2009				
	Revenue	Cost of Sales	Gross Margin - \$	Gross Margin - %
AFIRS UpTime	\$ 4,417,313	\$ 2,092,831	\$ 2,324,482	52.6%
Other	689,181	151,770	537,411	78.0%
Total	\$ 5,106,494	\$ 2,244,601	\$ 2,861,893	56.0%

2008				
	Revenue	Cost of Sales	Gross Margin - \$	Gross Margin - %
AFIRS UpTime	\$ 2,356,025	\$ 1,978,679	\$ 377,346	16.0%
Other	820,970	181,167	639,803	77.9%
Total	\$ 3,176,995	\$ 2,159,846	\$ 1,017,149	32.0%

Net Loss, General and Administrative and Marketing Expenses

In 2010, the key driver of our performance continued to be the timely closing of contracts with prospective customers, airline installation schedules of AFIRS on contracted aircraft due to their maintenance schedules, and the timely receipt of STC approvals from multiple regulators. The key challenge continues to be the speed with which potential customers execute contracts and the difficulty in predicting the accuracy of customer-supplied aircraft maintenance schedules. As well, the global downturn in the aviation industry adds the challenge of increasing the backlog of contracted aircraft. In addition, the Company is placing significant resources into the development of the next generation AFIRS 228 to meet the needs of the aviation industry and the changing international regulations. As a result, the net loss for the year ended

December 31, 2010 was \$9,121,181 compared with \$4,539,718 loss for 2009. If direct research and development expenses were excluded from the net loss the resulting net loss before research and development would be \$4,263,686 for 2010 compared to a loss before research and development in 2009 of \$3,965,274. Efforts are being made to have Original Equipment Manufacturers (“OEM”) install AFIRS in the factory and with the announcement in 2010, an agreement with Hawker Beechcraft has been established. AMA is working to strengthen the OEM initiatives throughout 2011.

Expense categories are not segregated by department for 2010 as the entire company has been focused on delivering our main products, AFIRS, UpTime, FLYHTStream, FIRST, and FLYHT Fuel Management System out to customers. For the year ended December 31, 2010, expenses were \$12,123,028 compared with \$7,399,269 for 2009. If direct expenses related to the research and development activities carried out during the year, including the extensive development of the next generation AFIRS 228, were removed, expenses for 2010 would be \$7,265,533 compared with \$6,824,825 for 2009.

Major Expense Categories	2010	2009	Variance	Explanation
Salaries and benefits, third party consulting, and share compensation	\$ 4,930,400	\$ 4,554,823	\$ 375,577	Staff levels in technical positions increased in 2010 causing salaries to increase \$232,122 over 2009, and related statutory payments and benefits increased \$57,854. Technical staffing levels were increased to meet the needs of the AFIRS 228 project and to increase the senior level technical depth of AMA. To continue to attract and retain industry leading professionals, variable compensation was further instituted in 2010 resulting in increased variable compensation payments of \$96,692. Variable compensation was 7.2% of salaries in 2010 versus 4.7% in 2009. The use of third party consultants increased in 2010 resulting in an increase in consulting costs of \$146,678. Share based compensation decreased by \$155,722 over 2009. Other staffing related expenses decreased by \$2,047.
Research and development costs	4,857,495	574,444	4,283,051	The increase in research and development is the result of increased direct research and development activities related to the next generation AFRS 228 hardware which will meet the requirements of regulatory changes in the aviation industry.
Office, computer services, insurance, depreciation, stock exchange fees and bad debts	693,844	739,297	(45,453)	Office costs decreased \$45,453 primarily due to overall costs containment initiatives that began during 2009. The significant changes were a reduction in miscellaneous expenses of \$108,151 as the result of the fact that in 2009 this expense category included the relocation of the corporate offices. Insurance expense decreased \$20,042 due to an aggressive marketing of the Company to insurance underwriters resulting in increased coverage at a lower premium. Bad debt expense increased by \$90,110 due to two customers declaring bankruptcy as compared to one in 2009. Telephone expense increased \$9,456 due to the increased activity with customers and potential customers in various ares of the world. Equipment expenses relating to the maintenance of computer equipment increased \$20,048. Foreign exchange loss decreased \$69,616 from 2009 as the result of the strengthening of the Canadian dollar during 2010. Amortization increased \$33,658 due to the additional of equipment and leasehold improvements during the later part of 2009 and into 2010. Other office related expenses tracked either at the same level or lower than 2009.

Major Expense Categories	2010	2009	Variance	Explanation
Interest and bank charges	48,692	41,319	7,373	Bank charges increased in 2010 due to interest on the debenture issued in December 2010 of \$8,741 and the amortization of debt issue costs of \$1,931 which was partially offset by a reduction in capital lease interest of \$4,226.
Rent	471,758	400,784	70,974	Rent expense increased in 2010 as the result of the recognition of contracted increase in lease rates over the five year rental period.
Marketing	460,163	415,795	44,368	The increase in marketing expenses is primarily related to increased travel and associated travel expenses of \$57,888. The Company expects the expenses in marketing to increase over the next year, as the industry continues to rebound and AMA continues to target global markets with its solutions. Expenditures on advertising and trade shows decreased \$6,608 which was the result of a the adoption of a targeted approach to trade show attendance based on the success data from previous years. Expenses related to marketing supplies and materials reduced \$6,912 from 2009 as there were adequate levels of inventory to meet the 2010 needs. The Company expects expenditures on marketing supplies materials to increase in 2011 as supplies are updated to reflect new product offerings. Marketing costs do not include salaries.
Investor relations	102,067	85,656	16,411	Investor relations costs increased \$16,411 due to the increased emphasis on maintaining a presence in the capital markets by presenting the Company to institutional investors, retail brokers, and retail investors via one on one meetings. As well the Company believes that one on one meetings are the most effective use of funds and anticipates that costs will increase in future years. As well during the latter part of 2010 the Company invested in the preparation of a social media launch during early 2011.
Professional fees	558,609	587,151	(28,542)	Legal fees were lower in 2010 by \$34,387 because of the decreased need for legal representation relating to an action by a Toronto based company and a reduction of \$28,017 in general legal costs. These reductions are partially offset by increased legal fees of \$17,906 relating to intellectual property protection in 2010 and increased costs of \$50,777 related to work with the Federal Aviation Administration on behalf of customers. Consulting fees were \$95,077 in 2010 compared to \$144,211 in 2009, a decrease of \$49,134. This decrease is primarily due to consulting related to the operations of Wingspeed of \$33,461. Audit and accounting related expenses increased from \$121,664 in 2009 to \$176,642 in 2010 or \$54,978 due to increased audit expenses, IFRS consulting to prepare for the January 1, 2011 implementation, and the increased audit work associated with the increased complexity of the business.
Total	\$12,123,028	\$7,399,269	\$4,723,759	

Quarterly Results

2010				
	Q4	Q3	Q2	Q1
Revenue (GAAP)	\$1,491,909	\$1,081,929	\$1,281,147	\$1,112,876
Revenue (cash)	1,644,702	1,361,860	1,704,791	1,338,670
Loss	1,907,360	2,596,646	2,548,584	2,068,591
Loss (before R & D)	590,595	1,135,458	1,370,475	1,259,988
Loss/Share (basic & fully diluted)	0.02	0.03	0.02	0.02
Assets	11,023,683	5,937,150	8,051,911	10,206,469
Long Term Financial Liabilities	2,414,001	155,001	219,392	273,512

2009				
	Q4	Q3	Q2	Q1
Revenue (GAAP)	\$1,006,664	\$1,521,894	\$1,324,004	\$1,253,932
Revenue (cash)	725,565	1,133,796	2,783,947	2,828,469
Loss	1,189,445	717,268	1,333,969	1,299,036
Loss (before R & D)	1,056,053	706,747	1,103,034	1,099,440
Loss/Share (basic & fully diluted)	0.01	0.01	0.02	0.02
Assets	11,748,758	4,293,568	5,284,262	6,023,170
Long Term Financial Liabilities	321,043	398,074	335,399	307,060

2008				
	Q4	Q3	Q2	Q1
Revenue (GAAP)	\$1,392,671	\$789,994	\$596,263	\$398,067
Revenue (cash)	1,934,462	1,498,481	1,210,833	608,842
Loss	1,912,469	1,814,010	2,709,237	2,087,512
Loss (before R & D)	1,654,311	1,803,489	2,478,302	1,887,916
Loss/Share (basic & fully diluted)	0.02	0.02	0.03	0.03
Assets	5,959,845	7,196,256	8,685,414	9,748,505
Long Term Financial Liabilities	318,577	368,314	375,476	400,471

UpTime recurring fees should increase over time as more aircraft are installed with AFIRS and existing customers contract for additional services such as FIRST, FLYHT Fuel Management System and technical consulting.

Research and Development

Research and development (“R&D”) costs are being expensed as incurred. The majority of R&D costs are consulting expenses related to the design, testing, and manufacture of AFIRS, the design and testing of UpTime, and the design and testing of FIRST, FLYHTStream, and FLYHT Fuel Management System. During 2010 R&D efforts on the development of the next generation AFIRS known as AFIRS 228 moved into the full development stage resulting in R&D expense for 2010 of \$4,857,495 versus \$574,444 which is an increase of \$4,283,051. As mentioned in Liquidity and Capital Resources, the costs related to the work undertaken by SNC totaling \$1,821,601 are currently being renegotiated.

While this initiative is significant, this next generation product is important to any air carrier if it is to meet the global regulatory changes to air traffic control systems. Subsequent to the end of 2010, the Company received federal government repayable funding of up to \$1,967,507 to offset some of the R&D expenses related to the AFIRS 228.

Foreign Exchange

All international sales of the Company’s products and services are denominated in U.S. dollars. Accordingly, the Company is susceptible to foreign exchange fluctuations. In 2010, over 98% of the Company’s gross sales were made in U.S. dollars, unchanged from 2009. The Company expects this to continue since the aviation industry conducts a majority of its transactions in U.S. dollars, thus limiting the opportunity for sales in Canadian dollars or other major currencies. The Company will continue to look for opportunities to denominate agreements in other major currencies to reduce the exposure to fluctuations in the U.S. dollar.

Transactions with Related Parties

During the year, the Company’s transactions with a company owned by a director to supply consulting services and travel expenses totaled \$92,944 compared to \$113,101 in 2009. All of the transactions were amounts that were agreed upon by the parties and approximated fair market value. The related party provides business development services such as trade show attendance and corporate introductions related to the business jet initiatives of the Company. All other transactions with related parties were normal business transactions related to their positions with the Company. These transactions included expense reimbursements for business travel and other company expenses paid by the related party and were measured at exchange amounts that the related party paid to a third party and were substantiated with a third party receipt.

Liquidity and Capital Resources

During 2010, the Company issued common shares through a brokered private placement and the exercise of stock options. The Company also issued unsecured convertible debentures. This has improved the financial position of the Company, especially when coupled with the decrease in cash revenue which is the result of a lower level of AFIRS installation kit shipments during the year.

On December 23, 2010, the Company issued 14,985,080 share units pursuant to a brokered private placement at \$0.25 per share unit resulting in gross proceeds of \$3,746,270. Each share unit consists of one common share and one common share purchase warrant (each, a “Share Unit Warrant”). Each Share Unit Warrant entitles the holder thereof to acquire once common share at a price of \$0.40 until December 23, 2013, subject to adjustment in certain events; provided that

in the event that the 20-day moving average trading price of the common shares on the TSX Venture Exchange equals or exceeds \$1.00, AMA shall be entitled to accelerate the exercise period of the Share Unit Warrants to a period ending at least 30 days from the date notice of such acceleration is provided to the holders of the Share Unit Warrants. The net cash proceeds after issuance costs of the brokered private placement totaled \$3,484,031.

Concurrent with the share unit offering, on December 23, 2010, the Company issued 3,159 debenture units pursuant to a brokered private placement at \$1,000 per debenture unit resulting in gross proceeds of \$3,159,000. Each debenture unit consists of one \$1,000 convertible secured subordinate debenture of the Company ("Debenture") and 1,250 common share purchase warrants (each, a "Debenture Warrant"). The Debentures will mature on December 23, 2014 (if not otherwise converted or redeemed in accordance with their terms) and bear interest at a rate of 8% per annum, which shall be accrued and paid annually in arrears commencing December 23, 2011. The Debentures convertible into common shares at a conversion price of \$0.40 per share at any time prior to maturity, subject to adjustment in certain events. Each whole Debenture Warrant entitles the holder thereof to acquire one common share at a price of \$0.75 until December 23, 2014, subject to adjustment in certain events; provided that in the event that the 20-day moving average trading price of the common shares of the TSX Venture Exchange equals or exceeds \$1.00, AMA shall be entitled to accelerate the exercise period of the Debenture Warrants to a period ending at least 30 days from the date notice of acceleration is provided to the holders of the Debenture Warrants. The Debentures are secured against all personal property of the Company, with the exception of the Company's intellectual property, and are subordinated in the right of payment to all existing and future bank and/or government indebtedness of the Company. The Company may, at its option, subject to providing no more than 60 and no less than 30 days' prior notice, redeem the Debentures, in whole or, from time to time, in part, at any time prior to December 23, 2013 at a redemption price equal to 125% of the principal amount of the Debentures then outstanding plus accrued and unpaid interest and, during the period from December 23, 2013 until maturity date, at a redemption price equal to the principal amount of the Debentures then outstanding plus accrued and unpaid interest; provided that in the event that the weighted average trading price of the common shares on the TSX Venture Exchange during the 20 consecutive trading days ending five trading days preceding the date on which the notice of redemption is given is less than \$0.40, the exercise price of the Debenture Warrants shall be adjusted immediately following any such redemption and become \$0.50 per share. The net cash proceeds after issuance costs of the Debentures totaled \$2,937,870.

A further 132,000 common shares were issued to directors, officers, employees, and consultants on the exercise of stock options. The weighted average issue price of these common shares was \$0.25, resulting in cash proceeds of \$33,350.

The concurrent private placements were arranged through a syndicate of agents (collectively, the "Agents"). In consideration for their services, the Agents were paid an aggregate cash commission of \$483,369 (equal to 7% of the gross proceeds raised under both offerings). In addition, the Agents were issued agents' warrants ("Agent Warrants") to acquire up to 1,601,780 common shares (equal to 7% of the aggregate number of common shares underlying the Debentures (on an "as converted" basis) and 7% of the number of share units sold pursuant to the share offering). Each Agents' Warrant is exercisable to acquire one common share at a price of \$0.40 per share, subject to adjustment, in certain events, until December 23, 2014; provided that in the event that the 20-day moving average trading price of the common shares on the TSX Venture Exchange equals or exceeds \$1.00, AMA shall be entitled to accelerate the exercise period of the Agents' Warrants to a period ending at least 30 days from the date notice of such acceleration is provided to the Agents.

The successful equity and debenture offerings combined with the level of cash based revenue and expenses before research and development throughout the year created sufficient capital to continue to operate and to provide capital for inventory to be deployed in order to continue the efforts to expand our customer base.

Working capital at December 31, 2010 was \$4,339,976 compared to \$7,572,447 in 2009, a decrease of \$3,232,471. The decrease in working capital is primarily attributed to the net funds generated from the issuance of share units and debenture units of \$6,421,901 less the operating loss for the year of \$9,121,181; the remaining decrease of \$533,191 is the result of various changes in working capital components as the result of business operations during the year.

Neither customer deposits nor the current portion of unearned revenue are refundable and if those two items were not included in the working capital calculation, the resulting modified working capital at December 31, 2010 would be \$6,972,842 compared to \$9,785,744 in 2009. As well, at December 31, 2010 the Company had outstanding accounts payable to Sierra Nevada Corporation ("SNC") of \$1,821,601 relating to their involvement with the development of the AFIRS 228. The development effort for the AFIRS 228 program was split into four general modules: (1) hardware and (2) board support software (both developed by a Calgary contractor), (3) Embedded Logic Applications ("ELA") (which were developed by AMA staff in Calgary), (4) core software (which was the responsibility of SNC). Late in 2010, it was recognized by management that the progress on the AFIRS 228 program was on track for year end delivery for the hardware, board support software and ELA. However, estimates to complete the core software continued to slip in time and costs had escalated. In early 2011, management of AMA reviewed the state of the core software development with SNC in order to develop a plan and prepare for the transition from an SNC deliverable to AMA maintained software. It was determined by management that the best course of action to successfully complete the 228 in a timely fashion was to repatriate the core software development to Calgary and build a team around the existing resources of our Calgary based contractors and staff. That transition occurred in February 2011 and it is anticipated that a product will be delivered to customers in 2011 with full certification by mid 2012 which meets the timeliness required by our current customers and prospects. The current accounts payable amount of \$1,821,601 as at December 31, 2010 is being reviewed by both parties and negotiations are ongoing to reduce this liability while maintaining the relationship for manufacturing and military marketing.

The Company currently has an available operating line of \$250,000 that had not been drawn at December 31, 2010. The operating line bears an interest rate of Canadian chartered bank prime plus 1.5% and is secured by assignment of cash collateral and a general security agreement.

The achievement of positive earnings before interest and amortization is necessary before the Company can improve liquidity. The Company has continued to expand its cash flow potential through its continued marketing drive to clients around the world. Management believes that the Company's installation momentum, conversion of installations to recurring revenue, new revenue streams, and ongoing sales will be sufficient to meet standard liquidity requirements going forward. To meet the shortfall in cash flow and improve working capital the Company has obtained additional financing from the capital markets. To continue as a going concern the Company will need to attain profitability and/or obtain additional financing to fund on going operations. If general economic conditions or the financial condition of a major customer deteriorates, the Company may have to scale back operations to create positive cash flow from existing revenue and /or raise the necessary financing in the capital markets.

As at April 6, 2011, AMA's issued and outstanding share capital was 118,615,466 common shares.

Contractual Obligations

The Company has entered into various leases for its operating premises and equipment. Future minimum annual payments under these operating leases are as follows:

Year	Premises	Equipment	Total
2011	\$ 432,652	\$ 90,328	\$ 522,980
2012	445,685	32,319	478,004
2013	458,718	-	458,718
2014	76,815	-	76,815
Total	\$ 1,413,870	\$ 122,647	\$ 1,536,517

In addition, the Company has repayment obligations related to two Government of Canada loan programs. Under the Industrial Research Assistance Program ("IRAP"), the outstanding balance is \$196,377 (2009 - \$246,134), which is to be repaid as a percentage of gross revenues, over a five to 10-year period commencing in October 2005. Under the Technology Partnerships Canada ("TPC") program, the Company has an outstanding balance of \$47,186 (2009 - \$66,298) to be repaid based on 15% of the initial contribution, which equates to \$19,122 per year for a 10-year repayment period.

The yearly repayment is due if the Company has achieved more than a 10% increase in gross revenue over the previous year and the gross revenue exceeds the base gross revenue that was set in fiscal of 2004 of \$556,127. The repayment period commenced January 1, 2005.

During 2010, AMA did not enter into new lease agreements for computer equipment (2009 - \$245,810). The equipment leased in previous years was accounted for as capital leases that expire in various years to 2012. The minimum lease payments are as follows:

Year	Total
2011	\$ 90,328
2012	32,319
Total	\$ 122,647

The imputed interest is \$4,500 (2009 - \$17,861), leaving a total obligation of \$118,147 (2009 - \$223,951).

RESULTS OF OPERATIONS – THREE MONTHS ENDED DECEMBER 31, 2010

Revenues

During the fourth quarter \$1,644,702 (2009 - \$725,565) was received in cash revenue which is calculated as \$1,491,910 (2009 - \$1,006,664) reported as financial statement revenue plus \$149,972 (2009 - \$293,460) being cash received for arrangement consideration less the portion of cash recognized during the quarter that is included in financial statement revenue of \$2,820 (2009 - \$574,560). There were five shipments during the fourth quarter compared to seven during the same quarter of 2009.

Revenue increased \$485,246 in the fourth quarter compared to the fourth quarter of last year, and AFIRS UpTime revenues increased by \$136,381 over the fourth quarter of 2009. Product sales revenue decreased \$6,542 and services revenue, license fees and interest increased \$355,407 over the same quarter of the previous year. The increase in AFIRS UpTime revenue is the result of the decreased number of shipments during the quarter compared to the same quarter of 2009 which was offset by an increase in recurring revenue. This decrease in shipments can be directly attributed to the reduction in capital spending in the aviation industry which was somewhat offset by increased per kit pricing. The offset was an increase of 21.8% in recurring revenue in the quarter versus the same quarter of 2009 to \$705,366 from \$579,248, which indicates that the initiatives to maximize the revenue from installed equipment continues to be successful. The decrease in product sales revenue can be directly attributed to the limited sale of Underfloor Stowage Units in the fourth quarter of 2010. Product sales revenue has historically and will continue to fluctuate between quarters. The services revenue increase was the result of consulting undertaken in the fourth quarter of 2010 for a major airline to assist them with Federal Aviation Administration dealings and the completion of an operations command centre installation for an African aviation authority.

Gross Margin and Cost of Sales

Cost of sales in the fourth quarter of 2010 was \$472,835 compared to \$356,597 in 2009, an increase of \$116,238. The gross margin for the fourth quarter of 2010 was 68.3% versus 64.6% for the same period of 2009. Included in cost of sales are costs of non-routable parts and travel expenses for our engineers on initial installations of aircraft. This is also coupled with increasing recurring revenue as a percentage of total revenue during the quarter, which will increase the overall margin as a percentage of sales since the cost of sales for recurring revenue is lower than that for AFIRS shipments and its corresponding non-routable supplies and support. As well, the gross margin on the consulting and operations centre revenue was a factor in the increased gross margin.

Net Loss, General and Administrative, and Marketing Expenses

The net loss for the quarter ended December 31, 2010 was \$1,907,360 (2009 - \$1,189,445). Marketing costs are included in general and administrative expenses. Marketing expenses increased by \$1,793 to \$129,213 over the fourth quarter of 2009. The Company's focus is on generating new customers and as such will continue to engage resources in marketing; as a result, initiatives commenced in 2009 continue as the sales and marketing team has focused on the use of technology to meet the needs of potential customers while minimizing the costs associated with marketing to the global aviation industry. The use of agents in key markets has further reduced the need for North American based sales personnel to travel as extensively. As the aviation industry rebounds and demand for the Company's products

and services increases marketing costs are expected to increase. As well, the Company will require updated collateral marketing material to meet a changing market focus and this will result in increased marketing expenses.

Office expenses decreased by \$62,039 in the fourth quarter over the same period of 2009, primarily due to the continued expense containment initiatives which saw general office expenses such as stationary, etc. decrease \$56,909 over the fourth quarter of 2009. Insurance expense decreased \$4,792 and consulting expense decreased \$19,439. The expense related to equipment increased \$17,837 due to the Company's investment in non capital system upgrades during 2010. The remainder was an increase of \$1,195 in investor relations and stock exchange costs.

Salaries, the main cost of doing business, increased to \$1,056,015 for the quarter versus \$1,028,532 for the fourth quarter of 2009, a \$27,483 increase. This increase is the result of the requirement to add technical expertise to meet the needs of the AFIRS 228 project as well as bolster the senior level technical capabilities of the Company. The Company continues to hire qualified personnel to meet the demands of the growing customer base and to ensure resources are in place to meet the requirements of our strategic business alliances. As these opportunities are solidified, it is expected that salaries will increase to meet the demands of the marketplace.

Stock-based compensation was \$5,432 in the fourth quarter of 2010 compared to \$81,737 in the same period of 2009. The decrease was due to no option grants being recognized. However, the Company recognized the vesting of options grants made in May 2009 and May 2010 to consultants.

Research and Development

R&D costs are being expensed as incurred. The fourth quarter development costs for 2010 were \$1,316,763 as compared to \$133,392 in the same quarter of 2009. The increase during the quarter is the direct result of the development of the next generation AFIRS known as AFIRS 228 which moved into the full development stage in 2010, which was not the case in the fourth quarter of 2009. While this initiative had a significant impact on the financial results for the quarter this next generation product is important to any air carrier if it is to meet the global regulatory changes to air traffic control systems. The majority of R&D costs are comprised of consulting expenses, testing and certification, and other expenses. These research and development costs will continue during the first quarters of 2011. As mentioned in Liquidity and Capital Resources the costs related to the work undertaken by SNC is currently being renegotiated. The total SNC costs in the quarter were \$843,590.

Critical Accounting Policies and Estimates

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in Canada. The preparation of these financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. These estimates are based on management's historical experiences and various other assumptions that are believed by management to be reasonable under the circumstances. Such assumptions are evaluated on an ongoing basis and form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

The following are the Company's critical accounting policies, significant estimates, and assumptions used in preparing our financial statements:

1. The Company maintains an allowance for doubtful accounts for estimated losses that may occur if customers are unable to pay trade balances owing to the Company. This allowance is determined based on a review of specific customers, historical experience, and economic circumstances.
2. Inventories are carried at the lower of cost and net realizable value. Provisions for excess or obsolete inventory are recorded based on Management's assessment of the estimated market value of raw materials and AFIRS completed.
3. The Company evaluates its future tax assets and records a valuation allowance where the recovery of future taxes does not meet the required level of certainty. At December 31, 2010, valuation allowances are provided for the full amount of future tax assets.
4. The Company records amounts for warranty based on historical warranty data and are recognized when the underlying products or services are sold.
5. Intangible assets are stated at cost and comprise a license, customer contracts, and customer relationships. The license has an indefinite life. The customer contracts and relationships are amortized using the straight line method over the remaining life of the assumed contract. Intangible assets not subject to amortization are subject to an annual impairment test or more frequently if events or circumstances change that indicate that the carrying value may not be recoverable. Intangible assets subject to amortization are tested for impairment if events or circumstances indicate that the underlying value of the contract or relationship has changed.
6. The Company recognizes revenue from rental type agreements as agreement consideration, which is recorded as unearned revenue and recognized into revenue over the term of the rental agreement. Sales type agreement consideration is deferred as unearned revenue and corresponding expenses are recorded as work in progress until the system is fully functional and customer acceptance has been obtained at which time the full deferred amount is recognized in revenue along with the work in progress as cost of sales. For both types of agreements the 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 Underfloor Stowage Units is recognized when the unit is shipped, title is transferred, and collection is reasonably assured. Certain customers have prepaid for products or 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 products or services are delivered.

Technical services are provided based upon orders and contracts with customers that include fixed or determinable prices that are based upon, daily, hourly or contracted rates. Revenue is recognized as services are rendered and when collectability is reasonably assured.

Financial Instruments

The Company is exposed to fluctuations in the exchange rates between the Canadian dollar and other currencies with respect to assets, sales, and purchases. The Company monitors fluctuations and may take action if deemed necessary to mitigate its risk.

The Company is exposed to changes in interest rates as a result of the operating loan, bearing interest based on the Company's lenders' prime rate. The convertible secured subordinate debenture has a fixed rate of interest and therefore does not expose the Company to interest rate changes.

There is a credit risk associated with accounts receivable where the customer fails to pay invoices. The Company extends credit generally to credit worthy or well-established customers. In the case of agreement consideration or product sales the invoiced amount is generally payable before the AFIRS or other product is shipped to the customer. The Company assesses the financial risk of a customer and based on that analysis will require that a deposit payment be made before a service is provided. As well, for monthly recurring revenue the Company has the ability to disable AFIRS UpTime and/or supply data in cases where the customer has not fulfilled its financial obligations.

Contingencies

In September 2007, the Company, among others, was 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 and no liability in respect to this action has been included in the consolidated financial statements, as management intends to vigorously defend the matter and believes the outcome will be in its favour. On November 7, 2007, the Company filed 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. During 2010 there has been no substantial progress on a resolution to the action. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable.

Subsequent Event

The Company signed a contribution agreement with Industry Canada under the Strategic Aerospace & Defense Initiative ("SADI") for the development of the next generation product AFIRS 228. Under the terms of the agreement SADI will make a repayable unsecured contribution to the Company of the lesser of 30% of eligible project costs from June 18, 2010 to December 31, 2012 or \$1,967,507. The amount is repayable over 15 years commencing April 30, 2014 and the yearly repayment amounts are calculated on a stepped basis starting at 3.5% of the contribution amount and increasing yearly until April 30, 2028 when the final payment is 24.5% of the amount contributed by SADI. The contribution is paid to the Company based on the quarterly submissions of eligible project costs to SADI. The eligible project costs prior to January 31, 2011 are limited to 20% of the estimated eligible costs of the program or \$1,311,671.

International Financial Reporting Standards Changeover Plans

International Financial Reporting Standards ("IFRS") are to be implemented by the Company on January 1, 2011 and CSA Notice 52-320 requires that progress on IFRS changeover plans be disclosed. AMA has completed the white papers on areas of significant difference, calculated the differences, and prepared the initial adjustments and opening Balance Sheet. This work has been reviewed by the Audit Committee and is in the process of being reviewed by the Company's external auditors. Note that the below noted discussion on IFRS differences is subject to final audit, adjustments anticipated by management to date are expected to be:

1. Stock Based Compensation

Stock options issued to an employee at the service commencement date but before the legal grant date are required to be initially recognized under IFRS at the estimated fair value upon commencement of service and subsequently adjusted to actual fair value upon the legal grant date. At the transition date AMA had two employees for which this occurred and the transition adjustment results in an increase in Contributed Surplus and an increase in the Deficit of approximately \$12,000, subject to final review during the 2011 fiscal year audit.

2. Inventory Disclosure

IFRS requires the disclosure of the amount of inventories that are to be expected to be recovered after more than twelve months from the balance sheet date. Based on the nature of AMA's inventory and purchasing requirements as at the transition date it has been determined that a portion of the inventory is not expected to turnover in the 12 month period subsequent to the transition date. The disclosure adjustment at transition date is expected to be between \$800,000 and \$1,000,000.

AMA previously identified the following areas where differences may occur and based on updated analysis believes the potential impact on its financial statements is as below:

3. Property Plant & Equipment

The decision to adopt the cost model instead of revaluation was made. Management assessed the IFRS requirement to componentize property, plant and equipment into material individual components for which different depreciation methods or rates are appropriate and determined that no further componentization is required. Current depreciation rates have been reviewed and deemed appropriate for all property, plant and equipment. First time adopters may use an optional exemption to use fair value as deemed cost upon date of transition. When this exemption is used, the deemed cost becomes the new IFRS cost basis and any accumulated depreciation recognized under Canadian GAAP prior to transition is set to zero. AMA expects not to elect to use this exemption. Subject to final audit the company believes there will be no adjustment to property, plant and equipment values.

4. Impairment

IFRS results in increased exposure to impairment writedowns. The Company has determined that it has two cash generating units ("CGU") related to the production of AFIRS units and Underfloor Stowage Units respectively. At each reporting period date, the Company will assess whether there is an indication of impairment. If an indication exists, the asset's or CGU's recoverable amount will be estimated and compared to the carrying amount. An impairment loss is recognized if an asset's (CGU's) carrying amount exceeds its recoverable amount. At each reporting date, the Company will assess whether there is an indication that a previously recognized impairment loss has reversed. Although subject to final audit, the Company believes there will be no impairment adjustment at transition.

5. Leases

Subject to final audit, the Company has determined that there will be no changes in the classification of capital versus operating leases from both a lessor and lessee perspective and therefore no adjustment to opening balances.

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.

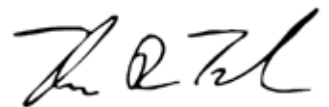
Financial statements are not precise since they include amounts based on estimates and judgments. Such amounts have been determined on a reasonable basis to ensure the financial statements are presented fairly in all material aspects. Management has prepared the financial information in this annual report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

The 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. AMA'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 findings to the Board of Directors before such statements are approved by the Board.



William Tempany
Chief Executive Officer
April 6, 2011



Thomas R. French, CGA
Chief Financial Officer
April 6, 2011

AUDITORS' REPORT

To the Shareholders of
AeroMechanical Services Ltd.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of AeroMechanical Services Ltd. ("the Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of loss, deficit and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from 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 our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated 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 Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2010 and 2009, and the results of its consolidated operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 to the consolidated financial statements which describes that the Company has incurred a net loss of \$9,121,181 and has negative cash flows from operations of \$6,466,764 for the year ended December 31, 2010 and, as of that date, the Company's deficit amounted to \$43,979,026. These conditions, along with other matters described in Note 1, indicate the existence of a material uncertainty which may cast significant doubt on the Company's ability to continue as a going concern.

A handwritten signature in black ink that reads "KPMG LLP". The letters are written in a cursive, slightly slanted style.

Calgary, Canada
April 6, 2011

CONSOLIDATED BALANCE SHEETS

December 31, 2010 and 2009

	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 6,617,852	\$ 7,161,427
Restricted cash (note 8)	250,000	250,000
Accounts receivable	883,319	529,869
Deposits and prepaid expenses	140,304	288,177
Inventory (note 3)	2,234,760	2,418,375
	<u>10,126,235</u>	<u>10,647,848</u>
Property and equipment (note 4)	402,535	478,968
Rental assets (note 5)	155,101	143,539
Intangible assets (note 6)	339,810	478,403
	<u>\$ 11,023,681</u>	<u>\$ 11,748,758</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 3,508,175	\$ 1,270,748
Current portion unearned revenue	2,105,409	1,589,313
Current portion of loans payable (note 7)	86,557	109,536
Current portion of obligation under capital lease (note 10)	86,118	105,804
	<u>5,786,259</u>	<u>3,075,401</u>
Unearned revenue	726,469	1,534,529
Loans payable (note 7)	157,006	202,896
Convertible debenture – debt component (note 9)	2,224,966	-
Obligation under rental lease	36,927	-
Obligation under capital lease (note 10)	32,029	118,147
Warranty	61,239	-
	<u>3,238,636</u>	<u>4,930,973</u>
Shareholders' equity:		
Share capital (note 11)	36,730,844	35,550,028
Convertible debenture – equity component (note 9)	389,110	-
Warrants (note 11)	5,134,018	4,181,685
Contributed surplus (note 11)	3,723,840	1,943,917
Deficit	(43,979,026)	(34,857,845)
	<u>1,998,786</u>	<u>6,817,785</u>
Going concern (note 1)		
Commitments (note 12)		
Subsequent event (note 18)		
Contingencies (note 19)		
	<u>\$ 11,023,681</u>	<u>\$ 11,748,758</u>

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, 2010 and 2009

	2010	2009
Revenue:		
AFIRS UpTime revenue	\$ 4,056,822	\$ 4,286,423
Product sales revenue	121,674	359,355
Services revenue and interest	789,365	460,716
	<u>4,967,861</u>	<u>5,106,494</u>
Cost of sales	1,961,745	2,244,601
Gross margin	<u>3,006,116</u>	<u>2,861,893</u>
Expenses:		
Salaries and benefits	4,678,302	4,147,003
Research and development	4,857,495	574,444
General and administrative	1,501,603	1,542,365
Marketing	460,163	415,795
Stock based compensation	252,098	407,820
Amortization	220,324	186,666
Bad Debts	131,199	41,089
Interest, accretion and bank charges	48,692	41,319
Foreign exchange loss (gain)	(26,848)	42,768
	<u>12,123,028</u>	<u>7,399,269</u>
Net loss before income taxes	(9,116,912)	(4,537,376)
Current income taxes	4,269	2,342
Net loss and comprehensive loss	(9,121,181)	(4,539,718)
Deficit, beginning of year	(34,857,845)	(30,318,127)
Deficit, end of year	<u>\$ (43,979,026)</u>	<u>\$ (34,857,845)</u>
Net loss per share:		
Basic and diluted	\$ (0.09)	\$ (0.05)
Weighted average shares:		
Basic and diluted	103,932,637	85,415,370

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2010 and 2009

	2010	2009
Cash provided by (used in):		
Operating activities:		
Net loss	\$ (9,121,181)	\$ (4,539,718)
Add items not affecting cash		
Amortization	220,324	186,666
Amortization of rental assets	35,460	60,306
Amortization of intangibles	138,593	23,099
Accretion of convertible debenture	8,741	-
Amortization of debt issue cost	1,931	-
Stock based compensation	252,098	407,820
Write down of rental assets	-	83,289
Warranty expense	61,239	-
Rental obligation	36,927	-
-	-	-
Unrealized foreign exchange loss (gain)	(18,417)	69,791
	(8,384,285)	(3,708,747)
Net change in non-cash working capital balances (note 17)	1,917,521	1,693,326
	(6,466,764)	(2,015,421)
Financing:		
Issuance of common shares	3,779,620	9,843,467
Issuance of convertible debentures	3,159,000	-
Repayment on capital leases	(105,804)	(75,262)
Share issue costs	(369,764)	(742,744)
Convertible debenture issue costs	(304,478)	-
Loan repayment	(68,869)	(80,079)
	6,089,705	8,945,382
Investments:		
Purchase of property and equipment	(143,891)	(159,513)
Purchase of intangibles	-	(466,509)
Purchase of rental assets	(47,022)	-
	(190,913)	(626,022)
Effect of foreign currency exchange rates on cash balances	24,397	56,084
Change in cash and cash equivalents	(543,575)	6,360,023
Cash and cash equivalents, beginning of year	7,161,427	801,404
Cash and cash equivalents, end of year	\$ 6,617,852	\$ 7,161,427

Supplemental cash flow information (note 17)

See accompanying notes to the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010 and 2009

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

AMA is a designer, developer, and service provider to the global aerospace industry. The Company's major products are the Automated Flight Information Reporting System ("AFIRS™"), UpTime™, AeroQ™, FIRST, FLYHT Fuel Management System, FLYHTStream™, and Underfloor Stowage Unit.

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, 2010, the Company had working capital of \$4,339,976 (2009 – \$7,572,447), a deficit of \$43,979,026 (2009 - \$34,857,845), a net loss of \$9,121,181 (2009 - \$4,539,718), and negative cash flow from operations of \$6,466,764 (2009 - \$2,015,421).

The Company has incurred significant operating losses and negative cash flows from operations over the past years and has positive working capital due to its ability to obtain additional financing to fund its on-going operations (note 16). The Company's ability to continue as a going concern is dependent upon attaining profitable operations and/or obtaining additional financing to fund its on-going operations. 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 containment strategy, the completion of research and development project, 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) Use of estimates:

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 the warranty provision are based on historical warranty information regarding the costs associated with replacing components that are not functioning related to AFIRS units.

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 sale and rental of AFIRS units and related UpTime usage fees, licensing fees and the provision of technical services. There are two types of revenue streams: sales and rentals, depending on the type of services agreement. Under the terms of rental 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 rental agreement. For sales type services 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 installations 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 Underfloor Stowage Units is recognized when the unit is shipped, title is transferred, and collection is reasonably assured. Certain customers have prepaid for products or 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 products or services are delivered.

Technical services are provided based upon orders and contracts with customers that include fixed or determinable prices that are based upon, daily, hourly or contracted rates. Revenue is recognized as services are rendered and when collectability is reasonably assured.

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
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 rented and in use in customer aircraft. Amortization is provided for units that are rented on a straight line basis over six years.

(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 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 active 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 at 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 were 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 criterion 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 and cash equivalents and restricted cash as held-for-trading, accounts receivable are classified as loans and receivables. Accounts payable and accrued liabilities, loans payable and convertible debentures are classified as other liabilities, all of which are measured at amortized cost

(j) Inventory:

Raw material inventory is stated at the lower of cost and net realizable value. Management evaluates raw material inventory for obsolescence and charges obsolescence to cost of goods sold. Cost is determined using the first in first out method. Raw material inventories include Underfloor Stowage Units and general parts which are held pending installation and sale to the customer.

AFIRS completed inventory is stated at the lower of cost and net realizable value. Cost is determined based on the cost of the raw material components plus a standard labour allocation.

Management evaluates AFIRS completed inventory for obsolescence and charges obsolescence to cost of goods sold. AFIRS completed inventory consists of AFIRS units that have been assembled and are held pending sale to the customer.

Installations in progress are stated at the lower of cost or net realizable value. Cost is determined based on the cost of the AFIRS unit and direct installation project costs. Labour is not allocated to installation projects. Installations in progress are recognized as cost of sales when the system is fully functional, customer acceptance has been obtained, and the full deferred revenue amount is then recognized in revenue.

(k) Cash and cash equivalents:

Cash and cash equivalents consist 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:

Amounts recorded for warranty are based on historical warranty data and are recognized when the underlying products or services are sold.

(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.

(n) Stock-based compensation:

The Company has a stock option plan for directors, officers, employees, and consultants of the Company. 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 assets:

Intangible assets are stated at cost and are comprised of a license and customer relationships. The license has an indefinite life. The customer relationships are amortized using the straight line method over the remaining life of the contract that was assumed on acquisition. Indefinite life intangible assets are subject to an annual impairment test or more frequent if events or changes in circumstances indicate that the carrying value may not be recoverable. Intangible assets subject to amortization are tested for impairment if events or circumstances indicate that the underlying value of the contract or relationship has changed.

3. Inventory:

	2010	2009
Raw material	\$ 1,065,714	\$ 1,139,816
AFIRS completed	490,662	561,268
Installations in progress	678,384	717,291
	\$ 2,234,760	\$ 2,418,375

Inventory amounting to \$883,086 was charged to cost of sales in 2010 (2009 - \$1,425,518).

4. Property and equipment:

2010	Cost	Accumulated amortization	Net book value
Computers	\$ 565,547	\$ 389,611	\$ 175,936
Software	285,663	258,481	27,182
Equipment	235,349	120,495	114,854
Leasehold improvements	126,592	42,029	84,563
	<u>\$ 1,213,151</u>	<u>\$ 810,616</u>	<u>\$ 402,535</u>
2009			
Computers	\$ 539,853	\$ 319,509	\$ 220,344
Software	228,120	158,073	70,047
Equipment	197,436	95,401	102,035
Leasehold improvements	103,850	17,308	86,542
	<u>\$ 1,069,259</u>	<u>\$ 590,291</u>	<u>\$ 478,968</u>

Included in computers, software and equipment are capital leases with a cost of \$292,751 (2009 - \$292,751), accumulated amortization of \$213,044 (2009 - \$114,185) and a net book value of \$79,707 (2009 - \$178,566).

5. Rental assets:

2010	Cost	Accumulated amortization	Net book value
Rental assets	\$ 206,718	\$ 51,617	\$ 155,101
	<u>\$ 206,718</u>	<u>\$ 51,617</u>	<u>\$ 155,101</u>
2009			
Rental assets	\$ 198,637	\$ 55,098	\$ 143,539
	<u>\$ 198,637</u>	<u>\$ 55,098</u>	<u>\$ 143,539</u>

In 2010, it was determined that certain rental assets in the amount of \$Nil (2009 - \$83,289) were obsolete. The 2009 obsolescence was recorded in cost of sales.

The remaining net book value of rental assets as at December 31, 2010 relates to assets currently rented under two rental type agreements.

6. Intangible assets:

	Cost	Accumulated amortization	Net book value
2010			
License	\$ 34,992	\$ -	\$ 34,992
Customer relationships	466,510	161,692	304,818
	\$ 501,502	\$ 161,692	\$ 339,810
2009			
License	\$ 34,992	-	\$ 34,992
Customer relationships	466,510	23,099	443,411
	\$ 501,502	\$ 23,099	\$ 478,403

7. Loans payable:

	2010	2009
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.	\$ 196,377	\$ 246,134
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.	47,186	66,298
	243,563	312,432
Less: current portion	(86,557)	(109,536)
	\$ 157,006	\$ 202,896

8. Bank loan:

The Company has available to it an operating demand loan up to a maximum of \$250,000 (2009 – \$250,000). The operating demand loan bears interest at Canadian chartered bank prime plus 1.5%. The operating demand loan is 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, 2010 and 2009, the facility had not been drawn.

9. Convertible secured subordinate debenture:

On December 23, 2010, the Company issued 3,159 debenture units pursuant to a brokered private placement at \$1,000 per debenture unit resulting in gross proceeds of \$3,159,000. Each debenture consists of one \$1,000 convertible secured subordinate debenture of the Company (“Debenture”) and 1,250 common share purchase warrants. The Debentures will mature on December 23, 2014 (if not otherwise converted or redeemed in accordance with their terms) and bear interest at a rate of 8% per annum, which shall be accrued and paid annually in arrears commencing December 31, 2011. The Debentures are convertible into common shares at a conversion rate of \$0.40 per share at any time prior to maturity, subject to adjustment in certain events. The Debentures are secured against all personal property of the Company, with the exception of the Company’s intellectual property, and are subordinated in right of payment to all existing and future bank and/or governmental indebtedness of the Company. The Company, may, at its option, subject to providing no more than 60 and no less than 30 days’ prior notice, redeem the Debentures, in whole or, from time to time, in part, at any time prior to December 23, 2010 at a redemption price equal to 125% of the principal amount of the Debentures then outstanding plus accrued and unpaid interest and, during the period from December 23, 2013 until maturity, at a redemption price equal to the principal amount of the Debentures then outstanding plus accrued and unpaid interest.

The Debentures have been classified as debt, net of issue costs and net of fair value of the conversion feature and warrants at the date of issue which have been classified as part of shareholders’ equity. The issue costs will be amortized over the term of the Debentures and the debt portion will accrete up to the principal balance at maturity. The accretion, amortization of issue costs and the interest paid are expensed within the interest and bank charges expense on the consolidated statements of loss and deficit. The fair value of the conversion feature was determined at the time of issue as the difference between the principal value of the Debentures and the discounted cash flows assuming a 15% rate which was the estimated rate for debt with similar terms at the time (note 11e). If the Debentures are converted to shares, a portion of the value of the conversion feature under shareholders’ equity will be classified to shareholders’ capital along with the conversion price paid.

Total interest and issue cost amortization charged to earnings for the year ended December 31, 2010 was \$10,672 (2009 - \$nil) which included \$8,741 of debenture accretion (2009 - \$Nil) and \$1,931 of amortized issue costs (2009 - \$Nil).

10. Obligations under capital lease:

The Company is party to various capital leases for computer hardware and software that expire in 2012 or earlier. Future minimum lease payments under the capital leases are as follows:

	2010	2009
2010	\$ -	\$ 119,165
2011	90,328	90,328
2012	32,319	32,319
	122,647	241,812
Less: imputed interest	(4,500)	(17,861)
Less: current portion	(86,118)	(105,804)
	\$ 32,029	\$ 118,147

11. 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, 2008	82,500,219	\$ 28,982,059
Issued for cash	20,175,000	9,670,000
Bifurcation of warrants	-	(2,240,000)
Exercise of employee options	823,167	173,468
Contributed surplus from exercise of employee options	-	101,485
Share issue costs	-	(1,136,984)
Balance December 31, 2009	103,498,386	35,550,028
Issued for cash	14,985,080	3,746,270
Bifurcation of warrants	-	(2,082,925)
Exercise of employee options	132,000	33,350
Contributed surplus from exercise of employee options	-	19,620
Share issue costs	-	(535,499)
Balance December 31, 2010	118,615,466	\$ 36,730,844

11. Share capital (continued):

(c) Stock option plan:

The Company grants stock options to its directors, officers, employees 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, 2010, there were 11,861,547 (2009 – 10,349,839) common shares reserved for this purpose. All options vest immediately at the grant date with the exception of 75,000 (2009 – 75,000) options granted to consultants during 2010 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 options, as at December 31, 2010 and 2009 and changes during these years is presented below:

	2010		2009	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Outstanding, beginning of year	2,784,496	\$ 0.42	2,308,998	\$ 0.52
Granted	975,000	0.41	1,955,000	0.31
Exercised	(132,000)	0.25	(823,167)	0.21
Forfeited/expired	(1,128,519)	0.51	(656,335)	0.69
Outstanding, end of year	2,498,977	\$ 0.39	2,784,496	\$ 0.42
Exercisable, end of year	2,423,977	\$ 0.39	2,709,496	\$ 0.43

Weighted average life remaining for the options outstanding and exercisable is 2.2 years.

The weighted average fair value of the options granted during the year was \$0.27 (2009 - \$0.31) per option. The fair value of the options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2010	2009
Risk-free interest rate	2.18%	1.34%
Expected life (years)	3.4	2.5
Volatility in the price of the Company's common shares	112%	124%
Dividend yield rate	0.00%	0.00%

(d) Contributed surplus:

	2010	2009
Balance, beginning of year	\$ 1,943,917	\$ 1,467,350
Employee stock options exercised	(19,620)	(101,486)
Warrants expired	1,448,291	170,233
Agent options expired	99,154	-
Stock based compensation	252,098	407,820
Balance, end of year	\$ 3,723,840	\$ 1,943,917

11. Share capital (continued):

(e) Warrants:

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

	2010	2009
Balance, beginning of year	\$ 4,181,685	\$ 1,717,678
Finder fee warrants exercised	-	-
Warrants issued on private placement	2,082,925	2,240,000
Warrants issued on debenture	163,771	-
Warrants expired	(1,448,291)	-
Agent warrants issued	253,082	394,240
Agent warrants expired	(99,154)	(170,233)
Balance, end of year	\$ 5,134,018	\$ 4,181,685

	2010		2009	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Outstanding, beginning of year	11,377,499	\$ 0.84	2,572,500	\$ 1.31
Granted on private placement	14,985,080	0.40	9,119,999	0.72
Granted on debenture	3,948,750	0.75	-	-
Expired	(2,100,000)	1.30	(315,000)	1.00
Agent warrants granted	1,601,780	0.40	-	-
Agent warrants expired	(157,500)	1.30	-	-
Outstanding, end of year	29,655,609	\$ 0.73	11,377,499	\$ 0.84

On December 23, 2010 the Company issued 14,985,080 units at \$0.25 per unit in connection with a brokered private placement with each unit consisting of one common share and one purchase warrant for net cash proceeds of \$3,484,031.

In connection with this brokered private placement 14,985,080 warrants were issued entitling the holder to acquire one common share of the Company at \$0.40 until December 23, 2013. In the event that the 20 day moving average trading price of the Common Shares on the TSX Venture Exchange equals or exceeds \$1.00, the Company shall be entitled to accelerate the exercise period to a period ending in at least 30 days from the date notice of such acceleration is provided to the holders of the warrants.

The estimated fair value of these warrants is \$2,082,926 or \$0.14 per warrant. The fair value of these warrants was estimated using the Black-Scholes option pricing model with average risk-free interest rate of 2.24%, expected life of 3.0 years, volatility in the price of the Company's common shares of 110% and dividend yield of 0.00%.

11. Share capital (continued):

In connection with a debenture placement (note 9) on December 23, 2010 3,948,750 warrants were issued entitling the holder to acquire one common share of the Company at \$0.75 until December 23, 2014. In the event that the 20 day moving average trading price of the Common Shares on the TSX Venture Exchange equals or exceeds \$1.00, the Company shall be entitled to accelerate the exercise period to a period ending in at least 30 days from the date notice of such acceleration is provided to the holders of the warrants.

The estimated fair value of these warrants is \$163,771 (net of issue costs). The fair value of these debenture warrants were estimated using the residual method with a discount rate of 15% (note 9). The equity conversion feature of the debenture is \$389,110 (net of allocated issue costs).

In connection with the brokered private placement and debenture placement completed on December 23, 2010 1,601,780 agent warrants were issued entitling the holder to acquire one common share of the Company at \$0.40 until December 23, 2014. In the event that the 20 day moving average trading price of the Common Shares on the TSX Venture Exchange equals or exceeds \$1.00, the Company shall be entitled to accelerate the exercise period to a period ending in at least 30 days from the date notice of such acceleration is provided to the holders of the warrants.

These agent warrants are accounted for as a charge to share issuance costs of \$253,082 or \$0.16 per warrant. The fair value of the agent warrants were estimated using the Black-Scholes option pricing model with a weighted average risk-free interest rate of 2.24%, expected life of 4.0 years, volatility in the price of the Company's common shares of 108%, and a dividend yield rate of 0.00%.

12. 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:

2011	\$	522,980
2012		478,004
2013		458,718
2014		76,815
	\$	1,536,517

13. Related party transactions:

During the year, the Company contracted with a company owned by a director to supply consulting services totaling \$92,944 (2009 - \$113,101). All of the transactions were measured at the exchange amounts, that being the amount of consideration established and agreed upon by the related parties which approximated fair market value.

14. 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 28.00% (2009 – 29.00%) as follows:

	2010	2009
Computed "expected" tax (recovery)	\$ (2,555,683)	\$ (1,321,798)
Non-deductible expenses	17,337	11,303
Stock-based compensation	70,587	118,268
Rate change and other	(1,048,456)	352,873
Valuation allowance	3,520,484	841,696
	\$ 4,269	\$ 2,342

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

	2010	2009
Capital assets	\$ 94,157	\$ 30,304
Intangibles	52,218	17,607
Inventory	7,681	7,706
Non-capital loss carry-forwards	8,565,882	7,084,002
Share issue costs	301,329	278,104
Scientific research and experimental development expenditures	3,053,254	1,125,987
Other	45,834	56,212
Valuation allowance	(12,120,355)	(8,599,922)
	\$ –	\$ –

- (c) The Company has non-capital losses for income tax purposes of approximately \$32,861,629 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:

2014	\$ 2,570,288
2015	2,461,959
2026	3,390,309
2027	5,596,948
2028	6,997,140
2029	2,791,748
2030	9,053,237
	\$ 32,861,629

15. 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 fair value of the convertible secured subordinate debenture outstanding at December 31, 2010 was approximately \$2,972,039 (2009 – Nil).

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 has 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.

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

	2010	2009
Current, 1 – 30 days	\$ 782,494	\$ 428,012
31 – 60 days	90,015	53,672
61 – 90 days	4,635	1,264
Greater than 90 days	6,176	46,921
	\$ 883,319	\$ 529,869

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

	Provision
Balance, December 31, 2009	\$ 40,407
Provision	131,199
Accounts receivable written off	(167,788)
Balance, December 31, 2010	\$ 3,818

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

(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. The convertible secured subordinate debenture carries a fixed interest rate. As at December 31, 2010, 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.

(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 would increase net earnings by approximately \$47,553 (2009 - \$48,512) and a strengthening of the Canadian dollar would decrease net earnings by approximately \$47,553 (2009 - \$48,512).
- (ii) Working capital – the Company has exposure to foreign exchange risk for working capital items denominated in US dollars. At December 31, 2010, working capital denominated in US dollars was approximately negative \$569,793 (2009 - positive \$139,928). As a result a 1% weakening of the Canadian dollar would decrease net earnings by approximately \$5,698 (2009 – increase \$1,399) and a strengthening of the Canadian dollar would increase net earnings by approximately \$5,698 (2009 – decrease \$1,399).
- (iii) The Company mitigates its exposure to foreign exchange risk in the following ways: 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.

16. 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, 2010 was 129.4% (2009 – 7.9%)

17. Supplemental cash flow information:

Change in non-cash working capital:

	2010	2009
Changes in non-cash working capital:		
Accounts receivable	\$ (363,767)	\$ 471,050
Deposits and prepaid expenses	152,215	60,827
Inventory	183,610	429,810
Accounts payable and accrued liabilities	2,237,427	(287,848)
Unearned revenue	(291,964)	1,021,768
Deferred lease inducement	-	(2,281)
	<u>\$ 1,917,521</u>	<u>\$ 1,693,326</u>
Interest (paid)/earned	\$ 4,095	\$ (11,139)
Taxes Paid	\$ 4,269	\$ 2,342
Cash and cash equivalents:		
	2010	2009
Cash in bank	\$ 6,617,852	\$ 7,161,427

18. Subsequent event:

On February 23, 2011, the Company signed a contribution agreement with Industry Canada under the Strategic Aerospace & Defense Initiative ("SADI") for the development of the next generation product, AFIRS 228. Under the terms of the agreement, SADI will make a repayable unsecured contribution to the Company of the lesser of 30% of the eligible project costs to December 30, 2012 or \$1,967,507. The amount is repayable over 15 years commencing April 30, 2014. The payments are on a stepped basis starting April 30, 2014 of 3.5% of the contribution and increasing 15% yearly until April 30, 2028 when the final payment is 24.5 of the contribution.

19. Contingency:

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 filed 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. During 2010 there has been no substantial progress on a resolution to the action. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable.

CORPORATE INFORMATION

Annual General Meeting

The Annual General Meeting of Shareholders will be held on Thursday, June 2, 2011 at 2 PM MDT time in the boardroom at AeroMechanical Services Ltd. offices Suite 200W, 1144-29th Ave NE, Calgary, Alberta, Canada.

Registrar and Transfer Agent

Valiant Trust Company
Telephone: 1-866-313-1872
Email: inquires@valianttrust.com
www.valianttrust.com

Share Listing

Shares are traded on the TSX Venture Exchange
Ticker Symbol: AMA

Investor Relations

Email: investors@flyht.com
Telephone: 1-403-250-9956
Toll Free: 1-866-250-9956
www.flyht.com

Barnes Communications Inc

Colin Languedoc
Email: clanguedoc@barnesmcinerney.com
Phone: 1-416-367-5000
www.barnesmcinerney.com

Directors

Bill Tempany
Richard Hayden
Doug Marlin
Mike Brown
Paul Takalo, CA
Jacques Kavafian
Jack Olcott

CEO of the Company
President of the Company
President, Marlin Ventures Ltd.
Partner, Geselbracht Brown
Vice-President, Standen's Limited
President and CEO, 7546220 Canada Inc.
President, General Aviation Company

Officers

Bill Tempany
Richard Hayden
Thomas French, CGA
Matt Bradley

CEO
President
VP Finance & CFO
VP Business Development

Auditor

KPMG LLP

Calgary, Alberta

Legal Counsel

Chris Croteau

Tingle Merrett LLP

Offices

Head Office

200W, 1144 - 29 Avenue NE
Calgary, Alberta T2E 7P1

US Office

Suite 130-310, 2951 Marina Bay Drive
League City, TX 77573

Share Data

As of December 31st, 2010 the share data for AeroMechanical Services were as follows:

Shares issued and outstanding:	118.6 million
Warrants outstanding:	29.7 million
Options outstanding:	2.5 million
Shares fully diluted:	150.8 million
Share price:	\$0.26
Market cap:	\$30.8 million



200W, 1144 - 29 Avenue NE, Calgary, AB, T2E 7P1, Canada
Phone 1.403.250.9956 | Fax 1.403.291.9717
Office 1-866-250-9956 | www.flyht.com

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AeroMechanical Services Ltd.